properly publish extracts from documents quoted in the judgment of the court without infringing any order it had made.

When the court saw what the newspaper had published on 8 November 1995, the natural inference was that the appellants or their advisers had breached the order which the court had made binding upon them, and that the newspaper had aided or abetted that breach. We are not at all surprised that Lord Taylor C.J. invited the Attorney-General to look into the matter, and we regard this as a proper application for the Attorney-General to have made in performance of his public duty. We are indeed grateful to him for bringing this matter before the court. Having, however, had the opportunity to consider the evidence in detail, with the benefit of most helpful submissions on both sides, we conclude that neither the actus reus of contempt nor the requisite mens rea is established. We accordingly dismiss this application.

Application dismissed with costs.

Solicitors: Treasury Solicitor; Kingsley Napley.

D. E. C. P.

[COURT OF APPEAL]

*ESSO PETROLEUM CO. LTD. v. MILTON

1997 Jan. 16, 17; Feb. 5 — Simon Brown and Thorpe L.JJ. and Sir John Balcombe

Practice—Set-off—Contract—Defendant occupying and managing plaintiffs' petrol station under licence agreements—Defendant agreeing to buy plaintiffs' petrol and to pay by direct debit—Defendant cancelling mandate after delivery but before payment—Plaintiffs suing for debt due—Defendant counterclaiming damages for repudiatory breach—Whether direct debit equivalent to cash—Whether set-off available—Whether plaintiff entitled to summary judgment

The defendant occupied and managed two petrol service stations under three-year licence agreements with the plaintiffs whereby he agreed to buy from them his entire requirements of petrol and to pay for such deliveries by direct debit arrangements with his bank. The defendant's bank account would normally be debited two days after any delivery by the plaintiffs. By clause 34 of schedule 7 to the agreement the defendant agreed not "for any reasons to withhold payment of any amount due to the plaintiffs." The defendant was forbidden to sell petrol at prices greater than those notified to him by the plaintiffs as the maximum recommended retail prices and was bound to pay them those prices less the licence margin. In November 1995 the plaintiffs informed the defendant that the licence margin would be reduced and his shop rental would be increased from 1 January 1996. In March 1996

the defendant was informed of a further rental increase from 1 May 1996. The defendant felt that he could not operate profitably on the plaintiffs' stringent financial terms and regarded their business relationship as over. Between 1 to 9 April 1996 the plaintiffs made nine deliveries totalling £167,885·81 to the two service stations. The defendant cancelled his direct debit to his bank on 9 April 1996 and on 11 April 1996 the plaintiffs gave the defendant notices purportedly terminating each of his licence agreements. On 16 April 1996 the plaintiffs issued a writ claiming the sum of £167,885·81. The defendant admitted the claim but counterclaimed for damages of £186,500 for repudiatory breach of contract and sought to set off those damages in extinction of his admitted debt. On the plaintiffs' application for summary judgment pursuant to R.S.C., Ord. 14 the judge, dismissing the application, gave the defendant unconditional leave to defend.

On appeal by the plaintiff:—

Held, allowing the appeal, (1) (Simon Brown L.J. dissenting) that modern commercial practice was to treat payments by direct debit in the same way as payments by cheque and the equivalent of cash; and that, in general, a payment for goods and services by direct debit should preclude a defence of equitable set-off although the precise circumstances might require further consideration (post, pp. 952F–953A, H–954A, C–E).

Dicta of Lord Wilberforce in *Nova (Jersey) Knit Ltd. v. Kammgarn Spinnerei G.m.b.H.* [1977] 1 W.L.R. 713, 721, H.L.(E.) applied.

(2) That the defendant's counterclaim was (*per* Simon Brown L.J. and Sir John Balcombe) insufficiently connected to the transaction giving rise to the plaintiffs' claim to be available as a set-off against the debt admittedly due to them or (*per* Thorpe L.J.) unarguable; and that, accordingly, the plaintiffs were entitled to summary judgment on their claim (post, pp. 951C–G, 952A–D, D–F, 954B, E–F).

Dicta of Lord Denning M.R. in *Federal Commerce & Navigation Co. Ltd. v. Molena Alpha Inc.* [1978] Q.B. 927, 974–975, C.A. and *Stewart Gill Ltd. v. Horatio Myer & Co. Ltd.* [1992] Q.B. 600, C.A. applied.

