Bresco Electrical Services Ltd (in liquidation) v Michael J Lonsdale (Electrical) Ltd [2020] USC 25, or "kicking the door wide open"

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Introduction

1. At a recent webinar I predicted that the Supreme Court may push open the door left slightly ajar by Lord Justice Coulson at the Court of Appeal in the case of *Bresco v Lonsdale [2019] EWCA Civ 27*. It has done rather more than that.

2. Lord Justice Coulson's judgment included the proposition that an insolvent Company could only adjudicate a dispute with a creditor in circumstances of mutual debts in "exceptional circumstances". Subsequent caselaw[1] has explored the extent of these "exceptional circumstances".

3. On appeal, the Supreme Court has provided a robust defence of adjudication by insolvent Companies in circumstances of mutual debt. The Court's judgment and its implications are the subject of this article.

Background

4. A insolvent Company that is in a situation of mutual debts with one of its creditors will give rise to insolvency set-off under IR 14.25. This set-off weighs the debts against one another, leaving a claim by one party to the remaining balance. Its aim is to avoid a situation whereby the creditor must pay into the insolvent Company in full, only to get back a fraction of what it is owed by proving in the Company's insolvency.

5. Adjudication is a process brought into being by the Housing Grants, Construction and Regeneration Act 1996, AKA the Construction Act. It is a dispute resolution process designed with the aim of providing a rapid resolution. An adjudicator will give a decision within a usual time limit of 28 days from when the dispute is referred. That decision will

[1] *Meadowside Building Developments Ltd (in liquidation) v 12-18 Hill Street Management Company Ltd [2019] EWHC 2651 (TCC)* ; *Balfour Beatty Civil Engineering Limited & Anor v Astec Projects Limited [2020] EWHC 796 (TCC)*

be enforceable[2] by summary judgment. If the responding party doesn't like the result, they must still abide by it until they can challenge it by litigating or otherwise resolving their dispute with the referring party. In other words, "pay now, argue later". There is clear benefit to maintaining cash flow and preventing disputes putting a halt to works in construction contracts.

6. The conflict between the two regimes was thought to arise because an adjudication will not be enforceable against a creditor in circumstances of mutual debts with the Company. The creditor cannot be made to "pay now", as that would create precisely the mischief that the insolvency set-off rule is designed to prevent.

7. Enter *Bresco v Lonsdale*. Bresco's liquidator, supported by a third-party funder who funded proceedings in exchange for a percentage of any award, attempted to adjudicate a matter against Lonsdale. Lonsdale sought an injunction against the adjudication on the basis that the adjudicator had no jurisdiction. The argument ran that one can only adjudicate a dispute "under the contract" and that upon insolvency set-off being triggered there could be no such dispute. The only "dispute" remaining was as to the balance left after set-off, and that was not a dispute "under the contract". Lonsdale relied upon a broad reading of Lord Hoffman's judgment in the case of *Stein v Blake [1995] 1AC 243*, where it was found that set-off extinguished individual causes of action such that they could no longer be assigned. All that was left was an action for the remaining balance after set-off.

8. Mr Justice Fraser[3] found this reasoning persuasive and held that the adjudicator would not have jurisdiction. He therefore granted the injunction.

9. The matter came up for appeal before Lord Justice Coulson who overturned the decision on jurisdiction but upheld the grant of the injunction on grounds of utility. Lord Justice Coulson's reasoning was that because the adjudicator's decision could not be enforced, the adjudication would be an exercise in futility (save in exceptional circumstances).

The Supreme Court's decision

10. On appeal to the Supreme Court, Bresco appealed the "utility" element of Lord Justice Coulson's decision and Lonsdale cross-appealed on the "jurisdiction" element.

[2] Save in circumstances of lack of jurisdiction or breach of natural justice.
[3] [2018] EWHC 2043 (TCC)

11. The Supreme Court dismissed the jurisdiction cross-appeal essentially on the grounds that to regard the construction "dispute" as disappearing upon insolvency set-off was to apply too literal a reading to *Stein v Blake*. For example, a liquidator may pursue a claim in contract and if it does so "the pleaded claim remains one based upon the underlying contract, even if an undisputed set-off is acknowledged".

12. As to utility, the Supreme Court observed that in practice even an unenforceable adjudication may have utility as a means of Alternative Dispute Resolution.

13. However the Court went further, observing that "the insolvent company has both a statutory and a contractual right to pursue adjudication" and that "it would ordinarily be entirely inappropriate for the court to interfere with the exercise of that statutory and contractual right. Injunctive relief may restrain a threatened breach of contract but not, **save very exceptionally**, an attempt to enforce a contractual right, still less a statutory right." (emphasis added).

14. The Supreme Court has gone much further than to merely widen the ambit of "exceptional circumstances", it has turned the matter on its head. It will now be for a party resisting adjudication of a dispute brought by an insolvent Company to show that there are exceptional circumstances in favour of *granting* the injunction.

Looking forward

15. The result of the Supreme Court's decision will inevitably be that more liquidators will attempt to adjudicate disputes with creditors, particularly if they can receive third-party funding to do so. Companies and other entities involved in the construction industry will need to keep a close eye on their insolvent partners, even long after they have become insolvent, and be ready to respond to an adjudication.

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