JUDGMENT : David Donaldson Q.C. 15th May 2001

The Application :

1. On 2 February 2001 (repeated on 5 and 6 February 2001) the Respondent, ("GAL') issued and served on the Applicant ("CCL") a Statutory Demand for £9,702.47 accompanied by a letter threatening the presentation of a winding-up opinion if the Demand were not complied with. An injunction was obtained without notice on 22 February 2001 from Lloyd J restraining GAL from presenting and advertising any petition based on the Statutory Demand or on the (alleged) debt scaled in the Demand, That injunction was continued by consent on 2 March 2001 pending the hearing of the present Originating Application for a final injunction to similar effect which came before me for hearing on 4 May 2001.

Essential Background :

2. CCL was the main contractor in the construction of four houses for Landreach Ltd: GAL were engaged as sub-contractors for the roofing works. After GAL had worked on the project for about two months, CCL terminated GAL'S contract on 21 November 2000.

3. The GAL sub-contract ("the Contract") was a *''construction contract*" within the meaning of sections 104 and 105 of the Housing Grants, Construction, and Regeneration Act, 1996 ("the Act"). In accordance with the requirements of section 110 of the Act the contract specified due dates and final dates for payment of sums due under two interim valuations and for the dates (not more than 5 days after the due dates) within which notice ("*a withholding notice*") had to be given by the contractor if it proposed to withhold any part of the payments. For valuation no. 1 the contract specified a due date for payment of 18 October 2000, and any withholding notice had to be given by 23 October 2000. which was also the final date for payment. The corresponding dates for valuation no. 2 were 16 November 2000 and 21 November 2000. The first valuation, in the gross sum of £9,235 + VAT, was submitted on 21 September 2000. After deducting a retention of 5% and a discount of 2.5% an application for payment for £8,553.92 was rendered by GAL. The sum of £8,553.92 was accepted by CCL. The second valuation was submitted on 24 October 2000 in the sum of £19,710. Deducting the retention of 5% and a discount of 3.5% resulted in a net figure of £18,256.39. That figure included the then unpaid £8,553.92 which was eventually paid by CCL on 15 December 2000, leaving as outstanding on the two valuations the balance of £9,702.47, which forms the basis of the Statutory Demand and the threatened winding-up petition. No withholding notice was ever served in relation to either valuation.

4. On 1 December 2000, some days after the final date for payment of the second valuation, CCL was informed by Landreach that the rear kitchen roofs were ponding severely, CCL reported this to GAL and asked for "*your agreement to us remedying this problem upon our agreement*". On 24 January 2001 CCL notified GAL that in addition to the leaks felt gutters had been fitted instead of lead, and asked GAL to attend to these items "*to enable the release of monies*" held by CCL. GAL's response was to deny any responsibility but it expressed willingness to investigate upon receipt of payment (in the event it did nonetheless visit the site on 9 February 2001 and repeated its rejection of responsibility).

5. In the meantime, an adjudication in accordance with section 108 had been instituted between CCL and Landreach concerning ingress of water from the roof and the materials used on the gutterings. It concluded with an agreed settlement recorded in a decision of the adjudicator dated 30 January 2001. This provided for CCL to reconstruct the balcony roofs and carry out remedial works to lead flashings; no works were required in connection with the felt gutters. Pending the completion of these works a retention of £12,500 was agreed.

6. CCL sought no input from GAL as regards either the adjudication or the settlement agreement. Indeed, GAL was unaware of either before the service of witness statements in the present proceedings.

7. CCL employed another sub-contractor to carry out the remedial works to the roof under the settlement agreement at a cost of £6,496 plus VAT (though the work would appear to be zero-rated). It claims to have incurred additional costs totalling £1,487.25 inclusive of VAT. It further contends that there should be a reduction of £3,503.49 to reflect the lower cost of felt compared with the specified lead guttering. It also seeks reimbursement of the adjudicator's costs which it has had to pay. It points

out that even the first and third of these items taken alone would significantly exceed the debt claimed in the Statutory Demand.

