Esso Petroleum Co Ltd v Milton

COURT OF APPEAL, CIVIL DIVISION
SIMON BROWN, THORPE LJJ AND SIR JOHN BALCOMBE
16, 17 JANUARY, 5 FEBRUARY 1997

Set-off – Cross-claim – Equitable right of set-off – Licence agreement in respect of garage – Provision for payment for fuel deliveries by direct debit – Defendant cancelling direct debit arrangement before paying for past fuel deliveries – Plaintiff commencing proceedings to recover amount owing and applying for summary judgment – Defendant alleging repudiatory breach of contract, counterclaiming for damages for future losses and seeking to set off those damages to extinguish admitted debt – Whether defence of equitable set-off available when direct debit cancelled after delivery of goods or services – Whether direct debit same as cheque – Whether counterclaim for future loss sufficiently connected with claim for payment for past deliveries to allow for an equitable set-off.

The plaintiff was the owner of a chain of garages and the defendant occupied and managed two such garages under licence agreements. Under the agreements the defendant agreed to pay for the motor fuels supplied by the plaintiff on or before delivery and to do so by banker's direct debit. Between 1 and 9 April 1996 the plaintiff made fuel deliveries totalling £167,885·81. That total was still outstanding when the defendant cancelled his direct debit mandate on 9 April. The plaintiff brought an action against the defendant to recover that amount and applied for summary judgment under RSC Ord 14. The defendant admitted the plaintiff's claim, but alleged that the increasingly stringent financial terms which the plaintiff had imposed, which had resulted in him not being able to continue to operate the two garages profitably, amounted to a repudiatory breach of contract, and he counterclaimed for damages for future losses which he sought to set off in extinction of his debt to the plaintiff. The judge dismissed the plaintiff's application and granted the defendant unconditional leave to defend on the ground that there was a properly arguable counterclaim. The plaintiff appealed, contending that equitable set-off was not available to the defendant.

Held – The appeal would be allowed for the following reasons—

(1) (Simon Brown LJ dissenting) Since modern commercial practice was to treat a direct debit in the same way as a payment by cheque and, as such, the equivalent of cash, the effect of cancelling a direct debit was the same as countermanding payment by cheque. Accordingly, since a mere right to set-off could never constitute a defence to a claim on a dishonoured cheque, it could not normally do so either to a claim following a cancelled direct debit (see p 606 *c* to *g* and p 607 *f g j* to p 608 *c*, post).

(2) In order for a defendant to be able to rely on equitable set-off, his counterclaim had to be closely connected with the same transaction as that giving rise to the plaintiff's claim, and the relationship between the respective claims had to be such that it would be manifestly unjust to allow one to be enforced without regard to the other. In the instant case, both claims arose out of a single agreement and the terms of the agreement governed each fuel delivery. However, the mere fact that both claim and counterclaim arose out of a single trading relationship between the parties was not sufficient to supply the close link

necessary to support an equitable set-off, and a close connection did not exist between each individual fuel delivery and the defendant's subsequent claim based on a repudiatory breach of the overall agreement. Nor, in the circumstances, would it be unjust to allow the plaintiff to recover payment for the fuel sales without taking into account the defendant's claim for future losses (see p 604 *a b j* to p 605 *a c d j* to p 606 *a*, p 607 *f g* and p 608 *c*, post); dictum of Lord Denning MR in *Federal Commerce and Navigation Ltd v Molena Alpha Inc, The Nanfri, The Benfri, The Lorfri* [1978] 3 All ER 1066 at 1078 applied.

Notes

For equitable set-off, see 42 *Halsbury's Laws* (4th edn) paras 424–431, and for cases on set-off in general, see 41 *Digest* (Reissue) 6–15, *4–133*.

Cases referred to in judgments

Axel Johnson Petroleum AB v MG Mineral Group AG, The Jo Lind [1992] 2 All ER 163, [1992] 1 WLR 270, CA.

Bankes v Jarvis [1903] 1 KB 549, [1900–3] All ER Rep 656, DC.

China National Foreign Trade Transportation Corp v Evlogia Shipping Co SA of Panama, The Mihalios Xilas [1979] 2 All ER 1044, [1979] 1 WLR 1018, HL.

Connaught Restaurants Ltd v Indoor Leisure Ltd [1994] 4 All ER 834, [1994] 1 WLR 501, CA.

Esso Petroleum Co Ltd v Craft [1996] CA Transcript 47.

Federal Commerce and Navigation Ltd v Molena Alpha Inc, The Nanfri, The Benfri, The Lorfri [1978] 3 All ER 1066, [1978] QB 927, [1978] 3 WLR 309, CA; *affd* [1979] 1 All ER 307, [1979] AC 757, [1978] 3 WLR 991, HL.

Gill (Stewart) Ltd v Horatio Myer & Co Ltd [1992] 2 All ER 257, [1992] QB 600, [1992] 2 WLR 721, CA.

Hanak v Green [1958] 2 All ER 141, [1958] 2 QB 9, [1958] 2 WLR 755, CA.

Motor Oil Hellas (Corinth) Refineries SA v Shipping Corp of India, The Kanchenjunga [1990] 1 Lloyd's Rep 391, HL.

Nova (Jersey) Knit Ltd v Kammgarn Spinnerei GmbH [1977] 2 All ER 463, [1977] 1 WLR 713, HL; *rvsg* [1976] 2 Lloyd's Rep 155, CA.

Scarf v Jardine (1882) 7 App Cas 345, [1881–5] All ER Rep 651, HL.

Shell UK Ltd v Lostock Garage Ltd [1977] 1 All ER 481, [1976] 1 WLR 1187, CA.

Cases also cited or referred to in skeleton arguments

Business Computers Ltd v Anglo-African Leasing Ltd [1977] 2 All ER 741, [1977] 1 WLR 578.

Coca-Cola Financial Corp Ltd v Finsat International Ltd [1996] 3 WLR 849, CA.

