Case No: CHBKF-99-0597-3

IN THE SUPREME COURT OF JUDICATURE
COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE HIGH COURT OF JUSTICE
(CHANCERY DIVISION) IN BANKRUPTCY
JACOB J.

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 13.10.99

Before:

LORD JUSTICE MORRITT
LORD JUSTICE BROOKE
and
LORD JUSTICE ROBERT WALKER

SIMON RUSSELL GARROW — **Respondent**
- and -
SOCIETY OF LLOYD'S — **Appellant**

Mr E Bannister QC and Miss L Hilliard (instructed by Society of Lloyd's for the appellant)
Mr C Purle QC and Mr L Jones (instructed by Grower Freeman & Goldberg for the respondent)

JUDGMENT

Lord Justice Robert Walker:

This is an appeal from an order of Jacob J made on 17 June 1999 setting aside a statutory demand dated 10 August 1998 served on Mr Simon Garrow by the Society of Lloyd's. The demand was for the sum of £196,167.13 under a judgment for £189,829.59 obtained by Lloyd's against Mr Garrow on 11 March 1998. Mr Garrow was a name at Lloyd's and the judgment debt was based on his undisputed liability to pay a reinsurance premium under the Lloyd's Reconstruction and Renewal Plan ("the R & R Plan"), a description of which can be found in the judgment of Colman J in *Society of Lloyd's v Leighs* [1997] CLC 759 at pp. 761-5. The amount of the reinsurance premium was £169,029.81; the balances over that amount in the judgment debt and the statutory demand were in respect of interest. Mr Garrow claims to have a counterclaim against Lloyd's for an amount at least equal to his liability to Lloyd's in respect of the premium, and it was on that ground that Jacob J set aside the statutory demand.

The judge described this as something of a test case. In autumn 1996 Lloyd's issued writs against over 600 names or former names who had declined to accept the R & R Plan. Colman J directed a number of test cases to be heard in order to determine the legal effect of clause 5.5 (which is often referred to as the "pay now, sue later" clause) of the reinsurance contract dated 3 September 1996. Colman J delivered two judgments, on 20 February and 23 April 1997 ([1997] CLC 759 and 1012) and these were upheld by this court on 31 July 1997 ([1997] CLC 1398). Other defences to Lloyd's claims under clause 5.5 also failed (see *Society of Lloyd's v Fraser* [1998]

CLC 127 and 1630). The outcome is that non-accepting names are bound by the terms of clause 5.5 and cannot raise any cross-claim by way of defence or set-off. Nevertheless many non-accepting names (including Mr Garrow) have put forward cross-claims against Lloyd's alleging fraudulent misrepresentations. The lead case is *Society of Lloyd's v Jaffray* in which the defendant's defence and counterclaim were served on 21 November 1997, and in which Mr Garrow is a claimant by counterclaim. On 30 June 1998 Colman J directed a preliminary issue in *Jaffray*. This preliminary issue (often referred to as the "threshold fraud point") is in the terms

> "whether Lloyd's made misrepresentations which it knew to be untrue and/or as to which it was reckless whether they were true or false and whether such misrepresentations were communicated to the name and if so when."

The trial of the threshold fraud point was to have commenced during October or early November 1999, with an estimated duration of three months. Between 24 and 29 June 1999 Cresswell J heard an application by Lloyd's to postpone the hearing until 1 February 2000. Cresswell J treated the application as a full management directions hearing and refixed the date for trial of the preliminary issue as 11 January 2000. His order (made on 1 July 1999) contains detailed directions as to preparation for the hearing. The directions include the trial of a further issue, that is whether each of three sample names relied on the pleaded representations during the relevant period. (Mr Garrow is not a sample name.) The estimated duration of the hearing is now three to six months.

In the meantime Lloyd's has obtained summary judgment against numerous other defendants in the same position as Mr Garrow, and has served statutory demands on many of them. Since the judgment of Jacob J. Lloyd's has agreed with the solicitors for the other counterclaimants that other applications to set aside statutory demands will be held in suspense until the determination of this appeal. But the agreement (and the status of Mr Garrow's appeal as a test case) go no further than that. Since the court's power to set aside a statutory demand involves the exercise of a judicial discretion, the outcome may depend on the facts of the particular case.

