CA on appeal from Commercial Court (HHJ David Mackie) before Potter LJ; Sedley LJ; Jonathan Partker LJ. 3rd April 2001

LORD JUSTICE POTTER :

INTRODUCTION

1. The issue on this appeal raises the question of the degree of connection which must be shown between (1) a claim for unliquidated damages for breach of a contract and (2) a cross-claim for unliquidated damages for breach of a different contract between the same parties, in order to permit the latter claim to be the subject of an equitable set-off against the former claim. The issue is of particular importance in this case because the second contract contains an arbitration clause.

2. Claim (1), brought by the claimant ("Bim Kemi") is a claim for damages for the alleged repudiation by the defendant ("Blackburn") of an exclusive distribution agreement which Bim Kemi allege, but Blackburn deny, was made in 1994 ("the 1994 agreement"). At that time the parties were already in a long-standing trading relationship pursuant to a technology and trademark licensing agreement made in 1984 ("the 1984 agreement"), which contained an arbitration clause. Claim (1) is for damages in respect of Blackburn's refusal to supply Bim Kemi with the products which were the subject of the 1994 agreement, Bim Kemi claiming damages in respect of its loss of profit during the period of notice provided for. The proceedings were commenced in the Commercial Court by writ dated 23rd April 1999. Claim (2), which Blackburn seeks to set-off against Bim Kemi's claim for damages, is a cross-claim for damages in respect of, so far unparticularised, financial loss resulting from Bim Kemi's alleged breaches of various terms of the 1984 agreement, which terminated in May 1999. Blackburn's pleaded counterclaim in respect of those losses has been stayed under s.9 of the Arbitration Act 1996.

THE BACKGROUND FACTS

3. Blackburn is an English company which makes and supplies chemicals, including anti-foaming agents, to paper manufacturers. Bim Kemi is Swedish corporation which also makes and supplies chemicals, principally to the paper industry in Sweden. By the 1984 agreement, Blackburn granted a licence to Bim Kemi to use its know-how in anti-foaming agents and to permit Bim Kemi to process concentrate made by Blackburn, selling on the anti-foaming agents which Bim Kemi produced under Blackburn's trademark. The 1984 agreement was for a period of 10 years, terminable thereafter by either side giving 24 months' notice to the other. The parties worked happily together for a number of years, Blackburn supplying Bim Kemi with concentrates to enable it to make products at its Swedish plants in return for 5% of net sales revenue. The parties implemented the terms of the 1984 agreement and Blackburn duly supplied concentrates under it until notice of termination by Blackburn took effect in May 1999.

4. In 1993 there were negotiations between the parties relating to new Blackburn products which were not the subject of the 1984 agreement and which Bim Kemi wished to purchase in their finished form for re-sale in Scandinavia. Following a meeting on 25th November 1993 Blackburn sent a fax to Bim Kemi dated 20th December 1993, which Bim Kemi say evidenced a new distribution agreement in relation to the new products. The fax was not the subject of a reply in writing; however, Bim Kemi rely on the conversation surrounding it and later communications between the parties as containing or evidencing a completed agreement in terms of the fax. It is Bim Kemi's case that the 1994 agreement took effect from 1st January 1994 and gave them exclusive sales rights in Sweden for Blackburn's product called Dispelair BS 469 and subsequent developments of such product, in particular Dispelair BS 470: that Bim Kemi were to have exclusive sales rights in Denmark, Norway and Finland for three years, which would continue if Bim Kemi attained 20% of the available market in any product range; and that the gross profit on the sale of products manufactured by Blackburn and sold by Bim Kemi would be split between the parties. The parties were to supply each other with all reasonable and relevant commercial information and the agreement would be terminated by either party giving 12 months' notice to the other from 1st January. Unlike the 1984 agreement, which related to sales made by Bim Kemi of anti-foaming agents produced by Bim Kemi from Blackburn's concentrate ("old products"), the 1994 agreement was simply one for distribution by Bim Kemi of Blackburn's own product ("new products").

5. In January 1995, Bim Kemi purchased a Finnish company, Cellkem, which made products, some of which competed with the old products licensed by Blackburn to Bim Kemi. In February 1995, following Blackburn's expression of concern, Blackburn recorded an assurance made by Bim Kemi that it intended to replace Cellkem's competing products known as "Tensidef" with Blackburn's Dispelair range. Whatever the contractual arrangements, the evidence is that, from 1994 onwards, as between the parties the arrangements for both the old and new products were treated commercially and in accounting terms as part of a single trading relationship.