Financial Techniques (Planning Services) Ltd v Hughes [1981] IRLR 32, CA.

Montebianco Industrie Tessili SpA v Carlyle Mills (London) Ltd [1981] 1 Lloyd's Rep 509, CA.

Morgan & Son Ltd v S Martin Johnson Co Ltd [1948] 2 All ER 196, [1949] 1 KB 107, CA.

Smyth (Ross T) Co Ltd v T D Bailey & Son Co [1940] 3 All ER 60, HL.

State Trading Corp of India Ltd v M Golodetz Ltd (now Transcontinental Affiliates Ltd) [1989] 2 Lloyd's Rep 277, CA.

Stirling v Maitland (1864) 5 B & S 840, 122 ER 1043.

Vaswani v Italian Motors (Sales & Service) Ltd [1996] 1 WLR 270, PC.

Vitol SA v Norelf Ltd, The Santa Clara [1996] 3 All ER 193, [1996] 3 WLR 105, HL.

Woodar Investment Development Ltd v Wimpey Construction UK Ltd [1980] 1 All ER 571, [1980] 1 WLR 277, HL.

Appeal

By notice dated 6 September 1996 Esso Petroleum Co Ltd (Esso) appealed with leave from the decision of Judge Anthony Thompson QC, sitting as a judge of the High Court in the Queen's Bench Division at Exeter on 21 June 1996, whereby he dismissed Esso's application for summary judgment against the respondent, Howard James Milton, for an admitted debt of £167,885·81. The facts are set out in the judgment of Simon Brown LJ.

Mark Hapgood QC (instructed by *Irwin Mitchell*, Sheffield) for Esso.
Michael Soole (instructed by *Anstey Sargent & Probert*, Exeter) for the respondent.

Cur adv vult

5 February 1997. The following judgments were delivered.

SIMON BROWN LJ. This is the appellants' appeal by leave of this court from the order of Judge Anthony Thompson QC sitting as a judge of the High Court in the Queen's Bench Division at Exeter on 21 June 1996 dismissing their application for summary judgment against the respondent for £167,885·81.

The relevant facts can be comparatively shortly stated. The appellants, Esso Petroleum Co Ltd (Esso), need no introduction. The respondent, Howard Milton, was for many years the licensee of two of their service stations in Exeter, Alphington and Seabrook. Esso own over 1,800 such garages and have some 734 licensees.

The respondent occupied and managed these two garages under successive three-year licence agreements, the final ones being entered into respectively on 1 February 1994 for Alphington, and 1 October 1995 for Seabrook. There were additionally shop agreements in respect of each garage, under which the respondent was licensed to operate an Esso shop. Similar licence and shop agreements exist in relation to Esso's many other garages.

By cl 6 of, and schedule 5 to, each licence agreement, Esso agree to sell to the licensee and the licensee agrees to buy from Esso his entire requirements of motor fuels, lubricants and so forth. The licensee is forbidden to sell petrol at prices greater than those notified to him by Esso as the maximum recommended retail prices and must himself pay Esso those same prices 'less the Licence Margin'. The licence margin, therefore, represents the licensee's gross profit on the forecourt sale of fuel out of which he has to pay all the expenses of operating the garage and out of which must come too, of course, any profit. Schedule 5 provides that the licence margin 'will be the sum specified in the First Schedule hereto or such other sums as Esso may from time to time notify to the Licensee', and requires Esso to review that sum prior to 1 November every year; if in Esso's opinion following that review, a change is required to the licence margin, they must notify the licensee of such change which then takes effect on 1 December of that year. Esso also 'reserves the right, if necessary, to make adjustments to the Licence margin … at any other time upon notification to the Licensee'.

Competition in the oil industry has increased steadily over recent years through the appearance of supermarkets and hypermarkets selling petrol at prices tending to undercut those of traditional garages. As part of their response to these pressures, Esso, in November 1995, notified the respondent that with effect from 1 January 1996, the licence margin would be reduced and his shop rentals would be increased. On 12 December the respondent wrote objecting: he complained that the proposals were 'at best unworkable, and at worst

impossible'. Nevertheless, on 1 January 1996 the shop rental for the Alphington garage was increased from £25,200 to £39,396 and the licence margin for both garages was reduced from 1·19p per litre to 1·1p, and then later, with effect from 15 February 1996, from 1·1p to 0·75p. All these changes were part of what was called Esso's 'Price Watch' initiative, and licensees were provided with a document outlining the savings which Esso believed could be achieved under a scheme known as 'Best Practice'.

On 29 March 1996 the respondent was told by Esso of a further proposed rental increase to take effect on 1 May. Put shortly, his case is that he could not continue to operate these two garages profitably on the ever more stringent financial terms Esso were imposing, so that he regarded the business relationship between them as being over. He was, he said, staring bankruptcy in the face. How precisely the relationship ended was as follows. Between 1 and 9 April 1996, Esso made nine fuel deliveries to Alphington and three to Seabrook. It is the contractual price of those deliveries totalling £167,885·81 that forms the subject matter of Esso's claim in this action. Routinely such deliveries are paid for under direct debit arrangements. This, indeed, was expressly required by cl 2 of schedule 5 in these terms:

> 'The Licensee agrees to make payment to Esso for the motor fuels, lubricants, antifreeze and any other products supplied by Esso on or before delivery as Esso may from time to time require and any concession granted by Esso may be withdrawn at any time. Payment will be made by banker's direct debit or in such manner as Esso may from time to time require.'

Pursuant to that provision, the respondent had issued direct debit mandates to his bank, the last such being dated 20 October 1995 in these terms:

> 'I instruct you to pay direct debits from my account at the request of Esso Petroleum, Company, Limited The amounts are variable and are to be debited on various dates … I will inform the bank in writing if I wish to cancel this instruction. I understand that if any direct debit is paid which breaks the terms of this instruction, the bank will make a refund.'

