Insolvency – winding up – whether petition should be restrained – whether arguable defence to debt claimed by statutory demand – whether debtor can rely on set-off – agreement not to claim set-off – whether "manifest error" or creditor's estimate – whether ouster of jurisdiction of the court

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Judgment: approved by the Court for handing down | *Delivered:* **26/9/03**

(subject to editorial corrections)

IN THE HIGH COURT OF JUSTICE IN NORTHERN IRELAND

CHANCERY DIVISION (COMPANIES WINDING UP)

IN THE MATTER OF SHERIDAN MILLENNIUM LIMITED

IN THE MATTER OF THE INSOLVENCY (NI) ORDER 1989

BETWEEN:

SHERIDAN MILLENNIUM LIMITED

Applicant

and

ODYSSEY PROPERTY COMPANY

Defendant

GIRVAN J

[1] This is an application by Sheridan Millennium Limited ("the tenant company") for an injunction to restrain the defendant Odyssey Property Company ("the landlord") from presenting a winding-up petition following the service of a statutory demand dated 8 July 2003 served on the company on 21 July 2003. Upon the hearing of the application Mr John Maxwell appeared on behalf of the tenant company and Mr Horner QC and Ms Danes appeared on behalf of the landlord.

[2] The tenant company operates the Pavilion and the Sheridan Imax Cinema at Queen's Quay, Belfast. The tenant company holds its interest in these premises under a lease made on 1 February 2001 for a term of 150 years less 10 days commencing on 1 February 2001 ("the lease").

[3] In the statutory demand Odyssey claims that the company owes the sum of £90,913.57 by way of service charges due under the provisions of the lease. From May 2002 until the service of the current statutory demand the landlord has served 14 statutory demands for various debts claimed by the landlord including rent, insurance, electricity and service charges. Payment has been effected in relation to all these with the exception of the current statutory demand. Since the service of the current demand further statutory demands have been served in respect of rent, insurance, electricity, service charges and legal fees.

[4] In relation to service charges payable under the terms of the lease the scheme of the lease is as set out in the Fifth Schedule of the lease ("the Schedule"). The mechanism for assessment and payment of service charges is to the effect that the landlord makes an estimate of the service charges likely to be due in the coming year. The tenant is required to make a payment on foot of the estimates described in the Schedule as an "interim sum". Paragraph 2 of the Schedule provides that the landlord shall prepare an estimate of the service costs expected to be incurred and they are charged in respect of the immediately succeeding accounting period. It provides that an estimate "shall (save where a manifest error appears) be conclusive and binding upon the lessee". The service charge payable by the tenant is defined as a fair proportion of the service costs for each accounting period (1 May – 30 April of each year). Part 3 of the Schedule sets out the incidental costs taken into account in the calculation. These include at paragraph 3.1 the costs involved in the employment or engagement of staff, independent contractors, agents, consultants, professional advisors and other personnel as in the opinion of the landlord, are necessary in connection with the provision or carrying out of the services. Paragraph 17 of the part relates to the costs of the proper fees and expenses of the landlord's surveyor and any other person or firm employed by the landlord for the general management of the complex (or if any such person is an employee of the landlord a reasonable fee for the landlord). Paragraph 3 of the Schedule deals with the payment of the interim sum and it provides that the tenant company shall pay "the interim sum by four equal quarterly payments in advance and without deduction (whether by set-off or otherwise) whatsoever". Paragraph 4 provides that as soon as practicable after the expiry of the accounting period the landlord shall provide the tenant with a certificate showing the service costs for the relevant accounting period. It is provided that if the certificate shows that the interim sum paid on account exceeds the service charge for the relevant accounting period an amount equal to the excess shall be accumulated by the landlord and shall be applied in or towards the service charge for the succeeding accounting period. It is also provided that the certificate shall "(save where manifest error appears) be conclusive and binding on the tenant".