6. Disharmony occurred in 1998. It is Bim Kemi's case that there was an implied term of the 1994 agreement that Blackburn would supply all Bim Kemi's reasonable requirements for Dispelair BS 469 and subsequent products and that they did so between 1994 and 1998, Bim Kemi in fact enjoying exclusivity in Denmark, Norway and Finland, in particular with Dispelair BS 470. In December 1998, Blackburn appointed new distributors in Sweden and Finland for BS 470 and refused to supply Bim Kemi with its requirements for that product in those countries. Bim Kemi relied upon that conduct as a repudiation of the 1994 agreement, claiming damages for loss of profit put at SEK 14,000,000.

7. Blackburn's principal defence in the proceedings is that they deny the existence of the 1994 agreement. They agree that they supplied new products, and in particular BS 470, as and when they received orders but deny that Bim Kemi was an exclusive distributor in Sweden, Finland, Denmark or Norway. Alternatively, they allege that, if

there was a binding 1994 agreement, it was repudiated by Bim Kemi's conduct in breach of such agreement in failing to inform Blackburn of its sales of BS 470, in failing to include Dispelair in its sales brochures, and in making or obtaining Tensidef anti-foaming agents for supply to customers in Sweden, Finland, Denmark and Norway instead of Blackburn's products. They also allege failure to supply information relating to Tensidef agents. In September 1998 Bim Kemi cancelled three large orders for BS 470 and it is Blackburn's case that that occurred because Bim Kemi was selling the competing product Tensidef, and had placed orders with Blackburn only as 'backup', which were then cancelled. Blackburn say they were entitled to decline to make further supplies of BS 470, although remaining willing to supply other products on an order by order basis (as they have continued to do).

8. It is also Blackburn's case, however, that, if Bim Kemi is entitled to claim damages for breach of the 1994 agreement, Blackburn is in any event entitled to set off damage and loss caused by Bim Kemi's breach of the 1984 agreement. It is alleged that in the course of favouring and developing Tensidef products at the expense of Blackburn's Dispelair range over the years since its acquisition of Cellkem, Bim Kemi breached the 1984 agreement by

   i) failing to use best endeavours to stimulate sales by not including Dispelair products in its brochures and promoting sales of Tensidef products instead of Dispelair and publicising the trademark of Tensidef rather than that of Dispelair;

   ii) producing Dispelair 150 and Tensidef anti-foaming agents otherwise than in accordance with the specifications laid down;

   iii) failing to communicate improvements modifications or developments of licensed know-how and information about Tensidef products, the technical aspects of modifications to Dispelair 150 and economic information about its use after 1995;

   iv) abusing Blackburn's rights in the trademark Dispelair by promoting and selling Tensidef products and offering Dispelair at reduced prices if customers were not satisfied with Tensidef.

THE PROCEDURAL HISTORY

9. On 13th October 1999 Bim Kemi made application to stay the set-off and counterclaim based on alleged breaches of the 1984 agreement, on the ground that the arbitration clause in the 1984 agreement required disputes to be referred to arbitration before the ICC in Stockholm. However, that is not in itself a ground for staying the defence of set-off. As made clear by Hoffmann LJ in ***Aectra Refining and Marketing Inc. -v- Exmar NV)*** [1994] 1 WLR 1634, in the case of a *"transaction set-off"* of the type pleaded (to be contrasted with *"independent set-off"* as between cross-claims for due and payable liquidated sums): *"The authorities are in favour of allowing the set-off to be pleaded, notwithstanding its submission to arbitration or a different jurisdiction [1649F] … The Defendant is pleading a confession and avoidance to the Plaintiff's claim. He is saying that although the facts alleged by the Plaintiff entitle him to judgment for the amount claimed, a wider examination of related facts would show that the claim is wholly or partly extinguished. It would be quite unreasonable for a plaintiff who has chosen to sue in one forum to rely on an arbitration or jurisdiction clause to confine the court to the facts which he chooses to prove and prevent it from examining related facts as well." [1650B-C]*

10. In the face of that authority, Bim Kemi amended its original application to contend that the pleaded set-off based on alleged breaches of the 1984 agreement should be struck out as not amounting to a defence to the claim in respect of the 1994 agreement, and/or for summary judgment on that issue. The issue was resolved against Bim Kemi by David Mackie QC, sitting as a Deputy Judge of the High Court, who held that Blackburn's cross-claims would, if established, amount to an equitable or transactional set-off which they were entitled to plead as a defence in the action. By order dated 17th March 2000, he ordered that the counterclaim be stayed to the extent that it was based on the 1984 agreement and that the hearing of the application be treated as the trial of the issue whether the liability (if any) of the claimant in respect of any alleged breach of the 1984 agreement pleaded in the defence might be set off against the liability of the defendant in respect of any alleged breach of the 1994 agreement; and he determined the issue in favour of Blackburn. The judge also granted permission to appeal.

