CA before Peter Gibson LJ, Waller LJ, May LJ : 28th June 2004.

LORD JUSTICE PETER GIBSON:

1. This is an appeal by the Thompson Partnership LLP ("the Partnership") from the order of Lloyd J, the Vice Chancellor of the County Palatine of Lancaster, on 16th January 2004. Thereby the judge dismissed an application by the Partnership for an order restraining the advertisement of a petition presented by Marchands Associates LLP ("Marchands") for the winding-up of the Partnership after a cheque for £14,000, payable by the Partnership to Martin Shaw, a partner in Marchands, was stopped. In the petition it was claimed that the Partnership was unable to pay its debts. Mr Shaw was substituted for Marchands as the petitioner. The judge ordered the Partnership to pay 80% of the petitioner's costs and refused permission to appeal.

2. The Partnership's application to this court for permission was refused on paper by Jonathan Parker LJ, but, on a renewed application, Arden LJ granted permission. She was told that the amount claimed to be due from the Partnership in the petition had been paid, and we are told that the petition has been dismissed. The appeal is in effect to seek to reverse the costs order. Despite Arden LJ's encouragement to the parties to try to reach a settlement, regrettably that has not been achieved. My regret at that result is the greater for learning that the amount in dispute, some £30,000, being 80% of the petitioner's costs before the judge, is greatly exceeded by the costs that have been incurred on this appeal. The intransigence of the parties is much to be regretted.

3. I now summarise the facts. Mr Andrew Thompson and Mr Shaw set up in partnership in 2001. It was a limited liability partnership under the name Thompson Shaw Associates LLP. Its purpose was to carry on the business of insolvency practitioners. Subsequently Charles Brook and Jeremy Frost joined the Partnership. Mr Shaw was the partner responsible for the partnership accounts. Unhappily, disputes and difficulties arose between Mr Thompson and Mr Frost on the one hand, and Mr Shaw and Mr Brook on the other. Mr Shaw and Mr Brook attempted to expel Mr Thompson from the Partnership. That led to proceedings, in which Mr Thompson and Mr Frost obtained an injunction against Mr Shaw and Mr Brook. The two factions decided to separate.

4. By a retirement agreement made on 10th September 2003 ("the Agreement") Mr Shaw and Mr Brook ceased to be members of the Partnership. They took that part of the business of the Partnership which is carried on in Huddersfield and Manchester. They were to carry on that business under the name of their new partnership, Marchands. Mr Thompson and Mr Brook were to carry on in partnership together under a new name, and the present name of the Partnership was chosen.

5. The separation of Mr Shaw and Mr Brook from the Partnership was effected by means of a sale by the Partnership to Marchands of the Huddersfield and Manchester premises, the goodwill of the business carried on there, certain cases which were to be transferred and certain other assets.

6. By clause 4.1 of the Agreement, provision was made for a price for the assets to be transferred. Prices totalling £23,003 were fixed for the various assets, except the transferred cases, the price for which was to be determined by "the Completion Accounts". Those accounts were to be prepared in respect of the period ending on the transfer date, which was fixed as 30th September 2003.

7. By clause 4.2, the price was payable by payment from Mr Shaw's and Mr Brook's capital and current accounts, as shown in the Completion Accounts, subject to the remaining provisions of clause 4. That appears to assume that the capital and current accounts would be in credit at the transfer date.

8. By clause 4.3, insofar as Mr Shaw's and Mr Brook's capital and current accounts were less than the price, Marchands agreed to pay the deficiency to the Partnership on the transfer date.

9. By clause 4.4, in so far as those capital and current accounts exceeded the price, the Partnership was to pay that excess by providing postdated cheques payable to Mr Shaw, to clear on specified dates, time to be of the essence.

10. By clause 4.4.1, £20,000 was payable on the transfer date.

11. By clause 4.4.2, a further sum was to be payable not later than 30th October 2003. By clause 4.5, that sum was expressed to be the difference between the £20,000 payable on completion and 50% of Mr

Shaw's and Mr Brook's current and capital accounts at 30th September 2003, once they had been determined in accordance with clause 6.

12. Clause 4.6 provided for Mr Shaw and Mr Brook to repay such part, if any, of the £20,000 as exceeded 50% of their accounts.

