JUDGMENT OF SHERIFF PRINCIPAL EDWARD F BOWEN QC EDINBURGH, 17 OCTOBER 2007

The Sheriff Principal, having resumed consideration of the cause, refuses the appeal and adheres to the Sheriff's interlocutor dated 18 April 2007; finds the appellants liable to the petitioners in the expenses of the appeal and remits the account thereof when lodged to the Auditor of Court to tax and to report thereon; remits to the Sheriff to proceed as accords.

1. In this case the petitioners (who are respondents in the appeal) brought a petition for an order to wind up the appellants, (who were formerly Brown Homes Ltd) founding in particular on section 122(1)(f) of the Insolvency Act 1986. By interlocutor dated 18 April 2007 the Sheriff dismissed the petition, finding the appellants liable to the petitioners in expenses. The present appeal is directed only to the Sheriff's award of expenses. I am satisfied that a question of principle arises and that accordingly the appeal ought to be entertained.

2. In 2001 the parties entered into a contract for the construction of a housing development at Callendar. The appellants were the employers and the petitioners were the main contractors. The contract is in the SBCC Scottish Building Contract with quantities (January 2000) form. It is not disputed that before any monies can become due for payment under the contract a payment certificate must be issued by the named architect.

3. Title to bring a petition for the winding up of a company is conferred by section 124(1) of the 1986 Act. It provides that *"...an application to the court for the winding up of a company shall be by petition presented either by the company, or the directors, or by any creditor or creditors (including any contingent or prospective creditor or creditors),..."*. In the petition the petitioners aver that they are contingent creditors of the appellants "*in that no final account has been agreed in respect of the building contract between the petitioners and the respondents and no final certificate has been issued by the architect*". This appeal raises the question of whether the petitioners are correct in contending that they are "contingent creditors" of the appellants.

4. From the terms of the pleadings and the submissions made on behalf of parties at the appeal it appears that the petitioners have maintained for some time that they are due certain additional sums in relation to the works carried out under the contract, notwithstanding that these have not been the subject of certification. On 21 September 2005 the petitioners served a Notice of Adjudication, seeking that the Adjudicator make an order for payment to them of the sum of £111,006.56. This Adjudication was met by a letter from the appellants' solicitor dated 13 December 2005. The terms of that letter were the subject of some discussion both before the Sheriff and in the course of the appeal. They are as follows:

   "Brown Homes Limited Hadden Construction Limited.

   I refer to the above matter and can confirm that I have now obtained my clients' instructions. You have already been provided with a copy of Brown Homes latest accounts for the year ended 31 March 2005. The position has not improved since that time. Accordingly the directors could place the company in liquidation. For PR reasons they are reluctant to do so. In these circumstances they have been making sufficient funds available to meet the company's debts as they fall due. In relation to your client's claim my clients are of the view that it is entirely unfounded and will fail as did your clients' previous claim. Accordingly, my clients deny that your clients are a creditor of Brown Homes and any attempt to pursue the claim will be defended. In the unlikely event that any award is obtained against Brown Homes in respect of that claim, I am advised that the company will be unable to meet the award and, at that stage, liquidation will become inevitable".

5. It is accepted that following this letter the petitioners did not proceed further with the Adjudication but raised the present petition. Following sundry procedure, the matter called for debate, for the second time, (the first diet having fallen due to lack of court time) on 18 January 2007. By this stage the appellants had produced accounts for the period to 31 December 2005 which showed that they were not balance sheet insolvent. In the light of that the petitioners did not seek to proceed with the petition, which was dismissed. They sought, however, an award of expenses on the basis that they had been justified in bringing the petition. The appellants resisted the request for expenses on the basis that the petition had been misconceived, in particular because the petitioners did not have title to present it.

6. The Sheriff's decision to award expenses to the petitioners was based on the following considerations. First, she rejected, in emphatic terms, a suggestion that the petitioners ought to have known from a perusal of the appellants' management accounts for the period for nine months to 31 December 2005 that there was no basis for the suggestion that the appellants were unable to pay their debts. She observed that these accounts were not introduced into the appellants' averments until 20 September 2006. She said: "*In my opinion it was reasonable for the petitioners to rely upon the clear and unambiguous representations made by the respondents' agents in December 2005 that the respondents were insolvent. It was only on the eve of this debate that accounts upon which third parties might rely were produced in which a different picture was painted. In these circumstances it would seem equitable that the respondents meet the expenses incurred to date".*

7. The Sheriff then dealt with the submission presented to her that the petitioners were not "contingent creditors" of the appellants within the meaning of section 124 of the 1986 Act. In this respect she made the following observations in terms of numbered paragraphs of her Note. These are:

   "15. Whatever may be the view of the respondents, whether any further sums are due to the petitioners under the contract is a question to be determined by architects who have been appointed for the purpose. Until a final certificate is issued by them it remains possible that further sums may be certified as due to the petitioner.