THE JUDGE'S REASONS

11. The judge referred to number of the principal authorities upon the appropriate test by which to determine whether, in a given case, a plea of equitable set-off may properly be relied on. In particular, following reference to ***Hanak –v- Green*** [1958] 2 QB 9, he quoted from ***Federal Commerce and Navigation Co Ltd –v- Molena Alpha Inc (and Others) ("The Nanfri")*** [1978] 1 QB 927: *"We have no longer to ask ourselves what would the courts of common law or the Courts of Equity have done before the Judicature Act. We have to ask ourselves what should we do now so as to ensure fair dealing between the parties? ….. this question must be asked in each case as it arises for decision: and then, from case to case we shall build up a series of precedents to guide those who come after us. But one thing is quite clear: it not every cross-claim which can be deducted. It is only cross-claims that arise out of the same transaction or are closely connected with it. And it is only cross-claims which go directly to impeach the Plaintiff's demands, that is so closely connected with his demand that it would be manifestly unjust to allow him to enforce payment without taking into account the cross-claim. Such was the case with the case of the lost vehicle in* ***Morgan & Son Limited –v- S. Martin Johnson & Co Limited*** *[1949] 1 KB 107 and the widow's misconduct in* ***Hanak –v- Green*** *[1958] 2 QB 9." (per Lord Denning at 974)* (emphasis added)

".. equitable set-off which is really a defence, does not arise in every case where there are cross-claims or even always where the cross-claims arise out of the same contract. *The circumstances must be such as to make it unfair for the creditor to be paid his claim without allowing that of the debtor if and insofar as well founded and thus to raise an equity against the creditor or, as it has been expressed, impeach his title to be paid."* (per Goff LJ at 981) (emphasis added)

12. The judge also quoted from the judgment of Lord Brandon in ***Bank of Boston Connecticut -v - European Grain and Shipping*** [1989] 1 AC 106 at 1102 in which he approved the criterion that the cross-claim should be one: *"Flowing out of and inseparably connected with the dealings and transactions which also give rise to the claim."*

13. Having referred to various other authorities the judge went on to pose and answer two questions. First, whether or not the claims sought to be set-off 'flow out of and are inseparably connected with the dealing and transactions which are the subject of the claim'. Second, if so, were there any factors which would render it unjust for a set-off to be permitted.

14. In paragraph 24 of his judgment he stated: *"Do the cross-claims flow out of and are they inseparably connected with the dealings and transactions which also give rise to the Plaintiff's claim? In my judgment they clearly do and are. Bim Kemi's central grievance is Blackburn's refusal to meet orders in 1998, they say because Blackburn appointed new distributors. Blackburn's grievance, developed since the Cellkem acquisition in 1995 and culminating in a refusal to supply BS 470 a "new product" in 1998, lies in its suspicions that Bim Kemi have, at the least, neglected their duties [in order] to further the objectives of its subsidiary Cellkem and its products Tensidef. Blackburn's response is expressed in claims about the old products, based on rights under the 1984 Agreement and to a lesser degree on claims under the 1994 Agreement, if it exists. These issues seem to me inextricably linked. The issue, in the context of dealings between the parties that treated both sets of products and their contracts as part of a single relationship, is crucially what each company was up to and why in 1998. The claims arise, if at all, under different contracts but will turn on the same, or very similar findings of fact. It would be unfair for Blackburn having first litigated all this in London to be compelled, even if a stay was available from a court here, to arbitrate such closely related claims in a different forum. The contractual differences between the two sets of products seem to me to carry little weight given the way the cross-claims converge on the issue which caused the dispute in 1998. The situation is different from that of many cross-claims where the alleged liabilities arise out of more separate distinct aspects of the relationship between the parties. In this case justice requires the cross-claims under the 1984 Agreement be treated as Defences to the claim."*