13. Clauses 4.4.3 to 4.4.8 provided for six postdated cheques, each for £14,000, to clear no later than the month ends from October 2003 to March 2004.

14. By clause 4.7, Mr Thompson and Mr Frost were to guarantee payment of the sums payable by the Partnership.

15. Clause 5.1.3 provided for Mr Shaw and Mr Brook to retain the accounts (and supporting papers) until they had been audited and agreed.

16. Clause 6 set out what were the requirements for the Completion Accounts. They were to be prepared by Mr Shaw and Mr Brook in accordance with the Companies Act 1985 and generally accepted United Kingdom accounting principles and applicable accounting standards and using the same accounting bases and policies as the Partnership had adopted prior to the transfer date in the preparation of its accounts.

17. Clause 6.4 referred to work in progress, and provided that it should be calculated by using the figure for work in progress at the end of July 2003, that is to say £389,197, with certain adjustments. That July figure is said by Mr Thompson to be a misrepresentation by Mr Shaw of the value of the work in progress and that it is far too high.

18. Clause 6.4 gave details of the requirements for work in progress in the Completion Accounts, including making an adjustment at the transfer date to current accounts to accord with what is called "clause 7" in the Partnership agreement, but which it is agreed should have been a reference to clause 15.2. That provided for work in progress to be valued at sales value, less an allowance for non-recoverable work still to be carried out. Also by clause 6.4 Mr Shaw and Mr Brook agreed to use reasonable efforts to procure that the Completion Accounts were prepared and delivered to Mr Thompson and Mr Frost as soon as possible following the transfer date and in any event within 21 business days thereof, that is to say by 28th October 2003.

19. Clause 6.6 provided for the parties to use all reasonable endeavours to procure that all records, working papers and other information as might reasonably be required for the purposes of clause 6 be made available on request, and generally to provide all reasonable assistance and information necessary for the preparation of the Completion Accounts or for resolution of any dispute in relation to the same.

20. Clause 6.7 provided that, on receipt of the Completion Accounts, Mr Thompson and Mr Frost were to carry out a review, and within fourteen business days of receipt they were to notify Mr Shaw and Mr Brook of any objection to the Completion Accounts, on the basis only that the Completion Accounts were not prepared in accordance with clause 6. In the absence of any objection notice served in time or in the absence of any manifest error, the accounts were to be deemed agreed and final and binding.

21. By clause 6.8, if within ten business days of receipt of the objection notice the parties failed to agree, the dispute was to be referred to an independent expert for final decision.

22. The judge, in paragraph 30 of his judgment, summarised the position under those provisions as being that who pays whom and what depended on whether the Completion Accounts showed the capital and current accounts of Mr Shaw and Mr Brook as being more or less than the price for the transferred assets, and that price could not be determined until the Completion Accounts were settled. The judge, in paragraph 31 of his judgment, said that the process of getting to finalised Completion Accounts could be seen as capable of lasting into December and that it was distinctly over-optimistic to say in clause 4.4.2 that the sum payable under clause 4.5 was to be paid no later than 30th October. Of course by that date the Completion Accounts should have been available to the Partnership for at least two days.

23. On the transfer date Mr Shaw and Mr Brook took the transfer of the agreed assets, and £20,000 was received by Mr Shaw in accordance with the agreement.

24. On 24th October Mr Shaw sent what he called in a covering letter "draft Completion Accounts" to Mr Hennessy. He is a chartered accountant who undertook the audit of the accounts for Mr Thompson and Mr Frost, and he has joined the Partnership as a partner.

25. Mr Hennessy asked by four letters and emails between 30th October and 9th November for accounting information from Mr Shaw. Mr Hennessy says in his affidavit that that request has only been supplied in part. In particular he points to failures to provide information relating to work in progress, as he details in his evidence.

26. Nevertheless, on 21st November 2003, by letter to Mr Thompson, Mr Shaw asserted that he had answered all of the queries raised by Mr Hennessy and that Mr Thompson and Mr Frost were out of time for lodging an objection notice.

27. The Partnership responded on 24th November, claiming that there had been fundamental breaches of clause 6. It warned that it was considering stopping the postdated cheques.

28. On 30th November 2003 the £14,000 cheque due to be cleared by that day was stopped, on the basis, as the petitioner's solicitors were informed, that the Partnership believed that proper Completion Accounts would show a deficiency. The petitioner's solicitors said that £14,000 due at the end of November had been paid into a client account of the solicitors. A further cheque for £14,000, payable at the end of December, we are told, was also paid into that account.

