JUDGMENT : MR JUSTICE HART : Chancery Division, High Court. 14th November 2001

1. This is an application to restrain the advertisement of and to dismiss a petition brought by Celsius Energy Control Limited (the petitioner) against AM Environmental Service Limited (the company). The petition is based on two alleged debts, one of which, in the sum of £ 1,199.75, has now been paid; the other in the sum of £8,834.43 plus VAT is said by the petition to be the outstanding balance of invoices 1048004A and 1048005B on a project for Ofgem. It is this sum about which the debate before me has revolved.

2. The Ofgem project involved a construction contract between Ofgem, the new tenant of a building at 9 Mill-bank, and Inspace Limited, under which Inspace was the main contractor, the company was the primary sub-contractor and the petitioner was the secondary sub-contractor. The contract under which the debt is alleged to have arisen is, therefore, the secondary sub-contract between the company and the petitioner.

3. The secondary sub-contract was a *"construction contract"* within the meaning of Part 2 of the Housing Grants Construction and Regeneration Act 1966 and had, therefore, to comply with the requirements of that Act in relation to the mechanisms and dates for payment of sums becoming due thereunder.

4. The scheme adopted by the contract, so far as relevant, was contained in clauses 7, 8, 9 and 11 thereof when read together with the schedule. Clause 7 provided that:
"All interim payments to the secondary sub-contractor shall be the total amount due for work properly completed as herein provided, less any previous payments under the secondary sub-contract, and subject to the retention as provided for in the schedule hereto and less any other sums whatsoever which are due or become due to the primary sub-contractor from the secondary sub-contractor.

8(1) The secondary sub-contractor shall, not less than seven days before the due date specified for each payment, submit to the primary sub-contractor a written statement of the value of all work properly done under the secondary sub-contract. The statement shall be in such form and contain such details as are specified in the schedule hereto, and the value of the work done shall be calculated in accordance with the rates and prices specified in the secondary sub-contract.

8(2) The first and further interim payment shall be due at the end of the interim interval specified in the schedule hereto, at which interval will shall start when the secondary sub-contractor commences the secondary sub-contract works on site.

8(3) The personnel and further interim payments shall be made not later than seven days after they become due.

8(4) The primary sub-contractor shall notify the secondary sub-contractor in writing of the amount calculated as due as interim payments and the Final Secondary Sub-Contract Sum within five days of the date the payment becomes due. There will be written notification given by the primary sub-contractor to the secondary sub-contractor of amounts of payments due to the secondary sub-contractor under the secondary sub-contract shall specify the amount, if any, of the payment made or proposed to be made and the basis on which that amount was calculated.

9(1) Within 14 days of completing the secondary sub-contract works the secondary sub-contractor shall provide to the primary sub-contractor statement in such form and contains such details as specified in the schedule hereto.

9(2) Payment of the Final Secondary Sub-Contract Sum in accordance with this clause 9(2), and shall be due seven days after the secondary sub-contractor has finally performed his obligations to make good defects under the secondary sub-contract. The primary sub-contractor shall pay to the secondary sub-contractor the Final Secondary Sub-Contract Sum less any previous payments made under the secondary sub-contract, unless any other sums whatsoever which are due to the primary sub-contractor from the secondary sub-contractor within 21 days after the payment was due.

9(3) The retention held by the primary sub-contractor, if any, shall be included with the payment of the Final Secondary Sub-Contract Sum."

5 Then there is a provision in 9(4) which is not relevant and I need not read. Clause 11 provided that:
"Without prejudice to any rights and remedies he might possess, the primary sub-contractor shall be entitled to deduct and withhold from any monies payable to the secondary sub-contractor any sum or sums which the primary sub-contractor has suffered or incurred, or anticipates suffering or incurring, due to a breach of or failure to observe the provisions of the secondary sub-contract by the secondary sub-contractor or any other sums which are due and owing to the primary sub-contractor from the secondary sub-contractor howsoever arising, provided always that the primary sub-contractor shall have given to the secondary sub-contractor notice in writing specifying the amounts to be deducted and withheld and the grounds for so doing. Such notice shall be given not less than two days before the final date for payment from which the primary sub-contractor intends to deduct and withhold such sum or sums. Such notice shall not be binding insofar as the primary sub-contractor may amend it in preparing submissions or pleadings for any arbitration or other proceedings."

6 So far as relevant the schedule provided that the interim payment intervals were monthly. The date for commencement of works was 9th October 2000, and the period for completion was five weeks.