15. In relation to the second question, the judge considered particular points raised by Bim Kemi as follows. (a) Blackburn's agreement to submit disputes under the 1984 agreement to arbitration in Stockholm; (b) the unliquidated nature of both claims; (c) the lack of particularisation by Bim Kemi of the alleged breaches of the 1984 agreement; (d) the absence of detail about the measure of damage; and (e) the failure of Blackburn to complain about the 1984 agreement breaches until January 1999 notwithstanding that in 1997 Bim Kemi had given two years' notice of termination. The judge dismissed reliance upon the arbitration clause on the grounds of the potential injustice, delay and extra cost which would arise from a requirement to conduct a separate arbitration. In relation to the other matters he stated as follows: *"I do not find it useful to seek to evaluate, particularly at this early stage such matters as the lack of detail and particularisation of the breaches alleged by Blackburn. Further the ostensible reason for this is that Blackburn say they are still, and have been kept, in the dark … it is .. commonly the case that grievances lie unexplored and unarticulated until there is some change in the climate. Further, Blackburn say they complained as soon as their suspicions were confirmed. Moreover, sometimes meritless claims are made early and sound ones deplorably late. The further difficulty is that the further one moves into discretion the more features may become relevant. It is true that Blackburn has not at any point sought to raise the point, but I suggested to Mr Lazarus that if broad discretion is relevant it might not be unreasonable for Blackburn's cross-claims to be permitted to proceed in this court. It would obviously be much cheaper and quicker for all disputes to be resolved in one forum. It might be fair for that forum to be the Commercial Court, Bim Kemi's own chosen venue for its closely related claims. The insistence on arbitration may of course be a means of having a worthless claim kept out of the action. But it may also be a tactic to cause more cost and inconvenience to Blackburn than this move may cause Bim Kemi. The more one lengthens the list of potential discretionary factors, the further one moves away from the central issue which, as I see it, must be the nature of the claims and cross-claims itself."*

16. The judge then concluded that Blackburn had cross-claims which, if established, would amount to an equitable set-off which they could plead as a defence in the action.

THE GROUNDS OF APPEAL

17. For Bim Kemi, Mr Lazarus has argued the following grounds of appeal. First, he submits that the judge erred in law in failing to answer the question whether the cross-claim of Blackburn under the 1984 agreement 'impeached' the claim of Bim Kemi under the 1994 agreement. In that respect he relies upon the retention of that question within the test propounded by Lord Denning MR in ***The Nanfri*** as emphasising the necessity for a close connection between cross-claims for the purposes of equitable set-off. Mr Lazarus suggests that the test, properly analysed, is to see whether the claimant's claim is impugned or undermined by the defendant's cross-claim. In this respect, he relies upon the approach of the Court of Appeal in ***Esso Petroleum Co Limited –v- Milton*** [1997] 1 WLR 2001] EWCA Civ 457 938 at 949-952 per Simon Brown LJ in which case the court made clear that: *"The mere fact that both claim and counterclaim arise out of a single trading relationship between the parties is … wholly insufficient to supply the close link necessary to support an equitable set-off."*

18. Second, Mr Lazarus submits that the judge misdirected himself in relation to Lord Brandon's test by asking in effect whether there was some factual connection between Bim Kemi's claim for damages for breach of the 1994 agreement and Blackburn's claim for damages for breach of the 1984 agreement. He submits that the judge found the necessary connection in his conclusion that the reason why Blackburn repudiated the 1994 agreement (if it existed) was that it considered Bim Kemi had breached the 1984 agreement. Mr Lazarus rightly submits that it is necessary to look beyond the mind of Blackburn into the facts of the case to see whether the necessary close connection is in fact established.

19. Third, Mr Lazarus also attacks the judge's apparent conclusion that it is sufficient if the matter will turn on very similar findings of fact. He submits, again correctly, that that is not a relevant matter in itself unless the claims are factually connected. Mr Lazarus argues that the form of the pleading is such that the real issue upon the 1994 agreement is simply whether or not such a binding agreement was ever reached. The cross-claim pleads breaches of specific terms of the 1984 agreement which are largely matters occurring prior to the 1994 agreement. However, he concedes there is a measure of overlap.

20. Fourth, the specific matters upon which Mr Lazarus relies as demonstrating that the cross-claim does not in fact impeach or impugn Bim Kemi's claim are these:

    i) the claims arise under separate contracts made ten years apart;

    ii) Bim Kemi's claim arises out of the wrongful termination out of the 1994 agreement whose existence is disputed, whereas Blackburn's cross-claim arises out of specific identified breaches of the 1984 agreement the terms of which are not in doubt;

    iii) the contracts relate to different products and contain significantly different terms;.

    iv) The 1984 agreement was essentially a licence for Bim Kemi to use Blackburn's technology and trademark in applying its own processes to concentrate supplied by Blackburn in return for a 5% royalty, whereas the 1994 agreement was simply for the supply of finished product in return for a 50% share of the gross profit;

    v) the breaches of the 1984 agreement relied on are largely terms protecting Blackburn's technology and trademark and thus the principal subject matter of the cross-claim consists of matters which have nothing to do with the making and/or breach of the later distribution agreement;

    vi) Bim Kemi's claim is for loss of future profits in relation to products not supplied during the agreed notice period whereas Blackburn's claim is in respect of financial loss for past breaches;

    vii) Blackburn never claimed or took action in respect of its complaints until Bim Kemi made its claim for non-performance of the 1994 agreement and, in any event, Blackburn has to date failed to particularise its alleged financial loss.