29. On 19th December 2003 Mr Thompson and Mr Frost, with the help of an independent accountant, Mr Tesciuba, as well as Mr Hennessy, served a detailed objection notice as if proper Completion Accounts had been produced, but they made clear that no proper Completion Accounts had been prepared in accordance with clause 6, that information which had been requested relating to those accounts had not been supplied and that, having regard to the overdrawn capital and current accounts of Mr Shaw and Mr Brook, Mr Shaw owed the Partnership £204,221 and Mr Brook £2,256.

30. Notwithstanding the objection notice, on 24th December Marchands presented the petition. In addition to the £14,000 on the stopped cheque, a claim was made for the sums on the postdated cheques due after that.

31. On 4th January 2004 the Partnership applied to restrain the advertisement of the petition, on the basis that there was a genuine dispute as to what the Completion Accounts should show and that there was a cross-claim on those accounts which would overtop the sums payable on the postdated cheques. The Partnership also claimed that Mr Shaw had made a misrepresentation on the value of the work in progress in July 2003, on which Mr Thompson had relied in entering into the agreement, and that the damages for that misrepresentation would exceed the liability under the cheque. Further, it was claimed that Mr Shaw and Mr Brook were in breach of the Agreement because they had failed to supply proper Completion Accounts or the information requested.

32. The judge in his judgment went carefully through the agreement. He noted that there was a dispute about the figures for work in progress and that Mr Groves for Mr Shaw and Mr Brook accepted before the judge that that may not have been calculated on the correct basis. He noted the complaint made by the Partnership about Mr Shaw's failure to comply with his obligations under clause 6.6. He also noted that in the objection notice more than £200,000 was said to be due from Mr Shaw and Mr Brook, rather than that any money was due to them. The judge said that, if that were right, there would be a deficiency and nothing would be payable to Mr Shaw under clause 4.4, and that the sum of £20,000 already paid would be repayable to the Partnership. The judge noted that Mr Groves accepted that there were defences to a dishonoured cheque but that such defences were very limited. The judge also referred to Mr Groves' acceptance that there were genuine disputes as to the content of the Completion Accounts, which might result in a deficiency being established. He referred to Mr Groves' submission that the amounts which the cheques represented had to be paid on the nail. The judge called that the main essence of the dispute. He directed himself by saying that the petition could not be struck out unless its presentation was an abuse of process, which it would be if the petition was the

subject of dispute. He said that the court did not allow a petition to be used for the purpose of deciding a substantial dispute raised on bona fide grounds. He noted the argument of Mr Elleray QC for the Partnership that, given the acceptance by Mr Groves that there was a substantial dispute as to what the Completion Accounts should show, there was a cross-claim or a defence to liability on the cheques, which were only payable if and so far as there was an excess. The judge then referred to the further point taken by Mr Elleray on misrepresentation in respect of the work in progress figure.

33. The judge said, in paragraph 52 of his judgment, that he could not be satisfied that there was a sufficient and strong enough cross-claim for misrepresentation to make it clear that at the hearing of the petition, if it were to proceed, the petition could not succeed because of a genuine dispute on substantial grounds. He said that that was a cross-claim and in that respect it brought into play the principles which had been discussed by this court in the case of **Re Bayoil SA [**1999] 1 WLR 147.

34. The judge described as more substantial Mr Elleray's submission that the sums shown in the postdated cheques were not due; but he said that, having regard to the way clause 4 of the Agreement worked, he had come to the conclusion that the cheques were intended to be payable in any event and without question, whatever might be the position under clause 6, unless and until the Completion Accounts were settled. He said that he could not be satisfied that, at the hearing of the petition, the petition could not succeed. The judge said in paragraph 61:

"I certainly cannot be satisfied, as I would have to be, that the debt is not due or is substantially disputed ..."

35. The judge referred to an argument by Mr Elleray on repudiation, but said in paragraph 62 that that too was inadequate to demonstrate that the debt was plainly disputed on substantial grounds. The judge acknowledged that the money for paying Mr Shaw and Mr Brook was available in the clients' account of the Partnership's solicitors, but nevertheless said that he would refuse the application.