7 I should also refer to the definition of the Final Secondary Sub-Contract Sum contained in clause 37(g) where it is defined as meaning "a price specified in the schedule hereto adjusted in accordance with the secondary sub-contract or such other sum as may be payable under the secondary sub-contract". The price specified in the schedule was £145,000.

8 In order to ascertain when the Final Secondary Sub-Contract Sum is due under clause 9(2) reference has to be made also to clause 18 which imposes the obligation to make good defects and extends the period of that obligation so as to make it coincide with the equivalent period under the primary sub-contract. I need not, I think, descend into the detail of this, since at least for the purposes of the petition it appeared to be accepted by the petitioner that this period had not expired or that, at the least, it was seriously arguable that it had not.

9 In a witness statement in support of the application, the company's contracts' director, Mr Wilkinson, explained at paragraph 16 and 17 as follows:
"The procedure for payment of the interim payments was for AMES, i.e. the company, to notify Celsius, the petitioner, of the amount to be paid and the basis for calculation under clause 8(4). In fact, the procedure we used was for Celsius to issue interim applications to us on pre-set dates, usually monthly, which we would review and then makes payments against after verification. We found that Celsius' applications were consistently higher than the value of work that they had actually done."

17: "Under clause 9(1) and (2) final payment was to be made as follows within 14 days of completing the work Celsius was to provide to AMES with a statement in the form set out in the schedule (see pages 25 and 35, KRW1) payment of the final sum is due seven days after Celsius finally performs its obligations to make defects under the contract. The final sum is paid net of any other sums properly deductible under the contract, (see clause 9(1) and 9(2)).

9 He also made the following allegations against the petitioner, paragraph 18:
"During the course of the work Celsius were falling behind on the timetable and did not do the job properly. In particular, we had complaints that their operatives were not disposing of waste and debris in the right place, had allowed water to leak on to the floor and had installed the wrong units."

19: "Although Celsius from were instructed to fit like for like controls they did not do so. The old controls were modulating controls, but the ones fitted by Celsius were not. After the client pointed this out we passed the complaint on to Celsius who agreed to refit modulating controls. It is my understanding that the ones fitted by Celsius would have worked, but they did not fulfil the criteria of being a like a like model as Celsius agreed."

20: "Celsius eventually replaced their units with modulating controls without extra charge. However, problems arose because of the delay involved. The original contract with Celsius provided that the job would be done within five weeks of 9th October 2000. In fact, because of the change from the first set of controls fitted to pulse controls the job was not completed until February 2001. This meant that the

builders, Inspace, as well as our operatives and Celsius were obliged to work nights and weekends. I should mention that Celsius had to install controls in the ceiling and on the walls, and for that work there had to be builders present."

21: "We subsequently received a claim from the main contractor, Inspace, for supervising the works which ran overtime and for the extra labour as a result of Celsius' delays and problems (see pages 48 to 49 KRW1). Inspace also claimed line connection and calls for a phone that was installed in the office. I admit that the phone was used by AMES' operatives as well as Celsius operatives, and I would guess that only £30 to £50 of the bill is attributable to Celsius' calls. The whole claim was for £16,428.06; all but some £300 of which is directly attributable to Celsius."

10 hat claim by Inspace was made by it under cover of a letter from Inspace to the company dated 9th July 2001, and appears to be made by an adjustment to the sum otherwise payable to the company by Inspace under the primary sub-contract.

11 he document relied on by the petitioner is an application for payment referred to in argument as an invoice made by it, dated 12th April 2001, in which it applied for the full value of the contract, £145,000, less a retention of 2.5 per cent, expressed to be *"reduced due to practical completion"* less £132,940.15 *"previously applied to date"*. The payment was said to be due in 30 days.

12 The answer to the question whether the company is indebted to the petitioner, turns on when, under the contract, the payment under this invoice fell due. If the application can properly be characterised as an application for the Final Secondary Sub-Contract Sum under clause 9(2), then the answer is that it is not due until the end of the defects liability period which, for the purposes of this petition, I take not yet to have happened. If, on the other hand, it is simply an application for an interim payment, the company would only be entitled to withhold payment to the extent that it had given notice before the due date of *"the amounts to be deducted and withheld and the grounds for so doing"* (see clause 11 reflecting the provisions of section 111(1) of the 1996 Act).