THE APPROPRIATE TEST

The Nature of the claims

21. The first point to be noted is that, in advancing his argument before us on this appeal, Mr Lazarus has not taken the point, which might seem to be open on the authorities, that an equitable or transaction set-off in respect of a cross-claim may only be relied upon in defence to a primary claim for a debt or other liquidated sum. It is of course the case that a set-off at law (or *'independent set-off'* as it has also been termed) is concerned with the right to set-off mutual debts arising from transactions of a different nature which were due and payable and ascertainable with certainty at the time of pleading. Thus, no plea of legal set-off could be relied upon against a claim for unliquidated or uncertain damages; nor, indeed, could a cross-claim for damages be set-off against a claim for a liquidated sum. Equity recognised a right to set-off a cross-claim for unliquidated damages where the claim and cross-claim were so closely connected that it would be unfair not to allow a set-off; see ***Young -v- Kitchen*** [1878] 3 Ex D 127, ***Bankes - v- Jarvis*** [1903] KB 549 and ***Government of Newfoundland -v- Newfoundland Railway Co*** (1888) 13 App Cas 199 at 212. The leading authorities prior to *Hanak –v Green* do not reveal any case where an equitable set-off was permitted in respect of a claim for unliquidated damages. However, ***Hanak - v- Green,*** in which the Court of Appeal recognised the right of the builder/defendant to set-off his cross-claim for damages, was itself a case in which the plaintiff/building owner's claim was for unliquidated damages in respect of defective work.

22. It is correct to say that the attention of the court in ***Hanak -v- Green*** was not drawn to the decision of the Queen's Bench Divisional Court (Lush and Salter JJ) in ***McCreagh -v- Judd*** [1923] WN 174. In that case, in considering an issue as to costs, the court held that, prior to the *Judicature Act 1873,* it was clear that a liquidated debt could not be used as a set-off against an unliquidated claim. The court therefore refused to allow the defendant to set-off an award in his favour previously obtained under the Agricultural Holdings Act which exceeded the plaintiff's judgment on his claim for damages for breach of contract to repair the farm premises of which the defendant was a tenant. In my view, Mr Lazarus was correct not to rely on that authority to take the point that, because Bim Kemi's claim is by way of damages for repudiation of a contract no plea of equitable set-off is maintainable in respect of Blackburn's cross-claim. It is submitted by the editors of *Halsbury's Laws of England* (4th Ed, Reissue) Vol 42 para 430 at note 15 that in principle a defendant should be permitted to rely on equitable set-off against an unliquidated money claim on the basis that if, as has long been recognised, the defendant may rely on a cross-claim for damages against an otherwise unimpeachable liquidated claim, the equities are more, rather than less, clearly in his favour where the primary claim is unliquidated and therefore has yet to be established in amount. I agree.

23. It appears to me that the decision in ***Hanak –v- Green*** is a sub silentio precedent for the proposition that an unliquidated cross-claim may be set-off against an unliquidated primary claim and is to be preferred to the decision in ***McCreagh –v- Judd***: see also the view expressed in *Wood: English and International Set-Off* para 4-124. The judgment of Morris LJ in ***Hanak –v- Green*** has been described as 'authoritative' (per Dillon LJ in ***BICC –v- Burndy Corporation*** [1985] 1 Ch 232 at 247) and as a 'masterly account' of the subject (per Lord Diplock in ***Gilbert Ash (Northern) Limited –v- Modern Engineering Bristol Limited*** [1974] AC 689 at 717) and it has subsequently been generally accepted as the starting point for modern consideration of the scope of the defence of equitable set-off, to which I now turn.

Close Connection

24. The origin of the 'impeachment' test for which Mr Lazarus argues is to be found in ***Rawson –v- Samuel*** (1839) 1 Cr & Ph 161 at 179. However, as already indicated, the modern law on equitable set-off was subject to close scrutiny and review in ***Hanak –v- Green*** [1958] 2 QB 9. That case recognised a general right to equitable set-off in cases where a *'close relationship existed between the dealings and transactions which gave rise to the respective claims'*; see per Morris LJ at 24. The court did not deal specifically with the degree of closeness required in the relationship, which was later elaborated in ***The Nanfri*** in the passages already quoted at paragraph 11 above. In that case, Lord Denning appears to have been of the view that a cross-claim could be regarded as going directly to impeach the plaintiff's demands when it was 'so closely connected with his demands that it would be manifestly unjust to allow him to enforce payment without taking into account the cross-claim'.