The grounds on which the court may grant an application to set aside a statutory demand are set out in Rule 6.5 of the Insolvency Rules 1986, paragraph (4) of which provides,

> "The court may grant the application if -
> (a) the debtor appears to have a counterclaim, set-off or cross demand which equals or exceeds the amount of the debt or debts specified in the statutory demand; or
>
> (b) the debt is disputed on grounds which appear to the court to be substantial, or ..."

The practice note *Bankruptcy Court: statutory demand (No 1 of 1987)* [1987] 1 WLR 119 provides guidance as to the exercise of the court's powers,

> "3. Where the statutory demand is based on a judgment or order, the court will not at this stage go behind the judgment or order and inquire into the validity of the debt nor, as a general rule, will it adjourn the application to await the result of an application to set aside the judgment or order.

> 4. When the debtor (a) claims to have a counterclaim, set off or cross demand (whether or not he could have raised it in the action in which the judgment or order was obtained) which equals or exceeds the amount of the debt or debts specified in the statutory demand or (b) disputes the debt (not being a debt subject to a judgment or order) the court will normally set aside the statutory demand if, in its opinion, on the evidence there is a genuine triable issue."

The practice note was signed by the Chief Bankruptcy Registrar, but no doubt after consultation with the Vice-Chancellor. It has not been suggested that the practice note should be overruled or departed from. It was referred to without any disapproval by this court in *TSB Bank v Platts* [1998] 2 BCLC 1,7.

Before Jacob J Mr Garrow relied on rule 6.5 (4)(a) and paragraph 4(a) of the practice note, which the judge referred to as the general rule. He said that that general rule accorded with the similar position in relation to companies laid down by this court in *Re Bayoil SA* [1999] BCLC 62. But before going further into the judge's reasoning, and the submissions made in this court, it is appropriate to summarize the essential facts of Mr Garrow's case.

Mr Garrow was elected as an underwriting member of Lloyd's in 1976. He was then 30 years of age and working as a self-employed artist. He became a member of the Outhwaite Syndicate 317/661 and as a member of that syndicate he sustained losses for the 1982 year of account. On 26 April 1988 he was informed by his underwriting agents that he faced "a substantial cash call for the Outhwaite 1982 Open Year" (then estimated at £10,000 to £15,000). On 1 July 1988 he resigned as an

underwriting member. The agents' estimate proved to be far too low and by the end of 1989 Mr Garrow owed Lloyd's Central Fund nearly £20,000, after calls on his deposited funds. At the end of 1990 he approached the Lloyd's Members' Hardship Committee ("MHC") but was dilatory in completing the necessary declaration of his personal financial position. He eventually submitted it to Lloyd's in October 1991.

In December 1992 the MHC indicated the terms which it was likely to recommend. These included taking a charge on Mr Garrow's beneficial half-share in his residence, 21 Cromwell Grove London W6, subject to a substantial building society mortgage. In June 1993 Mr Garrow wrote to the MHC to let them know that he and his wife were separating, the house was to be sold in order to pay off the mortgage, and his teaching job was coming to an end. The house was sold in May 1994 for £285,000, of which the mortgage took all but about £60,000. Mr Garrow's solicitors informed Lloyd's that the balance had been used to repay a loan from his father. On 27 February 1995 Lloyd's informed Mr Garrow that as he had chosen to repay his father in preference to Lloyd's, his hardship application had been withdrawn. Subsequently however Lloyd's reconsidered that position.

In July 1996 Lloyd's circulated to its underwriting members details of a settlement offer embodying the R & R Plan. Mr Garrow did not accept the offer. In October 1996 Equitas Ltd (the principal operating company of the Equitas Group established as part of the R & R Plan) assigned to Lloyd's the right to recover premiums payable under the plan. Lloyd's then issued over 600 writs against non-

accepting names, including Mr Garrow, leading to the proceedings already mentioned before Colman J and this court.

After Lloyd's obtained summary judgment against Mr Garrow and served the statutory demand on him, he was granted an extension of time for his application to have it set aside. In an affidavit sworn on 11 September 1998 he deposed that he had paid Lloyd's over £140,000 and had assets (cash at bank and an old car) valued at only £1000. He was training to be a teacher and subsisting on a local authority grant and income support. He was living in rented accommodation with his two daughters, both of whom are students. However, Mr Philip Coldbeck (the Assistant Manager of Lloyd's Financial Recovery Department) has deposed that Mr Garrow paid only about £57,000 (including the drawing down of his deposited funds). The judge made no reference in his judgment to this striking disparity in the evidence and it may not have been brought clearly to his attention.