Legal Analysis :

8. There are in essence two separate limbs to the analysis of this question:
   (a) is the debt capable of bona fide dispute? &
   (b) if not, is the grant of an injunction otherwise justified?

Is there an undisputed debt? :

9. CCL's primary contention is that the debt of £9.702.47 is not in fact due, on the basis of (a) an abatement due to the use of felt rather than lead and (b) set-off of damages for defective work; is therefore disputed bona fide on substantial grounds; and on that basis cannot on well-established principles going back to **Cadiz Waterworks Company v Barnett**, LR 19 Eq. 182 be relied upon for the purpose of a winding up petition. It was on the basis of that contention that CCL obtained the interim relief from Lloyd J.

10. The position is, however, radically affected by the impact of the 1996 Act upon construction contracts.

11. (a) Section 110(2) of die Act provides:
"Every construction contract shall provide for the giving of a notice by a party not later than five days after the date on which a payment becomes due from him under the contract, or would have become due if
(a) the other party had carried out his obligations under the contract and
(b) no set-off or abatement was permitted by reference to any sum claimed to be due under one or more other contracts, specifying the amount (if any) of the payment made or proposed to be made, and the basis on which that amount was calculated,"

Under section 111(2) the notice must specify the amount(s) proposed to be withheld and the grounds for withholding it (them).

(b) Section 111(1) provides: *"A party to a construction contract may not withhold, payment after the final date for payment of a sum due under the contract unless he has given an effective notice of intention to withhold payment."*

12. Emphasising the words *"payment of a sum due ..."* in section 111(1), Counsel for CCL argued that the section only applies where the monies are in fact due, and that this requires the court to consider whether the sum demanded by the contractor is irrecoverable (in whole or in part) because of its defective performance of the contract. But the clear intent of sections 110(2) and section 111 is to preclude the employer (in the absence of a withholding notice with specified content) from contending that all or part of the sum demanded by the contractor is not in fact due. If the work is defective, the employer retains the right to recover damages for breach of contract in subsequent litigation or arbitration, and can obtain a provisional order to the same effect by adjudication under section 108 of the Act. That does not however alter the position that by virtue of section 111 the employer is obliged to pay forthwith without deduction Absent a withholding notice, the rule is "pay now, litigate later". Indeed, any other construction of sections 110 and 111 would rob them of all practical significance.

13. Given the absence of a withholding notice in the present case, section 111 therefore requires CCL to pay the £9,702.47 without deduction regardless of any defence which might otherwise have existed by reason of the alleged defects in the works. The cross-claim and/or abatement thus provides no basis on which it can properly be disputed that the £9,702.47 is due and payable, GAL must therefore be regarded as a creditor of the company with locus standi to present a winding-up petition.

Is the grant of an injunction otherwise justified? :

14. The fact that GAL has locus standi to present a petition does not of course mean that the petition will succeed. Notwithstanding the existence of a debt the court may as a matter of discretion refuse to make a winding up order. Where however the proposed petitioner has, as here, locus standi in the form of an established debt, I could only properly stifle the action by injunction at or before birth if satisfied that no court hearing the petition and exercising its discretion could in due course rationally

do other than stay or dismiss the petition (per Lloyd J in **Greenacre Publishing Group v Manson Group**, [2000] BCC 11). That requires me to consider two questions:

(a) the principles which the court would apply for the purpose of exercising its discretion, and

(b) whether applying those principles the only reasonable way in which the discretion could be exercised would be to stay or dismiss the petition.

(a) The principles :

15. Reviewing earlier authority the Court of Appeal in **Seawind Tankers Corporation v Bayoil S.A.** [1999] Lloyds Rep 210 held that where a company had a genuine and serious cross claim (exceeding the petitioner's debt) which it had not been able to litigate, the petition should be dismissed or stayed unless there were special circumstances.