25. In ***British Anzani –v- International Marine Limited*** [1980] 1 QB 137 at 154G, Forbes J, following a detailed review of the authorities, and having referred to Lord Denning's remarks in ***the Nanfri***, said: *"In **Henriksens Rederi A/S –v- T.H.Z. Rollimpex (The Brede)** [1974] QB 233, 248 [Lord Denning] said much the same thing: "It is available whenever the cross-claim arises out of the same transaction as the claim; or out of a transaction that is closely related to the claim". In view of these passages and in particular having regard to the facts in **Bankes –v- Jarvis** [1903] 1 KB 549, it does not seem possible to conclude that it is in all cases necessary that claim and cross-claim must arise out of the same contract. Where, as in this case they do not, it still therefore remains for consideration whether in any particular case the two matters are so closely connected that the principles affecting equitable set-off can be said to apply."*

26. Having referred to the judgment of Morris LJ in ***Hanak –v Green*** a p.24, Forbes J went on at 155F: "*In other words, in considering questions of this kind it is what is obviously fair or manifestly unjust that will determine the solution. This is because today, while it is necessary to look back before the Judicature Act to discover the broad principles upon which equity would grant relief, it may not be helpful to seek to find out from the cases what a court of equity would have done in a similar case. The principle may be derived from the old cases. The application of that principle should be reached by a consideration of what today would be regarded as fair or just. It is but a reflection of the passage that I have already quoed from the judgment of Lord Denning MR in [**The Nanfri**]."*

27. In the *Bank of Boston* case, Lord Brandon enunciated a test which was essentially the same as in the ***The Nanfri.*** However, he plainly regarded the concept of impeachment of the title to the claimant's demand as unhelpful and elaborated upon the closeness of the connection required. At p.1102 he stated: *"The concept of a cross-claim being such as **'impeach the title for the legal demand'** is not a familiar one today. A different version of the relevant test is to be found in the decision of the Judicial Committee of the Privy Council in **Government of Newfoundland –v- Newfoundland Railway Co** (1888) 13 App Cas 199 … In this connection Lord Hobhouse, who delivered the judgment of the Board, said, at pp. 212-213;*

> *"There is no universal rule that claims arising out of the same contract may be set against one another in all circumstances. But their Lordships have no hesitation in saying that in this contract the claims for subsidy and non-construction ought to be set against one another."*
>
> *Lord Hobhouse then referred to **Smith –v- Parkes** (1852) 16 BEAB.115,119 and continued: "that was case of equitable set-off and was decided in 1852, when unliquidated damages could not by law be the subject of set-off. That law was not found to be conducive to justice, and has been altered. Unliquidated damages may now be set-off as between the original parties, and also against an assignee flowing out of and inseparably connected with the dealings and transactions which also give rise to the subject of assignment."*

…. the criterion which Lord Hobhouse applied … in deciding whether the government's cross-claim for unliquidated damages could be set-off against company's claim was not that the cross-claim "impeached the title of the legal demand" as in Rawson –v- Samuel … but rather that it was a cross-claim flowing out of and inseparably connected with the dealings and transactions which also give rise to the claim."

28. Subsequently in ***Dole Dried Fruit & Nut Co –v- Trustin Kerwood*** [1990] 2 Lloyd's Rep 309, the Court of Appeal considered the test propounded by Lord Denning in ***The Nanfri*** and held that the test approved by Lord Brandon in *The Bank of Boston* case was *"the same test in different language"*: per Lloyd LJ at 310. That was a case in which the plaintiff sued for the price of goods sold and delivered to the defendant under a series of sale contracts entered into in the course of the parties' relations under an earlier agreement by which the plaintiffs appointed the defendants their sole and exclusive agents for the importation of prunes and raisins in England. The defendants had earlier commenced proceedings against the plaintiffs for repudiation of that agreement. They sought and were permitted to set-off their claim for damages against the plaintiff's claim.

29. The *Dole Fruit* case illustrates the wise refusal of this court to become bogged down in the nuances of difference between the formulation of the test propounded in ***The Nanfri***, both in relation to the earlier criterion of

'impeachment of title' disapproved by Lord Brandon in the *Bank of Boston* case, and in relation to the reference to a need for a 'close connection' between claim and cross-claim which in the *Bank of Boston* case was elaborated as the need to demonstrate a cross-claim 'flowing out of and inseparably connected with the dealings and transactions which give rise to the subject of the claim": see also the discussion in ***P & O Steam Navigation Co –v- Youell and others*** (CA) 26 March 1997 97-0588 and ***Esso Petroleum –v- Milton*** (supra) at 950D, in which Simon Brown LJ stated that the cross-claim must be *'at least closely connected with the same transaction as that giving rise to the claim'*. It seems that, insofar as there may be a difference, the court has been content for the outcome to be governed by the notion of fairness involved in the proposition that it must be 'manifestly unjust' to allow one to be enforced without regard to the other. For myself, I consider that Lord Brandon's formulation is to be preferred because on the one hand it emphasises that the degree of closeness required is that of an 'inseparable connection', while on the other it makes clear that it is not necessary that the cross-claim should arise out of the same contract; all that is required is that it should flow from the dealings and transactions which gave rise to the subject of the claim. It is of course in such cases, which frequently involve periodic settlement of accounts between the parties on an 'overall' basis rather than separate treatment as between each transaction, that the injustice of disallowing a set-off is most likely to arise.

