

INSOLVENCY AND ADJUDICATION: A GROWING ISSUE DURING THE COVID-19 PANDEMIC

The outbreak of COVID-19 in the UK has caused significant disruption in the construction sector. While the government confirmed on 24 March 2020 that building work can continue if it can be done safely, an increasing number of projects are facing suspension for an indefinite period of time. The inevitable consequence of this is a serious cash flow problem for many contractors and sub-contractors, which sooner or later may lead to their insolvency.

Over the last 12 months, there have been a number of TCC cases dealing with the relationship between adjudication and insolvency. In light of the COVID-19 pandemic, this developing area is more relevant than ever.

This guide is intended to provide a useful overview of the current legal position and to act as a checklist for those who have concerns about insolvency in the context of adjudication.



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Emma is frequently instructed to act in and advise upon adjudications and enforcement proceedings. In the last 12 months, Emma has worked on a number of adjudication cases with an insolvency angle. She represented the successful defendants in *Indigo Projects London Ltd v Razin* [2019] Bus LR 1957, who resisted enforcement on the grounds of the claimant's insolvency.

Insolvency of the Referring Party

SUMMARY

- Is the referring party in liquidation, a CVA or another insolvency procedure? If so, consider the following:
 - Do the adjudication proceedings seek to determine the final net position between the parties; and
 - Has the referring party provided satisfactory security?
- If these criteria are not satisfied, consider an urgent application for an injunction to restrain the adjudication proceedings.

Introduction

1. Upon receipt of a Notice of Intention or Referral Notice from an insolvent party, there are several options available:
 - (1) You can press on and participate in the adjudication;
 - (2) You can seek an injunction in the TCC restraining the adjudication;
 - (3) You can refuse to participate in the adjudication and then resist enforcement of the adjudicator's decision (should it get to that stage); or
 - (4) You can try to settle the dispute.
2. There are pros and cons of each approach.
3. For example, if you refuse to participate in the adjudication and then resist enforcement of an unfavourable decision, you reduce your legal costs in the short term, but also run the risk that you are unsuccessful on enforcement and have by that time lost the opportunity to run a positive defence to the claim.
4. Due to this risk, it is worth considering, immediately upon receipt of the Notice of Intention, whether to seek an injunction restraining the adjudication.

Injunctions to restrain adjudication proceedings

5. An application for an urgent injunction is usually made under Part 7 (although it can be made under Part 8, as was done in *Bresco Electrical Services Ltd (in Liquidation) v Michael J Lonsdale (Electrical) Ltd* [2019] EWCA Civ 27).
6. In *Bresco*, the referring party was in insolvent liquidation. The responding party successfully applied for an injunction restraining the adjudication process. The injunction was granted on the basis that the adjudication would not determine the final net position between the parties (because the responding party had cross-claims which had not been referred). As the final net position would be determined by the liquidator as part of the liquidation process, the court considered that the adjudication proceedings were futile and should not be allowed to continue.
7. There are still circumstances in which a company in liquidation may successfully pursue adjudication proceedings. These circumstances were explored in *Meadowside Building Developments Limited (In Liquidation) v 12-18 Hill Street Management Company Ltd* [2019] EWHC 2651 (TCC) as follows:

"87. For these reasons, in my judgment, a case is likely to be an exception to the ordinary position in circumstances where:

- (1) **The adjudication brought or to be brought determines the final net position between the parties under the relevant Contract.** An adjudication, by definition, will not be able to determine the net position between parties with dealings on more than one contract. The extent to which the adjudication is not capable of dealing with the entirety of the mutual dealings between the parties (and as such will not mirror the Rule 14.25 process between the parties) is to be taken account of in all the circumstances when looking at the utility of the adjudication and the discretion either to injunct, or, following adjudication, to enforce;
- (2) **Satisfactory security is provided** both:
 - (a) **In respect of any sum awarded in the adjudication and successfully enforced**, so that it is repayable should the responding party successfully overturn the decision in litigation or arbitration brought within a reasonable time of the date of enforcement;
 - (b) **In respect of any adverse order for costs** made against (or agreed by) the company in liquidation in favour of the responding party in respect of:

(i) Any unsuccessful application to enforce the adjudication decision;

(ii) The subsequent litigation/arbitration, in which the responding party is seeking to overturn the adjudication decision;

The extent to which any such costs order is ordered to be met from the security would be a matter for the Court, insofar as it was not agreed.