   16. It was accepted that a contingent debt is a debt which will become enforceable only on the occurrence of an event which may or may not happen. The respondents maintain that there is no underlying obligation between the parties

and accordingly there can be no contingent liability. However it seems to me that the circumstances of the contract between the parties particularly where no final certificate has been issued mean that there are continuing obligations between the parties and the potential for further liabilities.

17. *In the case of* ***Costain Building and Civil Engineering Limited v Scottish Rugby Union PLC*** *1993 SC 650 to which I was referred parties had entered into a building contract in terms of which payment to the contractors was dependent upon certification by engineers appointed by the employers. No certificate had been issued and accordingly there was no immediate liability for payment. The sum claimed was conditional upon being certified as being due by the engineers. Arrestment in security in these circumstances was incompetent.*
18. *In my opinion there is a striking similarity with the circumstances of the present case. The parties entered into a building contract in terms of which payment to the contractors is dependent upon certification by architects employed appointed by the employers. The contractors have submitted a claim for payment. The architects have not yet issued a final certificate. If the architects certify that further sums are due to the contractors the employer will be under an obligation to make payment. I consider that counsel for the respondents is wrong in suggesting, as he did, that there would be no underlying obligation upon the respondents unless and until the claim was certified by the architects. Once the architects have certified that a sum is due to the contractors the debt is certain and enforceable. Until that stage the debt is future and contingent."*

The Sheriff went on to say that following the reasoning in ***Costain*** it appeared to her that the petitioners were contingent creditors of the appellants.

8. In broad outline the appellants contend that the Sheriff erred in law in holding that the petitioners were contingent creditors of the respondents for the purposes of section 124 of the 1986 Act, and further had erred in holding that there was a "*clear and unambiguous*" representation of insolvency in the letter of 13 December 2005.

9. In relation to the first of these matters counsel contended that a contingent creditor was someone to whom a contingent debt is owed. For a contingent debt to exist, there must be an existing obligation between the creditor and debtor, which will only become enforceable on the occurrence of an event which may or may not happen (Gloag on Contract 2nd Ed page 272; Bell Principles 10th Ed paragraph 47; Bell Commentaries (7th Ed) Vol 1 page 332). If, however, there is no underlying obligation there can be no contingent liability.

10. Counsel founded on the case of ***Walter L Jacob & Co v The Financial Intermediaries Managers and Brokers Recoglatory Association*** 1988 SCLR 184. In that case a petition was brought under section 122 of the 1986 Act, the right to petition being based on an assertion that the petitioners had raised an action in the High Court in London seeking damages for £25m from the respondents. It was contended that this made them contingent creditors. In dealing with the matter the Sheriff noted that the solicitor for the petitioners "*was obliged to concede that his position was effectively that a debt may arise in favour of the petitioners against the respondents if the action in the High Court in England was successful"*. He rejected the view that this made them contingent creditors. That, counsel contended, was exactly the same as the present case. A person could only be regarded as a contingent creditor where there is no dispute as to the existence of the underlying obligation which may be purified by the occurrence of the uncertain future event.

11. A petition for winding up is intended to be a summary procedure and it was well recognised that it is not a suitable opportunity in which to assess competing versions of facts. Thus in ***Stonegate Securities v Gregory*** 1981 Ch 576 Lord Justice Buckley (at page 587C) said: "*The whole doctrine of this part of the law is based upon the view that winding up proceedings are not suitable proceedings in which to determine a genuine dispute about whether the company does or does not owe the sum in question; and equally I think it must be true that winding up proceedings are not suitable proceedings in which to determine whether that liability is an immediate liability or only a perspective of contingent liability"*. If a petition for liquidation was not the appropriate form of proceedings in which to determine whether a present debt was truly due or not, it followed a fortiori that it was not appropriate for determining whether a contingent debt existed or not. The petitioner had accepted, in a Note of Argument for debate, that they may ultimately be due no further payment from the appellants. There was plainly a dispute between the parties and in these circumstances it could not be said that the petitioners were contingent creditors for the purposes of section 124 of the 1986 Act.

12. Counsel turned to the case of ***Costain.*** He observed that whilst the contractual arrangements between the parties may have been similar to the present circumstances the case was in no sense authority for the proposition that those in the position of the petitioners were contingent creditors for the purposes of section 124. The case was concerned with the circumstances in which it was appropriate to allow arrestment on the dependence of an action. It did not address the definition of "*contingent creditor*". The court had proceeded on the basis that the pursuers' averments required to be treated pro veritate and that an existing contractual obligation did exist.

13. That, maintained counsel was sufficient to enable him to succeed. The petitioners had no title to bring the present petition and should not have been awarded the expenses of it. Although accepting that it was very much a subsidiary argument he maintained that the Sheriff was not justified in observing that the appellants' agents had represented their clients as being insolvent. All that the letter of 13 December 2005 did was to indicate that they would be unable to pay a disputed debt if it became due following the occurrence of an uncertain event. For the purposes of proceeding with a winding up petition it was necessary to show that the company is unable to pay its debts.