30. That said, however, it is clear that the principle as stated by Lord Brandon and applied in the ***Dole Fruit*** case is apt to cover a situation where there are claims and cross-claims for damages in respect of different but closely connected contracts arising out of a long-standing trading relationship which is terminated. That fact will not per se establish the requisite *'inseparable connection'* but, in an appropriate case, it may well be manifestly unjust to allow one claim to be enforced without taking account of the other. Further, I consider that the necessary equity may well be demonstrable in a situation where, in the context of such a relationship, the claimant claims damages for the repudiation of a supply contract which the defendant justifies by asserting conduct of the claimant which not only breached the supply contract but also breached a related contract between the parties for supply of other products of the defendant, in respect of which the defendant counterclaims damages. That is, of course, this case.

31. In this case there are a number of overlapping matters of complaint upon which Blackburn rely as between the 1994 agreement for supply of Dispelair BS 470 and the 1984 licensing agreement, which was still extant at the time of Blackburn's termination of the 1994 agreement. It is clear, as Mr Lazarus has stressed, that the 1984 agreement was primarily an agreement covering know-how supplied to Bim Kemi in relation to concentrates supplied for the purposes of Bim Kemi making up anti-foaming agents at its own works for on-sale to the public under Blackburn's trademark, whereas the 1994 agreement concerned the supply of anti-foaming agents already made up for sale without any need for processing or alteration by Bim Kemi before on-sale to the public. However, the licensing agreement included provisions designed to develop and protect a long standing business relationship contemplated between the parties, in respect of the licensed products and which imposed obligations on Bim Kemi in respect of its commercial activities which were not limited to the processing of the concentrates supplied. Certain provisions were of general application to anti-foaming agents produced or proposed to be marketed by Blackburn and thus related generally to the sale of its Dispelair products in Sweden, Norway, Denmark and Finland.

32. In particular, clause 6(a) imposed mutual obligations on the parties to the effect that if either should *'make or discover or become aware of any anti-foaming agents or technical or economic information relating to the specifications for and marketing and use of the anti-foaming agents it shall forthwith communicate same to the [other] and shall fully disclose all particulars thereof to the [other]'*. Further, clause 11(a) required Bim Kemi to *'use its best endeavours by advertising, by public exhibition and by other forms of sales promotion to stimulate sales of the anti-foaming agents and to publicise the Trade Mark in the territory, and shall also use its best endeavours to meet the demand for the anti-foaming agents in the territory to an adequate extent'*. In addition, by clause 11(b)(i), Bim Kemi was obliged not to *'do or permit to be done anything which may be or become an abuse of the rights of [Blackburn] to the Know-How or in the Trade Mark'*.

33. The provisions of the 1994 agreement (if binding) contained terms inter alia that Bim Kemi and Blackburn *'are committed to continued co-operation and working together to achieve mutual benefit'; that the licensing agreement 'will remain in full force with respect to "old" products sold'*; that the parties *'agree to co-operate in the field of chemicals for Pulp and Paper Industry'*; that *'each partner agrees to supply all reasonable and relevant commercial information required to maintain the business';* 'that [Bim Kemi] will only source antifoam from [Blackburn]'.

34. It is Blackburn's case that between 1995 and 1998, following its acquisition of Cellkem, Bim Kemi was supplying to the market Tensidef anti-foaming agents made by Cellkem instead of Blackburn's Dispelair products which, on the one hand, harmed rather than promoted the market for new products (in particular BS 470) agreed to be supplied under the 1994 agreement and, on the other hand, constituted a breach of the provisions governing the old products as quoted in paragraph 32 above.