(3) What is satisfactory as security in form, duration and amount is a question on the facts in the ordinary way and may be provided incrementally (as it would be, for example, in any security for costs application). A combination of the following solutions might be appropriate:

(a) the liquidator undertaking to the court to ringfence the sum enforced so that it is not available for distribution for the relevant duration;

(b) a third party providing a guarantee or a bond;

(c) ATE insurance.”

8. Parties on the receiving end of a Notice of Intention/Referral Notice from a company in liquidation (or another insolvency procedure) should therefore consider the following questions:

(1) Does the adjudication seek to determine the final net position between the parties, or are there cross-claims which are not dealt with in the Referral Notice? Where, for example, the parties have cross-claims across multiple contracts, the answer will necessarily be ‘no’.

(2) Has satisfactory security been offered in respect of any sum awarded in the adjudication and successfully enforced and any adverse costs order? Relevant factors to consider will include (a) the financial position of the party offering security, (b) the scope and duration of the security offered and (c) whether the security is in place or there is only an offer to provide security at some point in the future.

9. If the answer to either of these questions is ‘no’, serious consideration should be given to making an application for an injunction to restrain the adjudication proceedings.

Resisting enforcement on the basis of the Referring Party’s insolvency

10. The same considerations will apply on enforcement.

11. A party in liquidation (or another insolvency procedure) is unlikely to be entitled to enforce an adjudicator’s decision unless the decision determines the final net position between the parties and satisfactory security is offered: see *Meadowside and Indigo Projects London Ltd v Razin* [2019] Bus LR1957.

Stay of Execution

SUMMARY

■ Is the solvency of the enforcing party such that it is likely that it would be unable to repay the judgment sum if ultimately ordered to do so? If so:

- Is its financial position the same or similar to its financial position at the time that the relevant contract was made; and
- Is its financial position due, either wholly or in significant part, to the defendant’s failure to pay the sums awarded by the adjudicator?

■ If the answer to both is ‘no’, consider applying for a stay of execution pursuant to CPR 83.7.

12. The defendant in enforcement proceedings should also consider whether to apply for a stay of execution of the judgment pursuant to CPR 83.7. If the court grants a stay, the adjudicator’s decision is technically enforced, but the defendant is not required to comply with the judgment enforcing the decision.

13. The test that the court will apply when considering whether to grant a stay of execution was set out by HHJ Coulson QC (as he then was) in *Wimbledon Construction Co 2000 Ltd v Derek Vago* [2005] EWHC 1086 at [26] as follows:

“d) *The probable inability of the claimant to repay the judgment sum (awarded by the Adjudicator and enforced by way of summary judgment)...may constitute special circumstances...rendering it appropriate to grant a stay (see Herschell).*

- e) *If the claimant is in insolvent liquidation, or there is no dispute on the evidence that the claimant is insolvent, then a stay of execution will usually be granted (see Bouygues and Rainford House).*
- f) *Even if the evidence of the claimant's present financial position suggested that it is probable that it would be unable to repay the judgment sum when it fell due, that would not usually justify the grant of a stay if:*
- (i) *The claimant's financial position is the same or similar to its financial position at the time that the relevant contract was made (see Herschell); or*
- (ii) *The claimant's financial position is due, either wholly, or in significant part, to the defendant's failure to pay those sums which were awarded by the adjudicator (see Absolute Rentals)."*
14. It should be emphasised that it is not easy for a defendant to obtain a stay of execution. The burden is on the defendant to prove the probable inability of the claimant to repay the judgment sum. There is no general obligation on the claimant to provide details of its financial position, which makes the burden on the defendant difficult to discharge.¹ However, if the defendant is able to provide persuasive prima facie evidence of the claimant's impecuniosity, the claimant will be expected to provide a response to that evidence.
15. The usual directions given by the TCC in enforcement proceedings do not set out timeframes for making an application for a stay of execution. However, it is generally advisable to file and serve such an application and supporting evidence at the same time as the evidence served in response to the enforcement application. If possible, both can be dealt with in the same witness statement.

This guide is intended to provide a useful overview of the current legal position and to act as a checklist for those who have concerns about insolvency in the context of adjudication. It does not constitute legal advice. I am very happy to receive comments and specific queries on the contact details set out above.

¹ Farrelly (M&E) Building Services Ltd v Byrne Bros (Formwork) Ltd [2013] EWHC 1186 (TCC)

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