16. What are special circumstances? Counsel for GAL argued that they could be found in the "pay up, litigate later" regime of the 1996 Act, which gave an exceptional status to a debt falling within it. That submission cannot however in my judgment be reconciled with Seawind, which also concerned a "pay up, litigate later" regime, albeit in the context of shipping law and imposed by case-law rather than statute. In Seawind the petitioning owners of a vessel obtained an interim final arbitration award against the company as voyage charterers for over US $1 million in respect of freight. The company had a cross-claim for breach of warranties as to inter alia the condition and speed of the vessel. It had been unable to rely on that cross-claim as a defence to the freight claim by reason of the special rule which precludes the set-off of such matters against a claim for freight. Though that rule, like the regime of the 1996 Act, is plainly intended to guarantee the cash-flow of a special category of creditors, the Court of Appeal in Seawind declined to hold that there were "special circumstances" which made it inappropriate for the petition to be dismissed or stayed. The fact that the award was immediately enforceable and there was no stay of execution was irrelevant in this connection: as Nourse LJ stressed (at p 216), "the ability of a petitioning creditor to levy execution against the company does not entitle him to have it wound up". That must apply also in the present context: the fact that the debt falls within the 1996 Act cannot in my view be a "special circumstance" in favour of a winding up order.

(b) Would the court refuse to make a winding-up order? :

17. On the basis of no "special circumstances", there are two specific matters which (the court hearing a petition based on this debt would have to address:
    (1) whether there is a genuine and serious cross-claim in excess of the debt
    (2) whether the cross-claim is one which the company has been unable to litigate.

As regards (1): whether there is a genuine and serious cross-claim in excess of the debt

18. The material before me relating to the cross-claim is not extensive. In particular, I regard the evidence produced by CCL as somewhat meagre. GAL'S ability to deal with the allegations was correspondingly limited: that ability was further restricted by the premature termination of the contract by CCL and by the fact that CCL did not involve GAL in the process of adjudication between CCL and Landreach. Nor is it clear to me. on the evidence whether CCL has any substantial answer to the points raised in the witness statement of Mr Dudney served on behalf of GAL. However, it is right to say that this aspect of the case was hardly addressed in the submissions of either Counsel, and I am reluctant to base my decision upon it.

As to (2) : whether the cross-claim is one which the company has been unable to litigate.

19. It is clear that, the company had no opportunity to raise the question of defective work by a withholding notice under section 110(2); it was unaware of the defects at the relevant time. Since becoming aware of them, however, it has taken no step to litigate a cross-claim for defective work. What is required by the Seawind guidelines in my view is a reasonable opportunity to litigate the cross-claim to the point of obtaining an enforceable order for payment. Had it sought to establish the cross-claim by arbitration or litigation, it is perhaps improbable that it would have obtained an award or judgment by now. An adjudication order under section 108(2), which would have been enforceable pending definitive resolution in arbitration or litigation, can however be obtained in a shorter time-

frame. The suggestion that an adjudication order on the cross-claim could in the present case not have been obtained by now is a proposition which CCL has not sought to support with any evidence. Any resulting uncertainty must in my view count against CCL. The onus is in my judgment on CCL to establish that its cross-claim is covered by the principles enunciated in Seawind, and therefore to adduce whatever evidence is necessary to establish that it has not been able to litigate that cross-claim. Moreover, even if one ignores evidential onus, in case of doubt it is impossible to determine at this stage that in all probability the court hearing a petition would rule in favour of the company on this point. Finally, if I am required to form a view on existing evidence, it seems to me probable that an adjudication award could have been obtained by now. In this connection I note that in the Landreach/CCL adjudication the adjudicator began drafting his decision (before being appraised of the settlement) only 19 days after his appointment, i.e. on 24 January, 2001, though I am mindful that the issues in the CCL/GAL adjudication would have been wider.

20. I accordingly conclude that there is at least a significant possibility that a future court hearing a petition may form the view that CCL has had a reasonable opportunity to litigate the cross-claim and could properly, therefore, in the exercise of its discretion decide to make a winding-up order. That conclusion prevents me from determining that the proposed petition would have no reasonable prospect of success. I must therefore allow GAL to present such a petition if it wishes and refuse the injunction sought by CCL.