Per Simon Brown L.J. and Sir John Balcombe. Even if clause 34 is clear enough to exclude a right of set-off, it is unreasonably wide and unenforceable (post, pp. 949E–F, 954F).

Decision of Judge Anthony Thompson Q.C., sitting as a judge of the Queen's Bench Division, reversed.

The following cases are referred to in the judgments:

Axel Johnson Petroleum A.B. v. M.G. Mineral Group A.G. [1992] 1 W.L.R. 270; [1992] 2 All E.R. 163, C.A.

Bankes v. Jarvis [1903] 1 K.B. 549, D.C.

China National Foreign Trade Transportation Corporation v. Evlogia Co. S.A. of Panama [1979] 1 W.L.R. 1018; [1979] 2 All E.R. 1044, H.L.(E.)

Connaught Restaurants Ltd. v. Indoor Leisure Ltd. [1994] 1 W.L.R. 501; [1994] 4 All E.R. 834, C.A.

Esso Petroleum Co. Ltd. v. Craft (unreported), 15 June 1995, Scott Baker J.; (unreported), 1 February 1996, Court of Appeal (Civil Division) Transcript No. 47 of 1996, C.A.

Federal Commerce & Navigation Co. Ltd. v. Molena Alpha Inc. [1978] Q.B. 927; [1978] 3 W.L.R. 309; [1978] 3 All E.R. 1066, C.A.

Gill (Stewart) Ltd. v. Horatio Myer & Co. Ltd. [1992] Q.B. 600; [1992] 2 W.L.R. 721; [1992] 2 All E.R. 257, C.A.

Hanak v. Green [1958] 2 Q.B. 9; [1958] 2 W.L.R. 755; [1958] 2 All E.R. 141, C.A.

Motor Oil Hellas (Corinth) Refineries S.A. v. Shipping Corporation of India [1990] 1 Lloyd's Rep. 391, H.L.(E.)

Nova (Jersey) Knit Ltd. v. Kammgarn Spinnerei G.m.b.H. [1976] 2 Lloyd's Rep. 155, C.A.; [1977] 1 W.L.R. 713; [1977] 2 All E.R. 463, H.L.(E.)

Scarf v. Jardine (1882) 7 App.Cas. 345, H.L.(E.)

Shell U.K. Ltd. v. Lostock Garage Ltd. [1976] 1 W.L.R. 1187; [1977] 1 All E.R. 481, C.A.

The following additional cases were cited in argument:

B.P. Refinery (Westernport) Pty. Ltd. v. President, Councillors and Ratepayers of Shire of Hastings (1977) 52 A.L.J.R. 20, P.C.

Business Computers Ltd. v. Anglo-African Leasing Ltd. [1971] 1 W.L.R. 578; [1977] 2 All E.R. 741

Coca-Cola Financial Corporation v. Finsat International Ltd. [1996] 3 W.L.R. 849, C.A.

Financial Techniques (Planning Services) Ltd. v. Hughes [1981] I.R.L.R. 32, C.A.

Montebianco Industrie Tessili S.p.A. v. Carlyle Mills (London) Ltd. [1981] 1 Lloyd's Rep. 509, C.A.

Morgan & Son Ltd. v. Johnson (S. Martin) & Co. Ltd. [1949] 1 K.B. 107; [1948] 2 All E.R. 196, C.A.

Philips Electronique Grand Public S.A. v. British Sky Broadcasting Ltd. (unreported), 19 October 1994; Court of Appeal (Civil Division) Transcript No. 1192 of 1994, C.A.

Smyth (Ross T.) & Co. Ltd. v. T. D. Bailey & Son Co. [1940] 3 All E.R. 60, H.L.(E.)

State Trading Corporation of India Ltd. v. Golodetz Ltd. [1989] 2 Lloyd's Rep. 277, C.A.

Stirling v. Maitland (1864) 5 B. & S. 840

Vaswani v. Italian Motors (Sales and Services) Ltd. [1996] 1 W.L.R. 270, P.C.

Vitol S.A. v. Norelf Ltd. [1996] A.C. 800; [1996] 3 W.L.R. 105; [1996] 3 All E.R. 193, H.L.(E.)

Woodar Investment Development Ltd. v. Wimpey Construction U.K. Ltd. [1980] 1 W.L.R. 277; [1980] 1 All E.R. 571, H.L.(E.)