The respondent cancelled that instruction on 9 April 1996. That was the Tuesday immediately following the Easter bank holiday, which must account for the larger than usual number of deliveries for which payment was outstanding: ordinarily, the licensee's bank account would be debited just two days after any given delivery.

In the result, Esso on 11 April gave the respondent notices purportedly terminating each of his licence agreements—I say purportedly because a dispute arises as to whether the agreements had or had not by then already been terminated in law by the respondent's cancellation of the direct debit mandate and his failure to pay for the April deliveries.

On 16 April Esso issued their writ in this action, and in response to a defence and counterclaim, applied for summary judgment under RSC Ord 14. On 21 June the respondent was granted unconditional leave to defend and the following month amended his defence and counterclaim. Esso now appeal.

Esso's claim is admitted. It could hardly be otherwise. The respondent counterclaims, however, damages for repudiatory breach of contract and those damages he seeks to set off in extinction of his admitted debt to Esso. Esso dispute his right to do so.

Mr Mark Hapgood QC, for Esso, advances four substantially independent arguments why the respondent should be denied leave to defend. Three are directed to the fundamental proposition that equitable set-off is simply not available to the defendant here; the fourth is that the counterclaim, in any event, fails to disclose a properly arguable case; it is not, submits Mr Hapgood, a credible counterclaim for a sum comparable to the admitted debt.

THE COUNTERCLAIM

It is, I think, helpful before turning to the important questions which arise regarding the availability of equitable set-off to indicate something at least of the essential nature of the counterclaim and, indeed, to reach a basic view on its cogency. What the counterclaim comes to is this. There was, submits Mr Michael Soole, for the respondent, a term to be implied into these various agreements that the shop rents and licence margins should not be adjusted to such a level as would prejudice the licensee's ability to operate and manage his garages at a reasonable, or indeed any, profit. Esso breached that term. The respondent was, in effect, driven out of business. That was a repudiatory breach which the respondent by cancellation of his direct debit mandate accepted. True, by taking that step the respondent was not apparently intending to put an end to the contract. On the contrary, as he himself has deposed:

> 'I … required the tanks at both sites to be full as I believed that if I stopped my Direct Debit Mandate I would need time to negotiate with Esso and had no wish to antagonise them further by closing either site or having fuels delivered from another source. We worked as normal over the Bank Holiday Weekend. I was disappointed that we were not as busy as I had expected. After a great deal of soulsearching and talking to Sandra my wife I decided to go for broke and make one last desperate attempt to force Esso to acknowledge that there was a problem with what they were attempting and to try and get them to recognise the dispute between us and to enter into dialogue.'

That intention, however, Mr Soole submits is immaterial. Whatever subjectively the respondent hoped and intended, cancellation of his mandate represented an unequivocal overt act inconsistent with the continuing subsistence of the contract. In law, therefore, it operated as an election to treat the contract as at an end. In support of this argument Mr Soole relies on three House of Lords authorities (see *Scarf v Jardine* (1882) 7 App Cas 345, [1881–5] All ER Rep 651, *China National Foreign Trade Transportation Corp v Evlogia Shipping Co SA of Panama, The Mihalios Xilas* [1979] 2 All ER 1044, [1979] 1 WLR 1018 and *Motor Oil Hellas (Corinth) Refineries SA v Shipping Corp of India, The Kanchenjunga* [1990] 1 Lloyd's Rep 391). Accordingly, the notices which Esso served on 11 April 1996 were of no effect: the agreements had already been determined. Those notices, I should perhaps record, were given under the terms of schedule 8 to the licence agreements which entitled Esso to terminate the licence forthwith, inter alia, if the licensee 'fails to honour on two or more occasions during the period of this licence any cheques or direct debits presented for payment by Esso'.

In the result, submits the respondent, he is entitled to claim damages to recover the losses which he has suffered by the premature determination of his garage business. As to these, he claims: (i) some £62,000 for loss of profit (based on his net 1995 figures) during the remaining period of the licence agreements ($9\frac{1}{2}$ months at Alphington, $29\frac{1}{2}$ months at Seabrook); (ii) £68,000-odd for the loss

of compensation to which he would have become contractually entitled had Esso declined to renew the licence agreements so as to operate the garages themselves (there being a suggestion at one time that Esso were proposing to replace licensees with agents, although in fact they have appointed new licensees to operate both the respondent's garages); (iii) £49,000 as the loss sustained through the respondent being denied the opportunity that he would have had to maximise his profits over the period of notice by cost savings such as, by reducing staffing levels and by increasing profit margins on retail goods—Esso having agreed to give three months' notice of any decision not to renew a licence and given that such a notice for Alphington could effectively have operated as a 23-month notice for Seabrook; and (iv) some £7,500 representing the respondent's loss through being unable to run two motor vehicles as a business expense.

These four claims together total some £186,500, an amount which exceeds the debt due to Esso, albeit of course the alleged losses occurred later.

Mr Hapgood points to a number of hurdles in the path of such a claim, hurdles which cumulatively, he submits, deprive it of any real plausibility. There are, he argues, difficulties in implying a term which he submits is contrary to Esso's express right to vary the licence margin and rental charges, difficulties in treating Esso's conduct in reducing the respondent's profits as evincing any intention on their part no longer to be bound by the agreements, difficulties in arguing in the face of the respondent's own affidavit evidence that the revocation of the bank mandate constituted an acceptance of Esso's alleged repudiation (a contention which only surfaced after the original defence and counterclaim), and a host of difficulties with regard to the damages' claims, in particular, heads (ii) and (iii).

For my part, I accept that certain aspects of the respondent's counterclaim are indeed highly problematic and I would expect him to have a very uphill struggle, not least in establishing his entitlement to the bulk of his alleged losses. Difficulties obviously exist on liability too—less perhaps with the implication of a term that he would not be effectively squeezed out of business (indeed, as I suggested in argument, Esso might themselves be thought in difficulty in establishing that the two 1996 adjustments to the licence margin were 'necessary' within the meaning of the schedule) than in establishing on the facts that such was the effect of these adjustments, and also in making good the argument that, his contrary intentions notwithstanding, the cancellation of the bank mandate operated as an acceptance of Esso's repudiatory breach. All that said, I, for my part, am not prepared to differ from the judge below in concluding that the respondent does here raise a properly arguable counterclaim.

