School construction projects : contractor insolvency

BRIEFING

Introduction

The decision to invest in a construction project is a major event for an educational establishment. So, if the contractor becomes insolvent, this can cause significant problems.

The case of ***Philpott & Orton v Lycee Francais Charles de Gaulle School*** [2015] EWHC 1065 (Ch) is a useful reminder of some of the issues that arise when a contractor enters an insolvency process and the importance of a skilfully drafted and negotiated building contract.

The facts

In 2008 Lycee Francais Charles de Gaulle School (the "School") entered into a JCT Intermediate Contract (With Contractors' Design) 2005 Revision 1: 2007 (the "Contract") in relation to a construction project at the School.

During the course of the construction works, Welconstruct Limited (the "Contractor") became insolvent and entered administration and then voluntary liquidation. Mr Philpott and Mr Orton, the joint liquidators of the Contractor (the "Liquidators"), sought to address the dispute that arose between the School and the Contractor in relation to the final account under the Contract. The School alleged that the sum of £270,000 was due to it. The Liquidators alleged that the sum of £615,000 was due from the School to the Contractor.

Proof of debt

Rule 4.73 of the Insolvency Rules 1986 deals with the proving of debts. In relation to a voluntary liquidation, rule 4.73(2) provides:

> *"In a voluntary winding up (whether members' or creditors') the liquidator may require a person claiming to be a creditor of the company and wishing to recover his debt in whole or in part, to submit the claim in writing to him."*

The School submitted a proof of debt to the Liquidators in the sum of £270,000. However, by the date of the court hearing, the Liquidators had neither accepted nor rejected the School's proof of debt, despite rule 4.82(2) providing that:

"*If the liquidator rejects a proof in whole or in part, he shall prepare a written statement of his reasons for doing so, and send it as soon as reasonably practicable to the creditor*".

Set-off

Instead, the Liquidators explained that because of the Contractor's claim against the School for £615,000, they could not decide whether to accept or reject the School's proof until an account had been taken of the cross-claims, which would require the dispute to be resolved.

The Liquidators relied upon rule 4.90 which

> "*applies where, before the company goes into liquidation there have been mutual credits, mutual debts or other mutual dealings between the company and any creditor of the company proving or claiming to prove for a debt in the liquidation*".

The School and the Liquidators each accepted that the situation here was one to which rule 4.90 applied. The Liquidators then relied upon rule 4.90(3), which provides:

> "*An account shall be taken of what is due from one party to the other in respect of the mutual dealings and the sums due from one party shall be set off against the sums due from the other*."

The Liquidators asked the court to give directions in respect of the taking of that account.

Arbitration

The School opposed the Liquidators' proposed way of resolving the dispute by the taking of an account through High Court proceedings on the basis that the Contract contained a clause which required disputes to be resolved by way of arbitration.

The School argued that this clause survived the voluntary liquidation of the Contractor and bound the Liquidator, with the effect that the Liquidator was prevented from seeking an account in the High Court. The School therefore sought a stay of the Liquidators' claim for an account and for directions in relation thereto.

Section 9 of the Arbitration Act 1996, entitled "*Stay of Legal Proceedings*" provides:

> "*(1) A party to an arbitration agreement against whom legal proceedings are brought ...in respect of a matter which under the agreement is to be referred to arbitration may ...apply to the court in which the proceedings have been brought to stay the proceedings...*
>
> *(2) …*
>
> *(3) An application may not be made by a person ...after he has taken any step in those proceedings to answer the substantive claim.*
>
> *(4) On an application under this section the court shall grant a stay unless satisfied that the arbitration agreement is null and void, inoperative, or incapable of being performed.*"

The grant of a stay is obligatory (unless one of the stated exceptions applies) if the court is satisfied that the subject of the court action was a matter that was to be referred to arbitration under the Contract.

In considering whether to grant the stay sought by the School, the court was invited to consider whether the Arbitration Act 1996 trumps the taking of an account under the court's directions, as envisaged by the Insolvency Rules 1986. His Honour Judge Purle QC decided that it does. He considered that any claim by the Liquidators against the School to recover the sum of £615,000 would fall within section 9 of the Arbitration Act 1996 and only the fact of the cross-claim brought rule 4.90 of the Insolvency Rules 1986 into the equation at all. That factor was not sufficient for the Liquidators to get around the arbitration clause in the Contract and any claim by the Liquidators would be the subject of a mandatory stay.

The Liquidators argued further that by submitting a proof of debt the School had compromised its position. The Judge rejected this argument. The Judge determined that submission of a proof of debt did not constitute a "*step in the proceedings to answer the substantive claim*" that would, under section 9(3) of the Arbitration Act 1996, prevent the School from being able to rely upon the arbitration clause.

Conclusion

The case is a reminder that the fact of insolvency of one party to a contract does not give a liquidator *carte blanche* to ignore its terms. The liquidator is not in a more advantageous position that the company of which he is liquidator would have been when it comes to resolving disputes under contracts that are subject to an arbitration clause.

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