Mr Garrow further deposed that as he had no assets of any material value, his initial attitude had been to let Lloyd's do its worst. However he had decided that he should at least try to pursue his counterclaim against Lloyd's. He believed that if Lloyd's succeeded in bankrupting him, his counterclaim would never reach the court. His defence and counterclaim were pleaded on 12 October 1998, largely by reference to the schedules to the defence and counterclaim in *Jaffray* (the fact that Mr Garrow put in a defence, despite having had summary judgment entered against him, is an oddity resulting from the terms of Colman J's directions).

In his judgment Jacob J did not attempt to quantify Mr Garrow's prospects of success in his counterclaim. The judge regarded that as a futile exercise. Instead he asked himself, following the guidance given by Nourse LJ in *Bayoil* [1997] 1 BCLC 62,71, whether the cross-claim was "genuine or serious or, if you prefer, one of substance". The judge was prepared to assume that if the cross-claim succeeded the damages would at least equal Mr Garrow's liability.

In this court counsel for Lloyd's have advanced a number of criticisms of the judge's approach and conclusions. They have submitted that (quite apart from the 'pay now, sue later' clause, on which they rely as a separate ground of appeal) the judge erred in finding that Mr Garrow had shown that he had a genuine and serious cross-claim. They have submitted that *Bayoil*, as a case concerned with corporate insolvency, has no application to proceedings relating to a statutory demand made against an individual. They have also submitted that the judge should have held that clause 5.5 of the reinsurance contract created a contractual bar preventing Mr Garrow relying on his counterclaim as a ground for having the statutory demand set aside. In order to lay the foundation for this last submission Lloyd's applied for permission to amend its notice of appeal (which already extended to nine paragraphs, some elaborately subdivided). This court gave permission for the amendments, although some of them raise points not argued (or not fully argued) before the judge.

Counsel for Lloyd's were critical of the pleading of Mr Garrow's counterclaim in the *Jaffray* action and of Mr Garrow's affidavit evidence in these proceedings. The burden is on Mr Garrow to show that he has a substantial cross-claim. Counsel relied on some observations of Lloyd J in *Re Latreefers* [1999] 1 BCLC 271, 282,

> "[Counsel for the cross-claimant company opposing a winding-up petition] pointed out that these cross-claims are asserted in the counterclaim and have not been the subject of an application to strike them out. That is beside the point. To bring the *Bayoil* practice into play he has to show, at least on a prima facie basis, the substance of the cross-claims, which involves more than just pleading them."

Whether or not *Bayoil* provides a close analogy in cases where an individual debtor is relying on a cross-claim in an application to have a statutory demand set aside, the general rule which the judge derived from rule 6.5 (4)(a) of the Insolvency Rules and paragraph 4(a) of the practice note requires the debtor to show that his cross-claim has substance and will, if it succeeds, at least equal the debtor's liability. Delay in putting forward a cross-claim may lead to an inference that it is not put forward in good faith, but only as a pretext in an attempt to stave off bankruptcy. However there may be a satisfactory explanation for delay, and the practice note recognises that failure to raise it in the original action against the debtor need not be fatal.

In this case Mr Garrow's own affidavit evidence cannot be described as a detailed verification of his cross-claim against Lloyd's. In his first affidavit sworn on 11 September 1998 he deposed,

> "However, I am in my present parlous position solely because of my involvement with Lloyd's and the trust that I placed in what I was told by Lloyd's and those who represented Lloyd's. I therefore wish to pursue my counterclaim against Lloyd's through the membership of the United Names Association to recover some at least of what I have lost."

In his second affidavit sworn on 15 February 1999 Mr Garrow referred to an affidavit of Mr Coldbeck seeking

> "to undermine the nature, purpose and impact of my allegations against Lloyd's which are, inter alia, that Lloyd's fraudulently suppressed relevant information and made fraudulent misrepresentations to names such as me, thereby inducing those names to become members of Lloyd's and/or to increase their participation and/or to renew their membership year by year."