Is equitable set-off available here?

I turn, therefore, to Esso's arguments as to why such a counterclaim, being for an unliquidated sum and, accordingly, available only by way of equitable set-off, is not in the present circumstances available to the respondent. These arguments are, first, that the respondent is in the same position as had he countermanded payment by cheque; a claim following a cancelled direct debit mandate is, Esso submit, equivalent to a claim on a dishonoured cheque to which elementarily a mere right of equitable set-off can never constitute a defence (the direct debit argument). Second, that the respondent's counterclaim for damages for loss of future profits is not sufficiently connected with Esso's claim in respect of past deliveries of fuel to allow an equitable set-off (the insufficient connection argument). Third, that the licence agreement expressly excluded the

respondent's rights of equitable set-off. The term on which Mr Hapgood relies is cl 34 of schedule 7, which, so far as material, provides:

> 'The Licensee agrees that he will not for any reasons withhold payment of any amount properly due to Esso under this Licence Agreement whatsoever … Esso may set off against any payment due to the Licensee hereunder any unpaid debts of the Licensee to Esso.'

This I shall call 'the express exclusion argument'.

Any one of these three arguments would, if sound, suffice to defeat the respondent's entitlement to leave to defend. Before turning to address them, it is important to make plain the court's proper approach to such issues on an interlocutory appeal of this nature. At first blush it might appear (and perhaps to the judge below, did appear) sufficient for the respondent's purposes to raise an arguable case in response. On reflection, however, and guided in particular by certain observations of Lord Donaldson MR in *Stewart Gill Ltd v Horatio Myer & Co Ltd* [1992] 2 All ER 257, [1992] QB 600, it is surely plain that we have no option but to reach a clear and final conclusion on each of the three points, no option that is apart from ordering a future preliminary hearing were it necessary for further evidence to be adduced on some particular issue.

Gill v Myer was a case on the third point concerning the fairness of an express contractual provision excluding the right of set-off. The defendants there accepted that if the clause could survive the impact of the Unfair Contract Terms Act 1977, the plaintiffs were entitled to summary judgment. Lord Donaldson MR said ([1992] 2 All ER 257 at 259, [1992] QB 600 at 604):

> '… such a clause, if it is to be effective at all, can only take effect either upon an application for summary judgment under Ord 14 or on the subsequent hearing of a preliminary point as to its reasonableness. To give unconditional leave to defend without ordering the hearing of a preliminary point is in effect to render the clause nugatory, since by the end of a final hearing it would not matter whether there was a set-off or separate judgments on claim and counterclaim. He [the judge below] should therefore have reached a decision on its reasonableness in the light of such evidence as he had.'

In my judgment, the same reasoning must apply equally to the direct debit argument and the sufficient connection argument. Mr Soole ingeniously suggests that even were the whole case to go to a final hearing, these points could still remain relevant to questions of interest and conceivably even costs. That, however, seems to me wholly unreal, not least given the disproportionate expense and difficulty of resolving them for so limited a purpose at that stage. Since none of the three arguments are suggested to require further evidence for their resolution—indeed, the direct debit argument is advanced as a pure point of law of wide application and general importance—we must, accordingly, decide all three points.

(1) The direct debit argument

The direct debit system is increasingly commonly used and its essential nature is well known. Those unfamiliar with the system will find it conveniently described in *Chitty on Contract* (27th edn, 1994) vol 2, paras 33-302 ff.

Esso submit that the closest analogy with the system would be for the intending purchaser to provide a number of signed blank cheques to be presented by the supplier on delivery of the goods or services contracted for. In neither

case, they point out, can the creditor prevent the debtor from countermanding his instruction to the bank and in neither does the bank itself assume a direct payment obligation to the creditor. Thus, the creditor in both cases is exposed to the risk of non-payment through the debtor countermanding his instructions. The central question presently arising is whether under the direct debit scheme the debtor should be entitled to escape the specially restrictive rules as to the stay of judgments and the scope of defences which apply with regard to dishonoured cheques. In submitting not, Mr Hapgood relies upon the well-known authority of *Nova (Jersey) Knit Ltd v Kammgarn Spinnerei GmbH* [1977] 2 All ER 463, [1977] 1 WLR 713, where the House of Lords by a four to one majority overturned the Court of Appeal's decision, which had allowed a plaintiff's action on a dishonoured bill of exchange to be stayed pending the resolution of the defendant's counterclaim for unliquidated damages (see [1976] 2 Lloyd's Rep 155). Lord Wilberforce said ([1977] 2 All ER 463 at 470, [1977] 1 WLR 713 at 721):

> 'When one person buys goods from another, it is often, one would think generally, important for the seller to be sure of his price: he may (as indeed the appellants here have) bought the goods from someone else whom he has to pay. He may demand payment in cash; but if the buyer cannot provide this at once, he may agree to take bills of exchange payable at future dates. These are taken as equivalent to deferred instalments of cash. Unless they are to be treated as unconditionally payable instruments (as the Bills of Exchange Act 1882, s 3, says, "an unconditional order in writing"), which the seller can negotiate for cash, the seller might just as well give credit. And it is for this reason that English law (and German law appears to be no different) does not allow cross-claims, or defences, except such limited defences as those based on fraud, invalidity, or failure of consideration, to be made. I fear that the Court of Appeal's decision, if it had been allowed to stand, would have made a very substantial inroad on the commercial principle on which bills of exchange have always rested.'