[5] It is common case that the sum certified as actually due for the period ending 30 April 2003 was £25,680.80 less than had been paid by way of

interim estimate for the same period. Accordingly the tenant company is entitled at some appropriate time to credit for that sum. An issue arises between the parties as to whether the landlord should give credit for that sum by way of reduction of the first quarterly estimate figure for the period 1 May 2003 to 30 March 2004. I shall return to this issue later in the judgment.

[6] The company refuses to pay the interim sum claimed for first quarter of the estimate on the basis that the total management costs being levied by the landlord are not reasonable and proper costs within the meaning of the Schedule and it is contended that they are too high having regard to a report furnished by Whelan Partnership ("the Whelan report") in January 2000 in which report Whelan Partnership set out the estimated level of service charges. It is contended that the level of management charges in proportion to the overall service charge is excessive. The tenant argues that it is incorrect and inappropriate under the terms of the lease to charge both a management fee for administration and collection of the service charge in addition to the actual cost and expenses of administration of the service charge. It is contended that the landlord is only entitled to pass on to the tenants the actual costs incurred in administering the service charge and not an additional percentage fee. The approach of charging both salaries and costs and a percentage management fee is an approach which has been adopted erroneously by the landlord from the outset even in the Whelan report and has been continued throughout each charging period by way of the estimates and the ultimately revised service charges. Mr Maxwell referred to the dispute resolution provisions set out in Clause 5.11.1 of the lease. Those provisions however involve agreement between the parties which does not appear to have been forthcoming. Insofar as the provisions of the lease provide that the estimate should be conclusive and binding on the tenant save where a manifest error appears it is argued that this appears to stifle disputes by the tenant company. Mr Maxwell argues that this amounts to an ouster of the jurisdiction of the court and is contrary to public policy. In any event he contends that "manifest error" is not confined to mere error of calculation on the face of the certificate or estimate but includes errors on the basis of charges and charging in a manner otherwise than permitted by the Schedule. The effect of the set-off clause must be construed by the courts in the light of the totality of the circumstances between the parties. Whilst the respondent may be entitled to judgment for the full amount of the estimate it does not mean that judgment should be unconditional. Counsel referred to Saga of Bond Street Limited v Avalon Promotions Limited [1972] 2 All ER 545 in the context of bills of exchange cases where the court made clear that while normally immediate judgment would be granted in relation to a dishonoured bill of exchange (which is treated as cash) it did not follow in all cases. Here, Mr Maxwell argued, it was an abuse of process for the landlord to proceed down the winding-up route. If it had issued proceedings the court on an Order 14 application could stay execution of any judgment granted pending determination of the company's counterclaim and could direct payment of the

money into court pending the outcome of the counterclaim. He contended that in any event the company should get immediate credit for the sum of £25,680.80 overpaid in the preceding period.

[7] Mr Horner QC on behalf of Odyssey contends that the estimate of service charges was correctly carried out. It is based on the previous accounting periods, the figures were audited and certified by Price Waterhouse and include only items defined as service charges. He argues that the Whelan report was prepared at an early stage before any claim for service charges and is irrelevant. The company paid the estimates in respect to previous years and other accounting periods as did the other tenants. There is no manifest error in the estimate and therefore it is conclusively binding. No deduction by way of set-off or otherwise is permitted. He contends that any payment on the estimates for an accounting period that exceeds the certified service charge for the accounting period is to be applied by the landlord towards "the service charge" in the succeeding period. That refers not to the estimate for the succeeding period but to the finally assessed figure. He concedes that in the past credit was given as claimed by the company on the first quarter estimate of the succeeding period but in view of the tenant company's obstructive attitude in relation to payment of debts the landlord is not bound by its previous course of conduct.

[8] There appears to be no dispute as to the correct approach to be adopted by the court in relation to the question whether an alleged creditor should be prevented from issuing a winding-up petition. The principles are discussed in Spanboard Products Limited v Elias [2003] NI Ch 3 and by McLaughlin J in City Hotel (Derry) Limited v Samuel Stevenson (21 January 2003). If the company can show that there is a genuine dispute on grounds showing a potentially viable defence requiring investigation then the matter should be tried out by action and the issuing of a winding-up petition would be inappropriate and an abuse of process.