13 Fastening in particular on the provisions of clause 9(3), counsel for the company argued that the invoice was an invoice in respect of the Final Secondary Sub-Contract Sum. It was for the full value of the contract, less only the reduced retention and what had already been paid. Clause 9(3) assumed, he argued, that the Final Secondary Sub-Contract Sum would include an application for payment of sums in addition to the retention.

14 On this analysis, as it seems to me, the invoice rendered in respect of the final month's work under a completed contract would always lose any character it might otherwise have had as an invoice in respect of an interim payment, and would become an invoice in respect of the Final Secondary Sub-Contract Sum.

15 The petitioner, on the other hand, argued that the fact that the retention was not claimed showed that the application was not an application for the Final Secondary Sub-Contract Sum: it was simply an application for another interim payment made on exactly the same basis as the earlier ones, namely, in respect of the value of works completed to date less the previous payments. It differed only from earlier ones in asserting that all the contract works had now been completed. It specifically did not seek payment of the retention as it would have done had it been a request for the Final Secondary Sub-Contract Sum.

16 Accordingly, it required a notice under section 110 of the Act prior to the end of the month, i.e. a notice under clause 8(4), or a section 111 withholding notice, i.e. a notice under clause 11, no more than five days after the end of the month if deductions were legitimately to be made from it. I do not doubt that the company's contentions in this respect are advanced on a bona fide basis. In that limited sense there can be said to be a bona fide dispute about its indebtedness, but the area of dispute appears to me to be one limited to the true construction of the contract against the background of the 1996 Act.

17 Unwelcome as it is to this court to have to venture into territory which would no doubt be navigated with less difficulty by the Technology and Construction Court, it seems to me that the point at issue is,

in the final analysis, a short one, and one on which the submissions of the petitioner are to be preferred. There is no material before me which enables me to distinguish between this application for payment and any of those which preceded it. All had the character of requests for interim payments under the contract. I agree that clause 9(3) assumes that there may be sums other than the retention which may be included within the Final Secondary Sub-Contract Sum. That, however, appears to me to be quite consistent with sums having been properly withheld at an earlier stage pursuant to valid notices given either under clause 8(4) or clause 11, i.e. section 110 and 111(1) respectively.

18 Accordingly, on this part of the case my conclusion is that the sum applied for became payable within 30 days of the invoice date, unless appropriate notices had been served by the company. As to this, I was referred to a number of letters written by the company during the course of the sub-contract in which complaints were made of various aspects of the petitioner's purported compliance with its obligations, and warnings given that the petitioner would or might find itself liable to the company as a result. On not one single occasion, however, did the company seek to quantify the amounts which it intended to claim in respect of such complaints or, indeed, purport to make such complaints subject to a notice either under clause 8(4) or clause 11. It was submitted on behalf of the company that the requirements of these clauses were satisfied by notification of an intention to set-off unspecified amounts provided that the amounts in question were capable at some point in time of objective assessment. This seems to me to be a bold and, in the end, impossible construction to put upon the words *"specifying the amounts to be deducted"* in clause 11.

19 Accordingly, the company was, in my judgment, at the date of the petition indebted to the petitioner in the sum claimed.

20 In **Re Bay Oil** -- **Seawind Tankers Corporation v Bay Oil SA(?)** [1999] 1AER 374, the Court of Appeal, after an extensive review of and analysis of earlier authority, held that:
"If a company has a genuine and serious cross claim in an amount exceeding the petitioner's debt which it has been unable to litigate, then in the absence of special circumstances the court ought to stay or dismiss the petition".

21 In the present case, I entertain no doubt that the company has a genuine and serious cross claim. It is clear that during the course of the contract complaints were made about delays occasioned by the petitioner's alleged shortcomings. A reasoned case has been made by Mr Wilkinson as to the petitioner's liability for those delays, and that the quantum of the liability, if established, exceeds the petition debt. The liability is disputed by the petitioner, but on grounds which are the classic stuff of a genuine dispute - see the petitioner's undated letter in reply to the company's letter, dated 14th September 2001.