Mr Hapgood points out that almost no cheques today are in fact negotiable instruments: virtually all are crossed account payee only. The creditor's expectations, he submits, are the same irrespective of whether the debtor is to pay by cheque or, as commercially now is found generally more convenient, by direct debit. The differences between the two means of payment are, he submits, for present purposes, technical and immaterial. Mr Hapgood also refers to a judgment of my own in *Esso Petroleum Co Ltd v Craft* [1996] CA Transcript 47 in which, refusing the defendant's ex parte application in this court for leave to appeal against summary judgment in circumstances not dissimilar to the present (save only that the counterclaim there was for damages for alleged short deliveries in the past rather than future loss of profits), I said:

> 'Payment for that [the particular delivery giving rise to the claim for £16,000-odd] was due under a direct debit arrangement, a liability equivalent to that arising upon a dishonoured cheque which, in turn, is to be treated as akin to cash.'

As the first instance judgment in that case records, however, it was 'common ground that the status of a direct debit … is similar to a cheque or other bill of exchange'. Whether that was rightly conceded is, of course, the very point at issue on this appeal.

Mr Soole submits that the position here is quite unlike that arising when a cheque is countermanded. In the first place, Esso's claim here is one for the price of goods sold and delivered, not on a dishonoured cheque. And that is no mere technicality: the respondent in this case gave no specific instruction to his bank to pay for these particular deliveries. It is one thing, Mr Soole submits, to cancel a general direct debit mandate; quite another to countermand payment of a signed cheque. Esso's argument, he submits, overlooks the central distinction between the (debtor's) bank mandate and the (creditor's) request for payment submitted pursuant to it. The mandate does not constitute a cheque, not least because it is not an instruction to pay 'a sum certain in money' as required by the Bills of Exchange Act 1882. And the request, so far from being a signed instrument equivalent to cash provided by the debtor, is drawn rather by the creditor.

In short, submits Mr Soole, the respondent is really in no different position than had he agreed to pay for deliveries by cash or cheque and then declined to do so. What he did was to dishonour a promise, not a cheque. His termination of the mandate gives Esso no rights independently of the licence agreement.

Before expressing my own conclusions on this important point it is, I think, worth setting out verbatim the final written formulation of Esso's argument:

> 'ESSO'S PROPOSITIONS OF LAW Payment by direct debit is equivalent to payment by cash. Accordingly:
>
> (1) In an action for the recovery of a debt, (a) the defence of set-off is not available to a defendant who has wrongfully countermanded a direct debit instruction to his bank and (b) execution of judgment will not be stayed pending the trial of a counterclaim.
>
> (2) Countermand is wrongful if the defendant has expressly or impliedly promised to pay the debt by direct debit.
>
> (3) The plaintiff must plead and prove (a) the consideration for the debt, (b) the defendant's agreement to pay the debt by direct debit and (c) the dishonour of the direct debit.
>
> (4) As in an action by the payee of a dishonoured cheque against the drawer, it is a good defence for the defendant to prove fraud inducing the issue of the direct debit or its invalidity (for example, on the ground that it was issued without the defendant's authority).'

By way of oral elaboration of those propositions, Mr Hapgood doubted whether the word 'wrongfully' was strictly required in para (1) (in which event para (2) would be unnecessary); explained that the reference in para (2) to an implied promise was included to enable a future decision to be reached on whether the opening of a direct debit mandate itself gives rise to a promise to pay by that system (such decision being unnecessary in the present case); accepted a variation suggested by Sir John Balcombe that there be added to para (2) the words 'and the plaintiff had not received notice of countermand of the direct debit at the time when consideration moved from him'; and explained that para (3)(a) reflected his recognition of the fact that, unlike the position with cheques, in direct debit cases there is no presumption of consideration in favour of the plaintiff.

Powerfully argued although Esso's case was on this issue, and commercially convenient although no doubt it would be in many, perhaps most, instances to place direct debit arrangements on the same footing as cheques, I find myself ultimately unpersuaded by the argument.

By no means all direct debit cases are akin to actions on a cheque—that, indeed, is reflected in the very complexity of Esso's final formulation of their argument. Of course there will be occasions when a direct debit arrangement is stipulated and accepted by the supplier, just like a cheque, as an alternative to a demand for cash payment. But that will not invariably be so, and I have no doubt that many direct debit arrangements are nowadays entered into for the settlement of transactions effected on credit rather than in substitution for cash transactions. I may have a charge account at a store which routinely allows its customers 28 days' credit. Were I, for convenience, to enter into an agreement to pay my account by periodic direct debit payments, that surely ought not to deny me my basic credit entitlement, nor limit the scope of such defences as would otherwise be available to me were some purchase to prove unsatisfactory. Similarly with service providers.

There are, of course, certain obvious similarities between cheques and direct debit arrangements just as there are obvious differences too. I find the similarities insufficient to justify deciding as a matter of policy and principle that for Ord 14 purposes the two are equivalent. Nor indeed does such an extension of the special rule for enforcing claims on dishonoured cheques seem to me commercially necessary—to avoid, as Mr Hapgood sought to submit, the supplier having to insist on payment by cash or cheque before delivery. Instead, a supplier intent on achieving by direct debit a position equivalent to that of the holder of a cheque can do so—as, indeed, by their third argument Esso assert they have—by expressly excluding equitable rights of set-off.

(2) The express exclusion argument

With this consideration in mind it is convenient to turn next to the express exclusion argument. I can deal with it really quite briefly. Esso accept that to be effective such a term must be plainly expressed: clear words are required to rebut the presumption that a party does not intend to abandon rights of set-off (see *Connaught Restaurants Ltd v Indoor Leisure Ltd* [1994] 4 All ER 834, [1994] 1 WLR 501). Here, Mr Hapgood contends, such clear words are to be found in the opening sentence of cl 34—the licensee's agreement not 'for any reasons [to] withhold payment of any amount properly due to Esso'. For good measure, he submits, the point is highlighted by the other sentence quoted from cl 34, contrasting as it does the licensee's obligation to pay without deduction with Esso's right to set-off any unpaid debts of the licensee.