36. Jonathan Parker LJ refused permission to appeal on the basis that he could see no error in the judge's exercise of discretion. Arden LJ granted permission on the basis of a possible argument that there might have been a failure of consideration for the grant of the cheques, which would be a good defence to proceedings on the cheques. However, she did not limit permission to that point.

37. Before this court, Mr Elleray submits that the judge erred in a number of respects in not accepting that the petition debt is disputed on substantial grounds and that the Partnership has a substantial cross-claim overtopping the petition debt.

38. First, he says that the Partnership has identified seriously arguable breaches of clause 6, in that Mr Shaw did not deliver Completion Accounts within the time specified or at all. In this context Mr Elleray says that what was delivered did not comply with the Companies Act 1985 (I understand that not to be in dispute) and with the required accounting principles and standards. Second, he challenges the figure for work in progress, and says that no attempt was made to assess realisable values, and in particular that there has been no removal of irrecoverable time or closed files. The judge had said that the point on closed files was only mentioned in Mr Thompson's first affidavit of 4th January 2004. That, as Mr Elleray points out, is incorrect, as it was mentioned in the objection notice. Mr Elleray says that the Partnership's accountancy advisers had explained in the objection notice that the work in progress figure should be reduced by over £166,000. He also refers to two further omissions totalling nearly £100,000.

39. Third, he submits that the Partnership has seriously arguable complaints of breaches by Mr Shaw of clause 6.6 in his failure to provide Mr Hennessy with information which had been requested, and that that breach sounded in damages in a sum equal to the value of the postdated cheques and interest on the overdrawn capital and current accounts.

40. Fourth, Mr Elleray submits that it was fundamental to the proper working of the Agreement that Mr Shaw should timeously perform his obligations under clause 6 to deliver Completion Accounts, revalue the work in progress at sales value under clause 6.4, and make available books and records. He therefore argues that there were fundamental breaches of the Agreement.

41. Fifth, Mr Elleray further says that the Partnership has a seriously arguable case, not only of breach of contract, founding a cross-claim for damages, but also that Mr Shaw owes the Partnership £204,221. If there is for no excess for the purpose of clause 4.4 for the Partnership to pay, he says that there is no consideration for the postdated cheques and so the petition debt is subject to a bona fide dispute.

42. Sixth, he submits that the judge was wrong to treat as insubstantial the misrepresentation claim. He says that the figure of £389,197, represented by Mr Shaw to be the value of the work in progress in July 2003, was false because it was not the lower of cost or realisable value and was in any event incorrect. It is Mr Thompson's case, which he has asserted in both his affidavits, that the Partnership would not have agreed the payments in clause 4 and the provision of postdated cheques if the representation had not been made.

43. Mr Groves submits to this court that the judge directed himself properly. He says that the judge correctly applied the test in **Bayoil.** He accepts that there are genuine disputes on the content and format of the Completion Accounts and that if the independent expert under clause 6 of the agreement determines that Mr Shaw is not owed anything, he would have to repay the £20,000 plus any instalments paid. He also accepts that there is a genuine dispute that Mr Shaw owes the Partnership not only the amount said to be owing under the overdrawn account, but also other monies totalling over £200,000. He argues that it was a fundamental part of the Agreement that it provided for the resolution of any dispute in relation to the Completion Accounts in the manner set out in clause 6. He says that that mechanism is not consistent with the stance that complaints in respect of the Completion Accounts can be used to justify the stopping of the postdated cheques.

44. Mr Groves also made reference to the decision of Harman J in **Cornhill Insurance Plc v Improvement Services Ltd** [1986] 1 WLR 1014. That judge in that case cited with approval the remarks of Ungoed-Thomas J in **Mann v Goldstein** [1968] 1 WLR 1091 at 1096, that persistent non-payment of an undisputed debt gave rise to a legitimate suspicion of inability to pay, the failure to pay being evidence from which the inference of inability to pay may be drawn. Those facts are not the facts of the present case.