22 More difficult is the question whether the company has been unable to litigate its cross claim and whether, even so, special circumstances exist for not dismissing or staying the petition. Both questions have recently been the subject of decision in the context of a contract governed by the 1996 Act. In **Re a company No 1299 of 2001** reported in the June 2001 issue of the Construction Industry Law Letter, Mr David Donaldson QC, sitting as a deputy judge in this division, had to consider the impact of a substantial cross claim on a petition based on an indisputable debt owed under a construction contract governed by the 1996 Act. He rejected an argument that the regime of the 1996 Act itself constituted special circumstances for the purposes of the rule in **Bay Oil**. He pointed out that the 'pay up litigate later' regime of the 1996 Act was no different in principle from the similar regime which, albeit it in the context of shipping law and imposed by case law rather than statute, had applied in **Bay Oil**. That approach seems to me to be correct - see in particular the judgment of Nourse LJ in **Bay Oil** at page 382, dealing with the submission there made to him that special circumstances existed in that case. He said:
"Mr Russen has submitted that the matters relied on by the judge in exercising his discretion did, in any event, amount to special circumstances. Shortly stated, those matters were the finality and unappealability of the interim award; the security for the company's counterclaim granted by Seawind's P&I Club; the judge's concern as to the potential commercial insolvency of the company, and the fact that there was no real evidence that the award could be paid. In my judgment, those matters do not amount to special circumstances. Indeed,

with the exception of the security for the company's counterclaim they, are likely to be found in many cross claim cases. Mr Russen has also relied on the fact that no stay of the interim award was sought or granted. That adds nothing to his other points. The ability of a petitioning creditor to levy execution against a company does not entitle him to have it wound up. Moreover, an order that a company be wound up, unlike a bankruptcy order, is often a death knell. Nor can it be certain that a liquidator, even with security behind him, will prosecute the company's claims with the diligence and efficiency of its directors. These, I believe, are considerations which go to justify the practice in cross claim cases. I emphasise that the cross claim must be genuine and serious or, if you prefer, one of substance; that it must be one which the company has been unable to litigate, and that it must be in an amount exceeding the amount of the petitioner's debt. All those requirements are satisfied in this case."

23 On the question whether the company in the case before him had been unable to litigate its cross claim, Mr Donaldson QC applied a test of whether the company had had "a reasonable opportunity to litigate the cross claim to the point of obtaining an enforceable order for payment" holding that the onus of establishing its absence was on the company. On the facts before him, which do not appear fully from the report, he held that the company had not discharged the onus to the point of satisfying him that a court hearing the petition would find in favour of the company on this point.

24 In the present case, the reason why the company has not progressed its cross claim either by litigation, arbitration or adjudication under the contract appears to have been the result of a number of factors. First, it has proceeded on the sincerely held, but, as I have held, misconceived view, that it was under no present liability to the petitioner in respect of the invoice. Taking that view, it was under no particular pressure to rush to judgment on its cross claim, an attitude that does not seem to have been discouraged by the petitioner.

25 Mr Wilkinson's evidence is that the petitioner was, in the period between the invoice and the period immediately proceeding the presentation of the petition, asked to "bear with us" while the company disputed the claims being made against it by Inspace. That is not denied by Mr O'Grady, on behalf of the petitioner, in his evidence.

26 Secondly, it appears that until July of this year, it did not know the quantum of the claim being made against it by Inspace. Thirdly, it did not, for reasons which have not been explained, seek to canvas the claim in correspondence with the petitioner until 14th September of this year. While blow and counter blow in correspondence were then still being exchanged the petition was presented -- it was fact presented on 19th September. Fourthly, its own dispute with Inspace has in the intervening months enlarged in scope with potential knock-on effects for the size of the company's cross claim against the petitioner - see paragraph 22 of Mr Wilkinson's witness statement dated 12th October 2001.

27 On that evidence, I am narrowly satisfied that the company has not had a reasonable opportunity to litigate its cross claim and, which may be a different test, has not acted unreasonably in not having litigated it as at the date of the petition. It does not seem to me appropriate to allow the petition to proceed simply on the basis that further evidence might persuade the court hearing the petition that the company had had a reasonable opportunity which it had unreasonably failed to take to litigate the cross claim as at the date on which the petition was presented. In practice the decision has to be taken one or another before the petition is advertised. The striking fact about the development of the dispute over the cross claim referred to above is that this petition was presented by the petitioner after it had been notified that there was a substantial cross claim, but while on its own case it had not yet received the details of that cross claim.

28 The company should not in my judgment be criticised for delaying the pursuit of its cross claim by adjudication, arbitration or litigation until after it had put the details of that cross claim to the petitioner. In those circumstances the company has in my judgment made out its case that the petition should be dismissed, and I will so order.

Mr S Thompson appeared on behalf of the Claimant.

Mr Y Kulkarni appeared on behalf of the Defendant.