Mr Soole advances two arguments in response. First, that the provision is insufficiently clear to achieve Esso's desired object. The use of the phrase 'properly due to Esso', he submits, begs the very question to be answered, and the express grant to Esso of a contractual right to set-off, so far from entailing an exclusion of the licensee's equitable right, if anything reinforces the view that this has not been expressly dealt with. Secondly, Mr Soole submits, as did the defendant in *Stewart Gill Ltd v Horatio Myer & Co Ltd* [1992] 2 All ER 257, [1992] QB 600, that the exclusion clause cannot be relied on because it is unreasonably wide. The clause in that case was, it may be noted, this:

> 'The Customer shall not be entitled to withhold payment of any amount due to the Company under the Contract by reason of any payment credit set off counterclaim allegation of incorrect or defective Goods or for any other reason whatsoever which the Customer may allege excuses him from performing his obligations hereunder.'

That was held unenforceable:

> '… the defendants succeed because, whatever the reasonableness of a clause which excludes or restricts a right of set-off, nothing could prima facie be more unreasonable than that the defendants should not be entitled to withhold payment to the plaintiffs of any amount due to the plaintiffs under the contract by reason of a "credit" owing by the plaintiffs to the defendants and, a fortiori, a "payment" made by the defendants to the plaintiffs. In this context "payment" must I think mean overpayment under another contract and credit mean "credit note" or admitted liability again under another contract, because otherwise it would be doubtful whether it could be said by the plaintiffs that any amount was due to them under the contract.' (See [1992] 2 All ER 257 at 261, [1992] QB 600 at 606 per Lord Donaldson MR.)

If, as Esso submit, the reference to 'any amount properly due to Esso' in cl 34 means the cost of all fuels delivered irrespective of whatever credits may be due and owing from them to the licensee—and there was, I should observe, provision in these agreements for the licensee to be given certain credits—then, in my judgment, cl 34 would be unenforceably wide even if one accepted, which on balance I do not, that it was sufficiently clear. In short, I reject Esso's express exclusion argument for each of the two reasons advanced by the respondent.

(3) The insufficient connection argument

I come finally, therefore, to the insufficient connection argument, Esso's contention that the counterclaim here does not truly impugn their entitlement to immediate payment for fuel deliveries so that no equitable set-off can in justice arise.

The modern law on equitable set-off starts with *Hanak v Green* [1958] 2 All ER 141, [1958] 2 QB 9, the case which decided that an unliquidated counterclaim can in certain circumstances be set-off against a liquidated debt—cases within group three of Morris LJ's analysis 'in which a court of equity would have regarded the cross-claims as entitling the defendant to be protected in one way or another against the plaintiff's claim'. Morris LJ referred to *Bankes v Jarvis* [1903] 1 KB 549, [1900–3] All ER Rep 656 and spoke of the 'close relationship [which existed there] between the dealings and transactions which gave rise to the respective claims', and Sellers LJ, referring to the three cross-claims in *Hanak v Green* itself, said of one that 'it arises directly under the contract on which the plaintiff herself relies', and described the other two as 'closely associated with and incidental to the contract … on which the plaintiff sues for breach' (see [1958] 2 All ER 141 at 150, 155, [1958] 2 QB 9 at 24, 31). *Hanak v Green* did not, however, seek to deal specifically with the requisite closeness. For that, one goes to *Federal Commerce and Navigation Ltd v Molena Alpha Inc, The Nanfri, The Benfri, The Lorfri* [1978] 3 All ER 1066 esp at 1078, [1978] QB 927 esp at 974–975, per Lord Denning MR:

> '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 is 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 demands that it would be manifestly unjust

> to allow him to enforce payment without taking into account the cross-claim.'

For equitable set-off to apply it must, therefore, be established: first, that the counterclaim is at least closely connected with the same transaction as that giving rise to the claim; and second, that the relationship between the respective claims is such that it would be manifestly unjust to allow one to be enforced without regard to the other.

It is, I think, helpful at this stage to notice one other, more recent, decision in this field, *Axel Johnson Petroleum AB v MG Mineral Group AG, The Jo Lind* [1992] 2 All ER 163, [1992] 1 WLR 270. The Court of Appeal pointed there to certain illogicalities in the law on set-off resulting from its historical development and noted certain special rules which had evolved (eg with regard to cheques). In conclusion, Staughton LJ said ([1992] 2 All ER 163 at 169, [1992] 1 WLR 270 at 276):

> 'It can be said that there is a case for reform of the law, which has to be discovered in a number of diverse rules based on no coherent line of reasoning. But in practice masters and judges, for whom the problem is of almost daily occurrence, manage to solve it without any great difficulty. Since the landmark case of *Hanak v Green* [1958] 2 All ER 141, [1958] 2 QB 9 a broad interpretation of the doctrine of equitable estoppel, or the grant of a stay of execution pending the trial of a counterclaim, has generally been sufficient to safeguard the defendant's cashflow when justice required that result, and not if the defendant did not deserve indulgence. It is rare indeed in my experience that legal set-off is mentioned, and even rarer for there to be such an elaborate and skilful argument as we have had in this case. So perhaps we can continue to tolerate the law as it stands.'

One finds there too, although the court was not apparently referred to the *Molena Alpha* case, the emphasis placed on the requirements of justice in determining when the doctrine of equitable estoppel may be invoked or a stay properly granted. (I should perhaps note in passing that the case does not, in my judgment, support the proposition for which it is cited in *The Supreme Court Practice 1997* vol 1, para 14/3–4/13, namely: 'If the scope of set-off is arguable as a matter of law unconditional leave to defend should be granted'—unless by 'the scope of set-off' is meant the counterclaim.)