45. This court is always properly slow to interfere with the decision of a judge on the familiar question of whether a debt is disputed on substantial grounds or whether there is a genuine and serious cross-claim, the more so when the judge is as experienced as Lloyd J undoubtedly is. Nevertheless, I have to say that I find the conclusion reached by the judge, with all respect to him, a surprising one. In this case the statutory ground on which the petition was brought was the inability of the Partnership to pay its debts, in circumstances in which, as the judge found, and as the petitioner knew, the money to pay the petition debt was safe in the client account of the Partnership's solicitors and the reason for the non-payment by the Partnership was that the Partnership considered that it did not owe any money at all, as would have been shown (as the Partnership contends) if Mr Shaw and Mr Brook had produced proper Completion Accounts in accordance with clause 6. Further, the Partnership's reason for non-payment was that Mr Shaw would have been shown in proper Completion Accounts to be a debtor in a substantial amount. It is not said that there is no genuine or substantial dispute on what the Partnership claims. It seems to me unfair if in those circumstances Mr Shaw could nevertheless obtain a winding-up order simply because the clause 6 mechanism has not been worked through, when the reason for that (as the Partnership claims) is Mr Shaw's and Mr Brook's failure to provide proper Completion Accounts.

46. The practice of the Companies Court in such cases is of long standing and has recently been restated by this court in **Bayoil.** As Nourse LJ, giving a judgment with which Ward and Mantell LJJ agreed, pointed out at page 150, there are two categories of case. One is where the petition debt is disputed in good faith and on substantial grounds. In such a case the petition is demurrable, the petitioner being unable to establish, at any rate without a trial, which the Companies Court will generally not permit in winding up proceedings, that he is a creditor with the standing to present a petition. The other is where the petition debt cannot successfully be said to be a debt disputed in good faith on substantial grounds, yet the company has a genuine and serious cross-claim against the petitioner which overtops the petition debt. In the latter case the court has a discretion, but the exercise of that discretion has

been narrowed by authority. In such a case, if the circumstances are that the company has been unable to litigate the cross-claim -- and, I add, it is open to question whether that is an essential condition (see the comments of this court in **Popely v Popely** [2004] EWCA Civ 463) - in the absence of special circumstances the practice of the court is to exercise its discretion by dismissing or staying the petition. In the cross-claim cases, it matters not that the petition debt is undisputed or the subject of a judgment or based on a cheque or other bill of exchange (see, for example, **Re LHF Wools Ltd** [1970] Ch 27, where the petition debt was a judgment debt based on a dishonoured bill of exchange). It matters not that the debt is one for which summary judgment would have been obtained or on which execution could be levied notwithstanding the cross-claim. A winding up order has more serious consequences and the Companies Court is entitled to adopt a different approach.

47. In the present case the Partnership has claims by which it disputes the debt, on the ground of absence of consideration, and claims which are cross-claims. It is sufficient to proceed on the footing that Mr Shaw and Mr Brook were entitled to be paid on the post dated cheques as they fell due to be cleared, but contended that the Partnership has a cross-claim for the amounts shown in the objection notice as being due from Mr Shaw, those amounts overtopping the petition debt. It is to be noted that more than half of that cross-claim is in respect of a simple claim on an overdrawn account, and that is not dependent on the Agreement. The judge does not expressly deal with that cross-claim, other than implicitly to reject it on the basis argued for by Mr Groves that clause 4 requires payment by the post dated cheques and clause 6 provides the mechanism for resolving such a claim and that, until the final outcome is agreed or determined by the independent expert, the cross-claim does not prevent Mr Shaw from proceeding on the post dated cheques to wind up the Partnership.

48. I accept that Mr Shaw could and probably would be able to obtain judgment, indeed summary judgment, on the cheques as they fell due, although it is at least arguable that the court would order a stay in the light of the argument based on the substantial cross-claim. Mr Shaw has not said that the detailed figures provided in the objection notice are wrong in any particular respect. Mr Groves' argument, which the judge accepts, is that, given the procedure for resolving disputes in the Agreement, Mr Shaw is enabled not merely to obtain payment by seeking judgment on the cheques in ordinary proceedings and by obtaining execution, but also to wind up the Partnership. The Agreement makes no mention of any right to wind up the Partnership. It would mean that even the possibility of a stay, which the Partnership might obtain if Mr Shaw had sued on the cheques, would be denied to the Partnership in the winding up proceedings, despite the serious consequences of a winding up order. That seems to me very remarkable.