APPEAL from Judge Anthony Thompson Q.C. sitting as a judge of the Queen's Bench Division.

By writ dated 16 April 1996 the plaintiffs, Esso Petroleum Co. Ltd., sued the defendant, Howard James Milton, for the sum of £167,885·81 together with interest being payment due under a direct debit arrangement for the delivery of motor fuels. By summons dated 22 May 1996 the plaintiffs applied for summary judgment pursuant to R.S.C., Ord. 14. By order dated 21 June 1996 the judge dismissed the plaintiffs' application and granted the defendant unconditional leave to defend the action.

By notice of appeal dated 6 September 1996 the plaintiffs appealed on the grounds, inter alia, that (1) the judge erred in law in finding that the plaintiffs were arguably in breach of the licence agreements in determining the licence margin to be 0·75p per litre. The plaintiffs had the contractual right to do so; (2) the judge erred in holding that the breach of each licence agreement allegedly committed by the plaintiffs was arguably a repudiatory breach which entitled the defendant to terminate the agreements; (3) it being common ground that, if the licence agreements had not previously been determined, they were lawfully determined on 11 April 1996, the judge erred in finding that the defendant had arguably accepted the plaintiffs' alleged repudiatory breach of contract before then; (4) the judge erred in holding, as he impliedly did, that the defendant had

A an arguable case for more than nominal damages on his counterclaim; and (5) the judge erred in holding that the defendant had an arguable claim for equitable set-off.

By respondent's notice dated 27 September 1996 the defendant sought to uphold the judge's judgment on the additional or alternative ground that the plaintiffs' conduct in adjusting the level of the licence margin/operating cost allowance/Esso shop annual fee on the basis of their B best practice projections constituted an arguable repudiatory breach of the implied terms of the partnership licence agreements and Esso shop agreements which entitled the defendant to manage both service stations.

The facts are stated in the judgment of Simon Brown L.J.

Mark Hapgood Q.C. for the plaintiffs.

C *Michael Soole* for the defendant.

Cur. adv. vult.

5 February. The following judgments were handed down.

D SIMON BROWN L.J. This is the plaintiffs' appeal by leave of this court against the order of Judge Anthony Thompson Q.C., sitting at Exeter as a judge of the Queen's Bench Division on 21 June 1996, dismissing their application for summary judgment against the defendant for £167,885·81. The relevant facts can be comparatively shortly stated. The plaintiffs ("Esso") need no introduction. The defendant was for many years the licensee of two of their service stations in Exeter, Alphington and E Seabrook. Esso own over 1,800 such garages and have some 734 licensees. The defendant 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 defendant was licensed to operate an Esso shop. Similar licence and shop agreements exist in relation to Esso's many other garages.

F By condition 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 G 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 H 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

defendant that with effect from 1 January 1996 the licence margin would be reduced and his shop rentals would be increased. On 12 December the defendant 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 defendant 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, 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 paragraph 2 of schedule 5 in these terms:

> "The licensee agrees to make payment to Esso for the motor fuels, lubricants, anti-freeze 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 defendant 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 Co. Ltd. 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 defendant 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 defendant 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 defendant'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 R.S.C., Ord. 14. On 21 June the defendant was granted unconditional leave to

A defend and the following month amended his defence and counterclaim. Esso now appeal.

Esso's claim is admitted. It could hardly be otherwise. The defendant 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. Hapgood for Esso advances four substantially independent arguments why the defendant should be B 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.

C *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 upon its cogency. What the counterclaim comes to is this. There was, submits Mr. Soole for the defendant, a term to be implied into D 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 defendant was in effect driven out of business. That was a repudiatory breach which the defendant by cancellation of his direct debit mandate accepted. True, by taking that step the defendant was not apparently intending to put an end to the E 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 F we were not as busy as I had expected. After a great deal of soul-searching 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 try and get them to recognise the dispute between us and to enter into a dialogue."

G That intention, however, Mr. Soole submits is immaterial. Whatever subjectively the defendant 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 upon three House of Lords' authorities: *Scarf v. Jardine* (1882) H 7 App.Cas. 345; *China National Foreign Trade Transportation Corporation v. Evlogia Shipping Co. S.A. of Panama* [1979] 1 W.L.R. 1018 and *Motor Oil Hellas (Corinth) Refineries S.A. v. Shipping Corporation of India* [1990] 1 Lloyd's Rep. 391. Accordingly the notices which Esso served on 11 April 1996 were of no affect: 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 defendant, 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 upon his net 1995 figures) during the remaining period of the licence agreements (9½ months at Alphington, 29½ 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 defendant's garages.