[9] Under the terms of the lease the estimate is conclusive and binding save when a "manifest error" appears. Mr Horner sought to rely on the approach adopted in cases such as Dixons Group Plc v John Andrew Murray-Oboynkski 86 BLR 32. That was a case where there was a decision made by an independent expert challenged by one of the parties who could only succeed if there had been a manifest error by the expert. Judge Bowsher held that a manifest error was an error that may easily be seen by the eye or perceived by the mind. He said that:

> "The error must be 'manifest'; the terms of the agreement do not contemplate an error which after lengthy inquiry may be made manifest".

Judge Bowsher adopted the approach adopted by Potter J in Healds Foods Limited v Hide Davies Limited (1 December 1994 Unreported):

> "By the use of the word manifest it is plain that the parties do not thereby intend to widen the area of the court's investigation beyond the ambit of the determination itself and any reasoning within it or discernable on its face."

[10] It is clear that that case and the other authorities discussed in the commentary on the case in the Building Law Reports were dealing with determinations made by independent third parties brought in to resolve a dispute between contracting parties. It does not follow that such an approach would be the correct one where one party to the contract is empowered to fix a figure as is the case here. If the clause fell to be applied and construed in the manner indicated by Judge Bowsher and Potter J the result would be that the decision of one of the contracting parties on the construction and application of the lease contract would only be susceptible to review by the court in relation to a special and limited category of error namely an error which is plain and obvious on the face of the certificate. An error may be made clear after lengthy inquiry but Judge Bowsher's approach would mean that the tenant could not rely on such an error because it is not manifest on the face of the decision. While parties may contract to submit to a third party's decision on that basis I consider that it would be an ouster of the jurisdiction of the court in relation to a decision by one of the parties to the contract. The relevant clause in the present lease accordingly would fail as constituting an ouster of the jurisdiction of the court unless it is construed in such a way as to make it compatible with the parties' rights to litigate freely being upheld.

[11] I consider that the proper legal effect to be given to the clause is that the tenant must accept the estimate as giving rise to a due debt unless the tenant can demonstrate that the landlord has approached the exercise of arriving at the estimate on an incorrect basis under the terms of the lease or has miscalculated the estimate because of error that can be demonstrated by the tenant. The estimate will stand unless the tenant can show it is erroneous. At this stage in an application to restrain the presentation of the winding-up petition the tenant would not need to prove his case but would need to adduce sufficient material to show that he has a defence which might succeed at the trial.

[12] This burden is interlinked to an extent with the question of the effect of the prohibition of any deduction by way of set-off or otherwise. If the tenant company can demonstrate that it has an arguable defence on the grounds of miscalculation or erroneous application and interpretation of the lease he would also demonstrate that he has an arguable counterclaim and set-off in respect of the preceding periods. The tenant's current argument is that the

claim to recover past overpayments exceeds the current debt allegedly due by the landlord.

[13] Parties to a contract may by the contract agree that the right of set-off by one party should not apply by way of defence in relation to a claim by the other party. The authorities make clear that clear and unequivocal words are required to exclude a tenant's right to setoff (see Gilbert Ash (Northern) Limited v Modern Engineering (British) Limited [1974] AC 689 per Lord Diplock at 717 and 718). In Famous Army Stores v Meehan [1993] 1 EGLR 73 a tenant sought to plead equitable set-off in respect of damages allegedly suffered as the result of failure by the landlord to carry out work necessary to achieve eligibility for and thereafter obtain a fire certificate. The lease obliged the tenant to pay rent "without any deductions". Steyn J held that the words were wide enough to exclude any right of set-off under the lease. He granted the landlord an immediate summary judgment under Order 14. However in Connaught Restaurants Limited v Indoor Leisure Limited [1994] 4 All ER 834 the Court of Appeal overruled that decision holding that a provision that rent should be paid without any deduction was insufficiently clear to exclude the tenant's equitable right to set-off a claim for damages for breach of covenant. In Grant v NZNC Limited [1989] 1 NZLR 8 the New Zealand Court of Appeal reached a similar conclusion. In BOC Group Plc v Centean LLC [1999] 1 All ER Comm 970 the Court of Appeal appeared to consider that words such as "payment in full without deduction or withholding of any sort" would be wide enough to exclude a purchaser's right of set-off.