What then is the connection between the counterclaim here and the transaction giving rise to Esso's claim, and would it be unjust to allow the latter to be enforced without taking account of the former? As to the first limb of that question, Mr Soole submits that the connection is a close one in that both claims arise out of a single agreement, that under which Esso agree to sell and the respondent to buy all the fuel he needs; the licensee's request for fuel, he submits, triggers the operation of the agreement which sets out the terms on which the fuel is sold. As to the justice of the case, Mr Soole invokes broad principles of equity and submits that, assuming this counterclaim were soundly based, it is Esso who have acted unfairly and imposed hardship on their licensee, and *Shell UK Ltd v Lostock Garage Ltd* [1977] 1 All ER 481, [1976] 1 WLR 1187 is relied on by analogy.

It is on this critical aspect of the case that, in my judgment, Mr Soole's arguments, admirably presented though they were, fail. True it is, as he submits, that the terms of the licence agreement govern each fuel delivery. But that is not to say that there exists a close connection between each individual delivery and a

subsequent claim based on a repudiatory breach of the overall agreement, still less that it would be unjust to allow Esso to recover payment for fuel sales without their taking into account the respondent's claim for future losses. In *Esso Petroleum Co Ltd v Craft* [1996] CA Transcript 47, addressing the position which would have arisen had the counterclaim there been for a liquidated sum, I said:

> 'The reality here is that the defendant has sought to recover alleged (but disputed) past losses by reneging upon an undoubted liability for a subsequent unconnected supply.'

The facts of the present case are stronger still from Esso's point of view: the alleged (but disputed) losses here were future not past when the respondent reneged on his liability for the April deliveries. At the point when those deliveries were made, there was no cross-claim at all in existence and no loss yet suffered by the respondent. No case has been cited to us in which payment of a debt presently due has been required to await the resolution of a cross-claim for future losses. The mere fact that both claim and counterclaim arise out of a single trading relationship between the parties is, in my judgment, wholly insufficient to supply the close link necessary to support an equitable set-off. The respondent disavows any calculated plan to create at Esso's expense a war chest out of which to fund his counterclaim. Let that be assumed—although I confess to some scepticism on the point, not least bearing in mind his own evidence as to the final deliveries. To my mind, that still cannot make it just to allow him to achieve precisely that result by what was clearly at the time an unlawful withholding of payment.

Although, as I repeat, the mere facts that the respondent agreed to pay for these deliveries 'on or before delivery' and 'by banker's direct debit', and that he did not notify Esso of his intention to cancel the mandate before the deliveries were made, do not, in my judgment, place this case on the same footing as a claim on a cheque, and although the additional agreement 'not for any reasons [to] withhold payment of any amount properly due to Esso' does not of itself exclude any right of equitable set-off, all these provisions and considerations seem to me properly in play when deciding the overall justice of the case. Of great importance too is the fact that these deliveries of fuel were, by forecourt sales, to be converted almost immediately into cash. This commodity being so readily realisable, even less reason exists for the buyer being entitled to postpone the discharge of his debt until there has been litigated to conclusion his necessarily somewhat speculative claim for subsequent losses.

I well recognise that my reasons for accepting Esso's insufficient connection argument include much of the thinking underlying their direct debit argument. That becomes particularly evident when one analyses the latter's final formulation and notes the qualifications eventually built into it. The two arguments, however, are by no means mirror images of each other, in particular because of the additional range of considerations to which regard can, indeed must, be had, when deciding the insufficient connection argument. Not least amongst these is, as stated, the essentially liquid nature of the commodity here supplied, a consideration obviously irrelevant to the direct debit argument. Tempting though I recognise it is to allow this appeal on that crisper, narrower ground, I am convinced it would be a mistake to do so. To treat cheques as cash is historically justifiable and achieves a broad measure of certainty and justice: to extend that principle to direct debit arrangements would not. For my part, therefore, I would allow this appeal only on the ground of insufficient connection.

THORPE LJ. I have had the advantage of reading in draft the judgment of Simon Brown LJ. I agree with its conclusion and gratefully adopt its very clear presentation of the issues. That enables me to go straight to the points on which I am more strongly for the appellants than he.

First, the counterclaim: whilst, of course, I accept that the defendant is entitled to argue that Esso's reduction of the margin and increase in the shop rent were in breach of express or implied terms of the licence agreement, the contention that the cancellation of the direct debit mandate operated as an acceptance of a repudiatory breach seems to me so unrealistic as to forfeit the label of properly arguable. Furthermore, the quantum of the pleaded counterclaim, seems to me, to reflect the pleader's ingenuity and determination to arrive at a sum total exceeding the claim. I cannot accept that, even if the defendant succeeded on liability, he has any realistic chance of establishing resultant damage approaching the magnitude pleaded.

Second, on the direct debit argument, I would hold for the appellant. Whilst I am conscious of difficulties and dangers involved in such an extension, I believe that it is consistent with the principle stated by Lord Wilberforce in *Nova (Jersey) Knit Ltd v Kammgarn Spinnerei GmbH* [1977] 2 All ER 463 at 470, [1977] 1 WLR 713 at 721). Where goods are effectively sold for cash, the seller should have the security that cash brings when for mutual convenience, the parties have adopted the banking mechanism in general usage for the transfer of cash from one account to another. Twenty years ago that was still by cheque. Theoretically the tanker driver could demand a signed cheque on arrival for an amount to be written in when ascertained by completion of the fuel delivery. But that is only theory. The defendant's annual petrol purchases under the licence agreements amounted to about £5m, and, as the evidence established, Esso's daily collection through the direct debit system for all petrol sales varies between £9m and £20m. The modern mechanism for handling what are effectively cash sales on that scale is the direct debit system. So, it seems to me, that it is a natural evolution rather than an extension of the *Nova Knit* principle to hold that the seller of goods for cash transferred by the direct debit mechanism should be in no worse position than if he had accepted a cheque on delivery. Mr Hapgood QC's formulation emerged in reply and was then modified in argument. No doubt it requires further consideration and perhaps further modification, but I would accept the fundamental principle for which he contends.