(iii) £49,000 as the loss sustained through the defendant 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. (iv) Some £7,500 representing the defendant'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 defendant'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 defendant'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 defendant'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 defendant 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

A equitable set-off, is not in the present circumstances available to the defendant. These arguments are first that the defendant 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 upon 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 defendant's counterclaim for damages for loss of future profits is B not sufficiently connected with Esso's claim in respect of past deliveries of fuel to allow of an equitable set-off (the insufficient connection argument). Third, that the licence agreement expressly excluded the defendant's rights of equitable set-off. The term upon which Mr. Hapgood relies is clause 34 of schedule 7 which, so far as material, provides:

> "The licensee agrees that he will not for any reasons withhold C payment of any amount properly due to Esso under this licence 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 defendant's entitlement to leave to defend. Before turning to address them D it is important to make plain the court's proper approach to such issues upon an interlocutory appeal of this nature. At first blush it might appear (and perhaps to the judge below did appear) sufficient for the defendant's purposes to raise an arguable case in response. On reflection, however, and guided in particular by certain observations of Lord Donaldson of Lymington M.R. in *Stewart Gill Ltd. v. Horatio Myer & Co. Ltd.* [1992] E Q.B. 600, it is surely plain that we have no option but to reach a clear and final conclusion upon 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 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 F Terms Act 1977, the plaintiffs were entitled to summary judgment. Lord Donaldson M.R. said, at p. 604:

> "such a clause, if it is to be effective at all, can only take effect either upon an application for summary judgment under R.S.C., Ord. 14 or on the subsequent hearing of a preliminary point as to its reasonableness. To give unconditional leave to defend without G 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."

H 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 is suggested to require further evidence for its 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 Contracts,* 27th ed. (1994), vol. 2, pp. 336 et seq., paras. 33–302 et seq.

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 upon 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 G.m.b.H.* [1977] 1 W.L.R. 713 where the House of Lords by a four to one majority overturned the Court of Appeal's decision ([1976] 2 Lloyd's Rep. 155) which had allowed a plaintiff's action upon a dishonoured bill of exchange to be stayed pending the resolution of the defendant's counterclaim for unliquidated damages. Lord Wilberforce said, at p. 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 in the Act, section 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 upon 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 creditors' expectations, he submits, are the same irrespective whether the debtor is to pay by cheque or, as commercially now is found to be 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* (unreported), 1 February 1996; Court of Appeal (Civil Division) Transcript No. 47 of 1996 in which, refusing the

A 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 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."

B

As the first instance judgment in that case ((unreported), 15 June 1995) 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 upon this appeal.

C

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 upon a dishonoured cheque. And that is no mere technicality: the defendant 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 (45 & 46 Vict c. 61). And the request, so far from being a signed instrument equivalent to cash provided by the debtor, is drawn rather by the creditor.

D

E

In short, submits Mr. Soole, the defendant 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 upon this important point it is, I think, worth setting out verbatim the final written formulation of Esso's argument:

F

> "*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)."

G

H

By way of oral elaboration of those propositions Mr. Hapgood doubted whether the word "wrongfully" was strictly required in paragraph (1) (in which event paragraph (2) would be unnecessary);

explained that the reference in paragraph (2) to an implied promise was included to enable a future decision to be reached upon 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 paragraph (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 paragraph (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 it's 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 Order 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] 1 W.L.R. 501.

Here, Mr. Hapgood contends, such clear words are to be found in the opening sentence of clause 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 clause 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.

A 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 the *Stewart Gill Ltd.* B case [1992] 2 Q.B. 600, that the exclusion clause cannot be relied upon because it is unreasonably wide. The clause in the *Stewart Gill Ltd.* case was, it may be noted, at p. 604:

> "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 C goods or for any other reason whatsoever which the customer may allege excuses him from performing his obligations hereunder."

That was held unenforceable by Lord Donaldson of Lymington M.R., at p. 606:

> "the defendants succeed because, whatever the reasonableness of a clause which excludes or restricts a right of set-off, nothing could D 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 E '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."