Later in the same affidavit Mr Garrow added, "If any further evidence were required to demonstrate that the [*Jaffray*] action represents a genuine and serious claim and is one of substance" reference might be made to what Colman J said on 15 January 1999 when dismissing an application made by Lloyd's for a stay of proceedings. Colman J is reported as having said,

> "The present case involved allegations by the names of the utmost seriousness, involving a pattern of deception by Lloyd's directed to maximizing its capacity in order to accommodate more business. These allegations are not confined to a short period of time many years ago. They allege a continuing culture of misrepresentation over many years. These allegations are exceptionally damaging to Lloyd's reputation and to the reputation of the London insurance market in general. Further, if they are made good at the trial, it may also be proved that this conduct has caused the names to suffer immense financial losses, so great in many cases that individuals have been driven to bankruptcy, physical illness and death as a result."

The judge found that Mr Garrow did have a genuine and serious claim and that Mr Garrow's delay was excusable "in the context of the massive complication of the Lloyd's litigation with all its ramifications and costs and the need for class or class-like claims and defences". In my judgment the judge was entitled to come to those conclusions. Mr Garrow's cross-claim has not simply been pleaded (although the fact that the allegation of fraudulent misrepresentation appears in a pleading signed by leading and junior counsel is not without significance). Intensive case-management has already made judges of the Commercial Court (Colman J and Cresswell J in particular) familiar with the issues in the group action, and many of the most important issues are to be tried within a matter of months. Mr Garrow is not one of the sample names in the further issue directed by Cresswell J, but he has deposed that he trusted Lloyd's and relied on representations made on its behalf.

That is not the end of this point because counsel for Lloyd's also criticised the judge's approach to the quantum of Mr Garrow's cross-claim. Here it is necessary to come back to the serious conflict in the evidence as to how much Mr Garrow has already paid to Lloyd's. Fortunately it is not necessary to resolve that conflict because leading counsel for Mr Garrow conceded that even if the figure of about £140,000 is correct, the counterclaim can equal or exceed Mr Garrow's liability in respect of the reinsurance premium only if that liability is itself brought in as part of the counterclaim (which leads straight into the clause 5.5 point). Conversely leading counsel for Lloyd's accepted that, even if the amount of the past payment was only about £57,000, the inclusion of the reinsurance premium would be decisive. The

clause 5.5 point has therefore acquired much more importance in this court than it was seen as having at first instance. The judge has been criticised for stating that he was "prepared to assume" that if Mr Garrow's counterclaim was good the damages awarded to him would at least equal his liability for the reinsurance premium. The judge's choice of words might have been improved on but he was right in his conclusion. On the evidence before him, however the conflict were to be resolved, Mr Garrow had a sufficiently large counterclaim unless Lloyd's can rely on clause 5.5 to oust any cross-claim in respect of the reinsurance premium.

Although the decision of this court in *Bayoil* featured prominently in the original notice of appeal and in the appellant's written argument, it was rightly given less prominence in counsel's oral submissions. There are obvious similarities, but also obvious points of difference, between the two statutory regimes dealing with individual and corporate insolvency, and the determination of this appeal does not depend on compiling a balance-sheet of similarities and differences. Rule 6.5(4) of the Insolvency Rules, as supplemented by the practice note, lays down the general rule as to setting aside a statutory demand served on an individual. That general rule is very similar to the principle in *Bayoil*, although there may be at least a difference in emphasis between the practice note ("whether or not he could have raised it in the action") and Nourse LJ's requirement ([1999] 1 BCLC at p.71) that the cross-claim "must be one which the company has been unable to litigate".

It is however material to note one significant difference between the individual and corporate insolvency regimes, that is the function of the statutory demand which is provided for in both regimes (in individual bankruptcy primarily ss 267 and 268 of the Insolvency Act 1986; in winding-up primarily s 123). But as Peter Gibson LJ said, delivering the judgment of the court in *TSB Bank v Platts* [1998] 2 BCLC 1, 6-7, the statutory demand is of crucial importance in individual bankruptcy:

> "It is accordingly quite different from a statutory demand in the field of company law which merely provides one means of establishing a company's inability to pay its debts, the usual ground on which a company is wound up compulsorily. In contrast in bankruptcy, it is not the debtor's general inability to pay his debts that is crucial but the apparent inability to pay the debt in the statutory demand, and at the hearing of the bankruptcy petition the failure to pay or secure or compound for that debt."