Third, I am perhaps more strongly for the appellants on the justice of the case. As Simon Brown LJ has demonstrated, claims to equitable set-off ultimately depend on the judge's assessment of the result that justice requires. Here, Esso were conducting a marketing campaign against supermarket competitors. Their strategy was to ensure that the price of petrol at any Esso filling station matched or undercut all competitors in the immediate vicinity. Margins were reduced and sales were increased. In consequence, each delivery of fuel was converted into cash very quickly. Thus, the defendant required 13 deliveries over the Easter holiday. He provided Esso with the service necessary to convert petrol into cash, the margin which he earned being 0·75 p per litre. Esso entered the direct debit on the day of delivery but the pace of the banking system delayed the posting of the credit to its account for a period of about two days. Thus, in practice, the defendant was not required to finance the purchase. The onward sales were more or less completed by the time payment was collected. When the defendant cancelled the direct debit mandate on the day after Easter Monday he must have known that the effect would be to stop payment for the deliveries made in Holy

Week. In his affidavit of 21 May 1996 he said that he had done so as a tactic to strengthen his dispute with Esso as to the future performance of the contract. But once Esso made plain on 11 April that there was to be no future performance, how could the defendant think that he was entitled to retain the cash into which the fuel had been converted? Of course the termination of the contract would require careful implementation with the taking of detailed accounts. No doubt he felt that he had an entitlement to compensation, but there could have been no anxiety that whatever sum was ultimately agreed or judged due to him would not be recoverable. The termination of 11 April was followed by vacation of the premises on 26 April. At the date of his affidavit of 30 April 1996 he had about £150,000 either in bank accounts or in other liquid form. By the date of this appeal, the value of the bank and other liquid assets had sunk to £38,000. Since the cessation of the business, he has spent the intervening months in home improvements which have effectively been financed with Esso's money. In labour and materials, he says that he has spent about £50,00 and increased the value of his property commensurately. He has perhaps justified that investment by reference to his counterclaim. But what he has effectively done is to anticipate almost complete success at the trial of the action and to spend the money that would become due on such an outcome in advance. Whatever his faith in the future that seems, at best, rash.

On that perspective of the facts, the defendant is not David picking up a pebble in preparation for his confrontation with Goliath, but a trader who has wrongfully taken advantage of his capacity to countermand a bank instruction in the brief interval between the delivery of the goods and the call for payment. Although Mr Soole throughout argued his client's case with great persuasion, advocacy cannot disguise the reality that justice is not required to safeguard the defendant's cash flow pending trial, to borrow the words of Staughton LJ in *Axel Johnson Petroleum AB v MG Mineral Group AG, The Jo Lind* [1992] 2 All ER 163 at 169, [1992] 1 WLR 270 at 276.

SIR JOHN BALCOMBE. I have had the advantage of reading in draft the judgments of both Simon Brown and Thorpe LJJ. I agree with them that this appeal should be allowed.

There were four substantial issues before us: (i) has the respondent a properly arguable counterclaim for a sum approximating to the undisputed amount of the debt claimed; (ii) should a defence of set-off be available where a direct debit given in payment for goods or services has been dishonoured after the goods or services have been received; (iii) was the counterclaim sufficiently connected with Esso's claim to allow a defence of equitable set-off and (iv) was a right of set-off effectively excluded by the licence agreement.

I express my views on these four issues briefly as follows. (i) Although I agree with much of what Thorpe LJ says about the weakness of the counterclaim, and in particular the quantum of the damage claimed, I share the view of Simon Brown LJ, that I cannot say that the judge below was wrong in saying that, in the context of an application for summary judgment under RSC Ord 14, the counterclaim was properly arguable. (ii) However, I agree with Thorpe LJ and would allow the appeal also on the ground of the direct debit argument. This is essentially a question of policy. As the evidence in the case discloses—and it is a fact of which we can take judicial notice—modern commercial practice is to treat a direct debit in the same way as a payment by cheque and, as such, the equivalent of cash. The fact that a cheque is, technically, a negotiable instrument

is for this purpose irrelevant; in any case modern practice is to require payment by cheque crossed 'A/C Payee only', which is not negotiable. It is its equivalence to cash which is the essential feature of a direct debit and which makes relevant Lord Wilberforce's explanation for the reason why a defence of set-off is not normally allowed in the case of a claim based on a bill of exchange (see *Nova (Jersey) Knit Ltd v Kammgarn Spinnerei GmbH* [1977] 2 All ER 463 at 470, [1977] 1 WLR 713 at 721). I accept that the precise circumstances in which a payment by direct debit will preclude a defence of set-off may require to be worked out as further cases show different combinations of fact but, like Thorpe LJ, I accept the fundamental principle that, in general, a payment by direct debit for goods or services received should preclude a defence of set-off. (iii) I agree with Simon Brown LJ, and for the reasons which he gives, that the counterclaim was here insufficiently connected with the claim to allow for a defence of equitable set-off. (iv) For my part I would have held that, on its terms, cl 34 of schedule 7 to the licence agreement was sufficient to exclude a right of set-off. However, the present case is indistinguishable from *Stewart Gill Ltd v Horatio Myer & Co Ltd* [1992] 2 All ER 257, [1992] QB 600, with the result that the clause is unreasonably wide and falls foul of the Unfair Contract Terms Act 1977.

Finally, I wish to express my full agreement with that part of the judgment of Simon Brown LJ where he applies the approach of Lord Donaldson MR to dealing with the questions of law raised by this appeal, even though this is an application for summary judgment under Ord 14 (see *Stewart Gill Ltd v Horatio Myer & Co Ltd* [1992] 2 All ER 257 at 259, [1992] QB 600 at 604). True it is that it would have been open to the judge, or to us, to send the questions of law for summary determination under Ord 14A, but—certainly in our case, where we have heard full argument on all points and where it is not suggested by either side that we lack any of the material facts—I can see no advantage to be gained by our taking that course.

Appeal allowed.

Paul Magrath Esq Barrister.