If, as Esso submit, the reference to "any amount properly due to Esso" in clause 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, F I should observe, provision in these agreements for the licensee to be given certain credits—then in my judgment clause 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 defendant.

3. *The insufficient connection argument*

G 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 Q.B. 9, the case which decided that an unliquidated counterclaim can in H certain circumstances be set off against a liquidated debt—cases within group 3 of Morris L.J.'s analysis, at p. 23: "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 L.J., at p. 24, referred to *Bankes v. Jarvis* [1903] 1 K.B. 549 and spoke of the "close relationship [which existed there] between the dealings and transactions which gave rise to the respective claims," and Sellers L.J., referring to the three cross-claims in *Hanak v. Green* itself, said, at p. 31,

of one that "it arises directly under and affected 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 . . ." *Hanak v. Green* did not, however, seek to deal specifically with the requisite closeness. For that one goes to *Federal Commerce & Navigation Co. Ltd. v. Molena Alpha Inc.* [1978] Q.B. 927, and in particular this passage from the judgment of Lord Denning M.R., at pp. 974–975:

> "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 A.B. v. M.G. Mineral Group A.G.* [1992] 1 W.L.R. 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, for example, with regard to cheques. In conclusion, Staughton L.J. said, at p. 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 Q.B. 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 requires that result, and not if the defendant does 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 *Molena Alpha* [1978] Q.B. 927, the emphasis placed upon 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 at paragraph 14/3–4/13 of *The Supreme Court Practice 1997*, vol. 1, p. 164 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.

A 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 defendant to buy all the fuel he needs; the licensee's request for fuel, he submits, triggers the operation of the B 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: *Shell U.K. Ltd. v. Lostock Garage Ltd.* [1976] 1 W.L.R. 1187 is relied on by analogy.

C It is upon 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 D into account the defendant's claim for future losses. In *Esso Petroleum Co. Ltd. v. Craft*, 1 February 1996, 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."

E 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 defendant reneged upon 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 defendant. No case has been cited to us in which payment of a debt presently due has been required to F 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 defendant 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 G 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 defendant 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 H 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 L.J. I have had the advantage of reading in draft the judgment of Simon Brown L.J. I agree with its conclusion and gratefully adopt its very clear presentation of the issues. That enables me to go straight to the points upon which I am more strongly for the plaintiffs 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 plaintiffs. 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 G.m.b.H.* [1977] 1 W.L.R. 713, 721 in the passage cited by Simon Brown L.J. 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'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 plaintiffs on the justice of the case. As Simon Brown L.J. has demonstrated, claims to equitable set-off ultimately depend upon 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 0·75p 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 £50,000 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 moneys 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 L.J. cited by Simon Brown L.J.

SIR JOHN BALCOMBE. I have had the advantage of reading in draft the judgments of both Simon Brown and Thorpe L.JJ. I agree with them that

this appeal should be allowed. There were four substantial issues before us: (1) Has the defendant a properly arguable counterclaim for a sum approximating to the undisputed amount of the debt claimed? (2) 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? (3) Was the counterclaim sufficiently connected with Esso's claim to allow a defence of equitable set-off? (4) Was a right of set-off effectively excluded by the licence agreement?

I express my views on these four issues briefly as follows. (1) Although I agree with much of what Thorpe L.J. says about the weakness of the counterclaim, and in particular the quantum of the damage claimed, I share the view of Simon Brown L.J. that I cannot say that the judge below was wrong in saying that, in the context of an application for summary judgment under Order 14, the counterclaim was properly arguable.

(2) However, I agree with Thorpe L.J. 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 G.m.b.H.* [1977] 1 W.L.R. 713, 721—the passage is cited in full in the judgment of Simon Brown L.J. 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 L.J., 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.

(3) I agree with Simon Brown L.J., 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.

(4) For my part I would have held that, on its terms, clause 34 of schedule 7 to the licence agreement was sufficient to exclude a right of set-off. However the present case is indistinguishable from the *Stewart Gill Ltd.* case [1992] Q.B. 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 L.J. where he applies the approach of Lord Donaldson of Lymington M.R. to dealing with the questions of law raised by this appeal, even though this is an application for summary judgment under Order 14. 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 Order 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 with costs.
Leave to appeal refused.

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M. F.