35. On that basis, it was and is the submission of Blackburn that the close, and indeed inseparable, connection between the claim sought to be set-off and the dealings and transactions the subject of the claim i.e. the 1994 agreement (if it existed) and its alleged repudiation is established on the following basis:

    (a) there was a single trading relationship between the parties instituted by the 1984 agreement and supplemented by the arrangements for the supply of new products under the 1994 agreement;

(b) the basis of the 1994 agreement (if made) was that the parties were committed to continued co-operation and working together to achieve mutual benefit;

(c) the basis of the trading relationship was that, subject to certain conditions, Blackburn would make anti-foaming agents available exclusively to Bim Kemi in Scandinavia, supported by Bim Kemi's obligation under the 'best endeavours' clause in the 1984 agreement and its obligation under the 1994 agreement that Bim Kemi would only source (i.e. obtain for sale in Scandinavia) antifoams from Blackburn;

(d) contrary to (c), Bim Kemi began to supply Tensidef anti-foaming agents made by its subsidiary Cellkem at the expense of the development of the market for Blackburn's products;

(e) this was repudiatory conduct which both justified Blackburn's refusal to continue supply of new products and entitled them to damages under the 1984 agreement in respect of the harm caused to the market for the product;

(f) in those circumstances, it would be manifestly unjust to consider and give relief in respect of the claim without investigating and taking into account Blackburn's claims that Bim Kemi was in breach of the 1984 agreement.

36. Like the judge, I consider that Mr Turner's submissions for Blackburn are correct. In so holding, again like the judge, I regard it as appropriate to apply the test propounded by Lord Brandon in the *Bank of Boston* case unconstrained by the former concept, difficult to define and apply, of 'impeachment of title', which has since been replaced, or at least redefined, in terms of a cross-claim which 'flows out of and is inseparably connected with the dealings and transactions giving rise to the subject of the claim'. While the circumstances of every case call for individual consideration, it seems to me that the *Dole Fruit* case provides a useful parallel with the situation in this case. There, the court was satisfied that there was a sufficiently close connection in the case of a claim for the price of goods sold and delivered pursuant to a contract made under the *'umbrella'* of a distributorship agreement which had been repudiated.

37. In this case, the connection is less close, in the sense that the alleged 1994 agreement related to the sale to Bim Kemi of "new" products, which were not the subject of the 1984 agreement. Nonetheless, it seems to me that the two agreements are inseparably connected within the continuum of the parties' trading relationship for the sale of Blackburn's anti-foaming agents, within which both contemplated a continuing expansion and exploitation of the market for Dispelair products in Scandinavia, the 1994 agreement supplementing rather than replacing the 1984 agreement. Both continued in parallel over the period prior to termination, so that conduct such as that alleged by Blackburn in relation to Bim Kemi's promotion of Tensidef products at the expense of the Dispelair range was a breach of obligations contained in both agreements. In these circumstances, it seems to me that Lord Brandon's test of a 'close and inseparable connection' is satisfied.

Manifest Injustice

38. As treated in ***The Nanfri***, the question of whether or not it would be manifestly unjust to allow a claimant to enforce payment of his claim is the criterion by which to judge the closeness of the connection between the claim and cross-claim. Goff LJ (at p.981) was content to rest the matter on whether or not it would be 'unfair' for the claimant to be paid without allowing for the defendant's claim. Once Lord Brandon made clear in the ***Bank of Boston*** case that the question of closeness required inseparable connection with the dealings and transactions giving rise to claim, without reference to the issue of ***'manifest injustice'***, it is difficult to envisage in what circumstances, assuming his test to be satisfied, it would be other than just to allow an equitable set-off, save in certain established categories of case where the court has traditionally taken a strict view of the right of the claimant to be paid the liquidated sum which he claims free of any set-off. Examples are to be found in claims for rent, freight, and sums due under bills of exchange. Nonetheless, as it seems to me, it is appropriate in every case to give separate consideration to the question of manifest injustice; cf. the approach of Simon Brown LJ in ***Esso Petroleum –v- Milton*** at 950D.

39. That was effectively the approach of the judge below (see paragraph 15 above). He dealt first with the closeness of the connection and, having found it sufficient, posed the further question whether, nonetheless, there were present factors or circumstances which militated against the justice or fairness of recognising Blackburn's right of set-off. He concluded that there was none. He was right to do so, given that none of the additional matters advanced on Bim Kemi's behalf (see paragraph 15 above) went to the central issue of the nature and inter-relationship of the claim and cross-claim pleaded, as supplemented by the witness statements and other documents before the court.

CONCLUSION

40. The judge was right in the conclusion to which he came and this appeal should be dismissed.

LORD JUSTICE JONATHAN PARKER: I agree

LORD JUSTICE SEDLEY: I also agree

ORDER: Appeal dismissed; costs in favour of Respondents assessed at £9,000. (Order does not form part of approved Judgment)

Michael Lazarus Esquire (instructed by Messrs Jeffrey Green Russell, London, for the appellant)
Jonathan D.C. Turner Esquire (instructed by Messrs Taylors, Lancashire, for the respondent)