Although Lloyd's has a judgment against Mr Garrow, it has chosen to proceed by way of a statutory demand and the statutory demand is crucial to the making of a bankruptcy order. It would be contrary to the scheme of the legislation, and to the practice of the bankruptcy court, to allow a doubtful statutory demand to stand on the ground that the debtor would still have the opportunity of opposing a bankruptcy petition, once presented. Counsel for Lloyd's have argued that that course would enable Lloyd's to present a petition and so establish a date by reference to which transactions might be invalidated or impeached under ss. 284 and 339 (and following) of the Insolvency Act 1986, while protecting Mr Garrow by an adjournment of the final hearing of the petition. However it is precisely because of the far-reaching effect of those sections (and comparable sections in the winding-up legislation) that the bankruptcy court and the Companies Court have a strong and well-established policy

of discouraging long or repeated adjournments of bankruptcy and winding-up petitions. The judge was right to reject the suggestion that he should allow a petition to be presented and then go into suspended animation.

The judge did, in deference to some submissions made on behalf of Lloyd's, accept from Mr Garrow and his father undertakings that they would (in the event of the son's bankruptcy on a petition by Lloyd's founded on the judgment debt) accept 10 June 1999 as the "relevant time" for the purposes of an application under s.339 in relation to the proceeds of sale of 21 Cromwell Grove. The undertakings were offered by Mr Garrow's counsel and are embodied in the judge's order. Lloyd's did not ask for them and has now raised doubts as to their efficacy. It is not necessary or appropriate to express any view as to those doubts. The undertakings plainly were not of central importance to the judge's conclusion that he must rule on the statutory demand on its merits, rather than allowing a petition to be presented and go into suspended animation.

There has been much more argument in this court on clause 5.5 of the reinsurance contract (the "pay now, sue later" clause) than there was below. It is in the following terms (ERL being a reference to Equitas Reinsurance Ltd),

> "Each Name shall be obliged to and shall pay his Name's Premium in all respects free and clear from any set-off, counterclaim or other deduction on any account whatsoever including in each case, without prejudice to the generality of the foregoing, in respect of any claim against ERL, the Substitute Agent, any Managing Agent, his Members' Agent, Lloyd's or any other person whatsoever and:
>
> (a) in connection with any proceedings which may be brought to enforce the Name's obligation to pay his Name's

Premium, the Name hereby waives any claim to any stay of execution and consents to the immediate enforcement of any judgment obtained;

(b) the Name shall not be entitled to issue proceedings and no cause of action shall arise or accrue in connection with his obligation to pay his Name's Premium unless the liability for his Name's Premium has been discharged in full; and

(c) The Name shall not seek injunctive or any other relief for the purpose, or which would have the result, of preventing ERL, or any assignee of ERL from enforcing the Name's obligation to pay his Name's Premium."

Counsel on either side referred extensively to two previous decisions of this court concerned with different aspects of the Lloyd's litigation. *Arbuthnot v Fagan* [1995] CLC 1396 concerned actions brought by Lloyd's names against their members' agents and managing agents. The standard forms of agency agreement contained a 'pay now, sue later' clause (clause 9(b) and (c) in the specimen form considered in the judgments). *Society of Lloyd's v Leighs* [1997] CLC 1398 was an appeal from the decisions of Colman J already mentioned, and was directly concerned with clause 5.5 of the R&R Plan reinsurance contract. *Arbuthnot* is not referred to in the judgment of the court (delivered by Saville LJ) in *Leighs*, although all three members of the court in *Arbuthnot* (Sir Thomas Bingham MR, Steyn LJ and Hoffmann LJ) made some valuable general observations about the construction of contracts.

In *Arbuthnot* clause 9(b) obliged the name to pay any funds required by the agent free of any set-off, counterclaim or other deduction, which was not to be a defence to any proceedings by the agent to enforce his requirement; the name waived

any stay of execution and consented to the immediate enforcement of any judgment.

Clause 9(c) then went on,

> "It shall be a condition precedent to the issue of proceedings or the making of any reference to arbitration by the name in respect of any matter arising out of or in any way connected with either the making of such requirement by the agent or the subject matter thereof, or the preparation or audit of the accounts referred to in cl.6, that the name shall have duly complied with any such requirement made or purported to be made by the agent, and no cause of action in respect of any such matter shall arise or accrue in favour of the name until such requirement shall have in all respects been duly complied with. At no time shall the name seek injunctive or any other relief for the purpose (or which has the result) of preventing the agent from making or enforcing any such requirement..."