[14] In the present case however the wording of the relevant clause precludes any deduction whatsoever ("*whether by way of set-off or otherwise*"). This expressly precludes any set-off or deduction and since the parties have expressly and unequivocally so agreed the court must give effect to the terms of the agreement. The obligation to pay the estimate without set-off and deduction cannot preclude the tenant bringing proceedings to establish a cross-claim and to recover any overpayment that can be demonstrated to have occurred.

[15] Inasmuch as the tenant is immediately bound to pay the estimate without deduction or set-off and thus could immediately be made subject to a judgment for the claimed amount the question arises as to whether if the landlord had proceeded to judgment relying on Order 14 the court would and could effectively deprive the landlord of the value of an immediate judgment (to which he would be entitled) by staying execution of the judgment while the tenant pursued its cross claim or by directing payment into court of the money claimed pending determination of the cross-claim (which may not come up for trial for a considerable period) or by granting unconditional leave to defend on the basis that there is a bona fide counterclaim. For the court to do so would effectively frustrate the effect of the agreed provision that the tenant would pay the money without deduction or set-off. In the context of

dishonoured bills of exchange the normal practice of the courts is to treat them as cash and to be honoured so that setoff and counterclaim by the tenant will not entitle him to resist an immediate judgment by the plaintiff on the bill. The present case is an a fortiori case because the parties have agreed that there would be no set-off. In the present case for the tenant to succeed in persuading the court in an Order 14 application that an immediate enforceable judgment should not be granted he would have to rely on the argument that he has an arguable set-off against the estimate, the very thing that he has agreed not to do by the terms of the lease. Accordingly I consider that the tenant cannot presently resist the landlord's monetary claim (subject to the question of the effect of the overpayment on the previous estimate).

[16] In any event I do not consider that the tenant company adduced sufficient material to persuade the court at this stage that it has a valid cross claim against the lessor in respect of past years or a valid claim to reduce the current estimate. Under the terms of the Schedule it is clear by virtue of Clause 17 that the lessor is entitled to recover the cost of employing staff, contractors and other personnel necessary to provide the services and is entitled to charge the proper fees and expenses of the landlord's surveyor and any other person or firm employed by the landlord for the general management of the complex or if any such person is in employ of the landlord a reasonable fee for the landlord. The tenant contends that the management fee of 8.1% claimed by the lessor is not a reasonable fee within industry norms and that it is not appropriate within industry norms to charge such a fee. The tenant has however adduced no independent expert evidence to establish such a proposition and simply relies on the ipse dixit evidence of the Chief Executive of the tenant company. The company has not adduced prima facie evidence to establish that the lessor has acted unreasonably or improperly within the terms of the lease. Furthermore the tenant seeks to argue that because the breakdown of the figures is out of line with the Whelan report that per se establishes prima facie evidence that the landlord's previous claims are unreasonable and outwith a reasonable estimate. The *total* service charges in the periods following the Whelan report are lower than anticipated by the Whelan report and the lessor's claims for services against the tenant are at a lower level than what was originally estimated as likely to be due. On the material presently adduced the court could not be persuaded as a logical conclusion that the lessor has prima facie overcharged the tenant.

[17] In relation to the overpayment in respect of the preceding period there seems to me to be a sufficiently arguable case on the construction of the lease that the estimate for the first quarter should be reduced by the amount of the overpayment. It seems to be arguable that the obligation under Clause 4.5 of the Schedule to "apply" the overpayment towards the service charge means that the overpayment should be treated as a sum that goes to abate the next sum payable by the tenant. Accordingly if the tenant company pays the sum of £65,232.77 it would be an abuse of process for the landlord to proceed by

way of winding-up petition on the basis of the disputed debt of £26,680.80 representing the overpayment in respect of which there is an arguable case.

[18] I shall hear counsel on the proper form of order and costs.