49. I cannot see how any of this accords with the practice of the Companies Court, where there is a genuine and serious cross-claim which the cross-claimant has not been able to litigate. If the judge considered that the form of the Agreement, with its provisions for dispute resolution, to be a sufficiently special or exceptional circumstance -- and he does not say so -- I would respectfully have to disagree with him. The existence of the genuine and serious cross-claim, which is not challenged, and which would overtop the petition debt, must, in my judgment, lead to the dismissal or stay of the petition. The judge's decision seems to me, with all respect to him, to be in conflict with the ordinary practice. On this ground alone, in my judgment, the appeal should be allowed.

50. This conclusion renders it unnecessary for me to say anything on the other grounds on which Mr Elleray challenged the judge's decision.

LORD JUSTICE WALLER:

51. I share my Lord's regret that this appeal has been argued out at considerable expense when, as my Lord has explained, the only live issue between the parties relates to the proper order which should be made as to costs before the judge. But argued out it has been, and I agree with my Lord's judgment and the order he proposes.

LORD JUSTICE MAY:

52. I agree that this appeal should be allowed for the reasons which Peter Gibson LJ has given. I gratefully adopt his account of the facts and circumstances of the appeal.

53. I too am concerned that the parties are apparently so at odds with each other that they have been unable to avoid the expense of an appeal to this court, when the amounts due on the postdated cheques have now been paid and the possibility of a winding-up petition based on the fact that they were not originally paid has now disappeared. The parties are now before this court only on account of the costs of the proceedings below. This is unsatisfactory in itself, but it is also unsatisfactory because these appeal proceedings do not appear to address or help to resolve what appears to be the real dispute between the parties. The real dispute between the parties appears to be about the settlement of the Completion Accounts or at least to include the settlement of the Completion Accounts.

54. As to the issue before the judge which my Lord has addressed, cheques are negotiable instruments. They are generally to be honoured upon presentation without question or set-off: the banking system could not otherwise operate. Subject to very limited exceptions, the holder of a cheque which is dishonoured can obtain summary judgment against the drawer for the amount of the cheque. Cross-claims will not usually prevent this. In most cases, but not every case, an application for a stay of execution of judgment for the amount of a cheque will not be granted. If the judgment is not satisfied, there are various orthodox means of executing the judgment.

55. If a limited company or partnership is unable to pay its debts, a winding-up petition may be presented; but in the present case the appellants were not unable to pay the relevant debts and they had a properly arguable case that, so far from the balance of account under the retirement agreement being in favour of the respondents to an amount of £104,000 -- the original £20,000 and the post dated cheques -- there was a substantial balance in favour of the appellants. The appellants have so far been unable to resolve this dispute by litigation or otherwise, in so far as this may be a necessary ingredient of the conclusion. The court would not, in my judgment, wind-up a company or limited liability partnership in these circumstances (see **Re: Bayoil** [1999] 1 WLR 147 and the other cases to which Peter Gibson LJ has referred). The court should not entertain the presenting of a winding-up petition as a substitute for orthodox execution or, as Mr Groves hinted, as legitimate commercial pressure to induce the appellants to honour the cheques. It would not be legitimate pressure because the premise that the court might make a winding-up order is, for the reasons I have given, unsustainable on the facts of the present case.

56. Mr Groves has substantial submissions on the construction of the agreement. They do not, however, extend to a construction to the effect that the parties had agreed that, if the cheques were not honoured, the respondents might present a winding-up petition in circumstances in which the court would not otherwise make a winding-up order.

(Submissions re: costs followed.)

LORD JUSTICE PETER GIBSON:

57. We will order the unsuccessful respondents to pay the successful appellants' costs of the hearing below and of the petition and of the costs of the appeal up until 7th May of this year. No order as to costs thereafter. We do that on the basis that Arden LJ had recommended an attempt at mediation, that the question of what was to happen to the petition had effectively been resolved by the letter of 21st April, even though the petition was not withdrawn until later, and because of the unhelpful response of the appellants' solicitors on 7th May that they *"do not feel mediation would assist"*.

ORDER: Appeal allowed; respondents to pay appellants' costs of hearing below and of the petition and costs of the appeal up until 7/5/4; no order as to costs thereafter.

MR ANTHONY ELLERAY QC (instructed by Marshalls, Hallsall L39 8RJ) appeared on behalf of the APPELLANT

MR HUGO GROVES (instructed by Pinsents, Leeds LS1 5AB) appeared on behalf of the RESPONDENT