The last sentence of clause 9(c) dealt with the application of funds in the agent's hands and is not directly in point. There are obvious similarities (although also some points of difference) between the part of clause 9(c) set out above and the provisions of clause 5.5(b) and (c).

The principal similarities are -

(i) the prohibition on the issue of proceedings connected with the name's obligation to make a payment until that obligation has been performed;
(ii) the postponement of the accrual of any cause of action connected with the obligation until the obligation has been performed; and
(iii) the prohibition on the name seeking injunctive or other relief preventing enforcement of the obligation.

In *Arbuthnot* Saville J and the Court of Appeal held that the purpose of clause 9(c) was to supplement clause 9(b) and ensure that agents' calls on names were met promptly, so as to enable claims to be met promptly. They rejected the agents' argument that clause 9(c) went further and extended to claims against the agents for

breach of duty since (as it was argued) "the loss and damage claimed relate directly to and are founded upon the cash requirements made upon the names for purposes of the underwriting business" ([1995] CLC at p.1398 G-H).

In this court the Master of the Rolls was influenced (p.1399 G) by the care with which the draftsman had defined the name's rights of suit which were to be postponed. The evident purpose of the clause was to ensure that funds were available for the prompt settlement of valid claims. The Master of the Rolls said (p.1400 A-B),

> "But that need does not require that names should forego all rights to complain of negligent underwriting while there are still calls outstanding or unpaid. There is no necessary connection between foregoing rights to challenge requirements until payment has been made and foregoing rights to complain of negligent underwriting not involving a challenge (on grounds of procedure or substance) to the requirement, and far from seeking to link them the text of the subclause is on my reading of it clear in its intention to treat them separately by directing its prohibition to the former situation and not the latter. I am fortified in my preference for the names' construction by the recognition that the agents' would, as I think, deprive the names of valuable rights without doing so clearly or for any obvious reason, would in certain situations work severe hardship to the names without corresponding benefit to the market and would give rise to offensive anomalies."

Steyn LJ noted (pp 1400 H - 1401 A) that counsel for the agents

> "emphasised that the fact of cash calls, and the payments made by names pursuant to the cash calls, must necessarily be part of the evidential material which will be placed before the court in aid of the quantification of the names' losses. That may be right. But the very deployment of such evidence by the names will presuppose the acceptance by the names of the validity of the cash calls."

Hoffmann LJ said (p.1403 E) that the clause's references to connections must be limited to those which were relevant to the purpose in hand. He continued (p.1404 A - C),

> "On this view, the proceedings brought by the names do not fall within (c). They are not calculated to challenge, invalidate or block the enforcement of the cash calls. The names acknowledge their liability in respect of those which remain unpaid. In some cases at least, the reason for non-payment is that they have no more money. But they wish to pursue claims for negligence by the agents in the conduct of the underwriting business. In my judgment these claims are not for the purpose of cl. 9 'connected with' the cash calls. The whole purpose of the clause in making the cash call an autonomous obligation is to ensure that there is no such connection.
>
> It seems to me legitimate to test the plausibility of a given construction by examining what the consequences would be. The construction for which the agents contend means that if they are going to be negligent, they should rather ruin their names entirely than leave them with enough resources to pay their calls. In the latter case they will be exposed to an action for negligence whereas in the former case they will be immune."

In *Leighs* the appellants in this court were non-accepting names whom Colman J had held to be bound by the R&R Plan and the "pay now, sue later" clause in the reinsurance contract. Many of the points considered by this court in *Leighs* do not arise on this appeal. But the sections of the judgment headed "Set-off etc" and "Stay of Execution" ([1997] CLC pp. 1406-10) contain some relevant passages. The court first rejected various arguments for a restrictive interpretation of clause 5.5. Then (p. 1408 C - H) it rejected the names' argument that their claims for damages for fraud should properly be regarded as a "pure" defence transcending the words in clause 5.5 "any set-off, counterclaim or other deduction on any account whatsoever" In the context of an application for a stay of execution the court said (p.1409 D),

> "Whilst it is agreed that the clause cannot oust the court's jurisdiction, it has potent effect. The insulation of the set-off and counterclaim was

> intended to achieve the speedy discharge of the indebtedness, which intention would be avoided and the whole function of the clause subverted by a stay of execution."

At the hearing of this appeal leading counsel for Lloyd's relied on clause 5.5 (b) and (c). He conceded that the presentation of a bankruptcy petition is not enforcement of a judgment: see *Re International Tin Council* [1987] Ch 419, 454 (Millett J) [1988] 3 AER 257, 359, 362-4 (Court of Appeal) and the earlier cases there cited. Bankruptcy leads not to the discharge of the debt owed to the petitioning creditor but to the administration of the debtor's assets for the discharge (so far as possible) of all the debts provable in his bankruptcy, after meeting the costs of the bankruptcy.

In his submissions on clause 5.5 (b) and (c) leading counsel for Lloyd's argued that it was the wrong approach to look at the position as it would be if Mr Garrow had been adjudicated bankrupt, when any contractual bar on mutual set off would be overridden by statute (see s.323 of the Insolvency Act 1986 and, under the old law, *National Westminster Bank v Halesowen Presswork & Assemblies* [1972] AC 785). Leading counsel for Mr Garrow, while referring to s.323 and *Halesowen* in the respondent's notice and in his written submissions, relied primarily on Colman J's description of clause 5.5 ([1997] CLC at pp.1032 H - 1033 A) as "a clause directed to nothing more than the procedural insulation of one class of claim" (so repeating the insulation metaphor used in *Arbuthnot*).

As he developed his argument in his oral submissions (and especially in his reply) leading counsel for Lloyd's relied strongly on this court's rejection in *Arbuthnot* of the 'pure defence' argument ([1997] CLC at p.1408), submitting that Mr Garrow's counsel was running essentially the same point in different clothing. I cannot accept that submission. Mr Garrow has made plain through his counsel that he does not (at any rate short of the House of Lords, if *Jaffray* were to go that far) challenge his liability for the reinsurance premium. He asserts that he has a genuine and serious counterclaim of sufficient size to enable him to ask the bankruptcy court to exercise its discretion to set aside the statutory demand served by Lloyd's. The real issue is whether the "procedural insulation" achieved by clause 5.5, fairly construed in accordance with the principles stated in *Arbuthnot* and *Leighs*, prevents him from doing so.

I do not consider that clause 5.5 has that effect, for reasons essentially the same as those given by this court in *Arbuthnot*. On the assumption that Mr Garrow's application to set aside the statutory demand amounted to the issue of proceedings and the assertion of a cause of action, it was not in my judgment "in connection with his obligation to pay his name's premium" within the meaning of clause 5.5(b). All the passages in *Arbuthnot* which I have already cited support that conclusion, with the exception of the Master of the Rolls' reliance ([1995] CLC at p.1399 G) on the careful enumeration of the restricted rights of suit. But that point cannot be determinative. All the other citations emphasise the need for a purposive construction of the vague phrase "in connection with".

Leading counsel for Lloyd's also relied on clause 5.5(c), pointing out that it refers to the enforcement of an obligation (rather than a judgment). But Lloyd's is a judgment creditor and Mr Garrow's original contractual obligation has been transformed into a judgment debt. In the circumstances of this case clause 5.5(c) adds nothing to clause 5.5(a).

In my judgment, therefore, the appellant's reliance on clause 5.5 fails as a matter of construction and it is unnecessary to consider whether (had the clause expressly referred to setting up a cross-claim of any sort in opposition to a statutory demand) the judge should have exercised his discretion so as to override a contractual provision inconsistent with the general scheme and policy of the bankruptcy legislation. That is a hypothetical question on which the court did not hear full argument and it is better to say no more about it.

The submissions made to the judge in relation to clause 5.5 seem to have been different from those advanced in this court and it is unnecessary to comment on the judge's reasons for rejecting them (apart from noting that what the judge said about the funding of the *Jaffray* action, whether or not wholly correct, seems not to have been central to the exercise of his discretion). If and so far as the judge did take account of any irrelevant matters in the exercise of his discretion, I would not arrive at any different conclusion in the exercise of a fresh discretion. The substance of the judge's conclusion was that he should apply what he called the general rule and that

the application of the general rule led to the setting aside of the statutory demand. I consider that the judge was correct in that conclusion and I would dismiss this appeal.

Lord Justice Brooke : I agree

Lord Justice Morritt : I also agree