14. The solicitor for the petitioners commenced his submissions by indicating that a much more detailed submission had been presented on behalf of the appellants than had been advanced on their behalf before the Sheriff. The Court should be slow to entertain the appeal and in particular should not entertain any arguments which had not been placed before the Sheriff. There had been no obvious miscarriage of justice and the decision on expenses was a matter within the Sheriff's discretion.

15. There were two essential questions, the first was whether there was a contingent debt upon which the respondents were entitled to found; the second was whether the appellant company was insolvent. On the subject of the existence of a contingent debt the petitioners' solicitor founded on the case of ***Costain,*** in particular on the remarks of the Lord President at page 582E, and in a passage of the Opinion of Lord McCluskey at 584A which is in the following terms: "*At the present time there is no debt. It may well be that at some stage, following the conclusion of such parts of the arbitration process as the parties invoke, that a debt will emerge one way or the other. Undoubtedly, therefore, there is a contingency: one party or the other may be able to demonstrate to the Arbitrator that one or more of the engineers' certificates is or are defective, by reason, for example, of being overgenerous or unduly mean. But, at this stage, any possibility of a net debt arising out of that must be regarded as contingent"*. In the present case the contingency depended on the issue of a certificate by the architect. The architect was in the employment of the appellants. It was within their power to have the certificate issued. If their position, in good faith, was that there was no debt they had it within their power to put that beyond doubt by arranging for the issue of a final certificate.

16. On the question of insolvency the respondents had been entitled to found on the appellants' agents letter of 13 December 2005. That said in terms that the company could not meet its debts as they were being paid by Directors as they fell due. In these circumstances there could be no question that the petitioners had title to bring the petition.

DISCUSSION

17. This case, in my judgment, is distinguishable from ***Walter M Jacob*** which was on any view a somewhat extreme one. The "*claim*" upon which the liquidation petition was founded in ***Jacob*** was no more than that - it was a claim for damages, apparently for libel, and until it was established no obligation of any nature existed. In that situation the Sheriff was able to hold that the petitioners were not contingent or prospective creditors. He took as the definition of "*contingent creditor"* that contained in the case of ***Re William Hockley Ltd*** 1962 1WLR 555 that is: *"A person towards whom under an existing obligation the company may or will become subject to a present liability on the happening of some future event or at some future date"* (<u>*Pennycuick J*</u> at 585).

18. The view that a person claiming unliquidated damages who has not obtained judgment is not a creditor for the purposes of presenting a petition for liquidation appears to be consistent with certain English authority (see Palmer's Company Law, paragraph 15.226.1). However, the note to that paragraph suggests that the subject is not free from controversy. The authors also observe in the paragraph itself that the term "contingent or prospective" creditor might "possibly" include persons claiming unliquidated damages.

19. It is tempting to say that there is no difference between the present case and that of ***Jacob*** in that the prospects of a debt arising is at best a possibility as it was in *Jacob.* But the present dispute arises against a background of work done under an existing contract, the issue being whether that work and the contractual terms governing it give rise to an additional entitlement of payment as well as damages. In my view a claim of that nature falls to be regarded as a contingent claim.

20. I accept counsel for the appellants' submission that the case of ***Costain*** is not direct authority on the question of what constitutes a contingent claim <u>for the purposes of liquidation proceedings</u> since the question before the Court was whether the pursuers' claims were of a nature which gave rise to the right to arrest on the dependence of the action. It was, nevertheless, necessary for the Court to categorise the claim and the petitioners' solicitor was justified, in my view, in founding on the passage in the Opinion of the Lord President at page 582E where his Lordship says: "Where a contract provides for payment for work done on the issuing of a certificate by an engineer or architect, the issue of a certificate is a condition precedent to the contractors' right to demand payment. A claim which is of that kind is a contingent claim because the debt is not due until the certificate has been issued". The present petitioners were on that view entitled to assert that they were contingent creditors.

21. What is equally clear in law is that a petition for liquidation is not regarded as the appropriate means by which to resolve a substantial dispute between parties as to whether a debt is owed or not (see for example, the acceptance of that position noted by Lady Smith in ***Baker Hughes Limited and Baker Hughes Inteq France SA*** 2005 SCLR 1084 at 1086A). That applies whether the debt is said to be present or contingent, although in many cases it may well be said to lie in the latter category.

22. Where I consider there may be room for confusion is in the introduction of the concept of "*title to sue"* into the situation of a creditor petitioning on the basis of a contingent debt. The argument presented before me proceeded under the banner of an attack on title, as it did before the sheriff. It is also to be noted that in ***Jacob*** the Sheriff said: *"I have concluded that the present petitioners have no title to present the petition as they have not established that they are properly to be considered contingent or prospective creditors*". Similarly in ***Baker Hughes*** *(supra)* Lady Smith said (at 1087A): *"If the debt claimed is disputed in good faith and on real and substantial grounds, then the petitioners cannot satisfy the statutory requirement that they be a creditor so as to have title to sue in a petition for winding up"*.

23. It is understandable that the issue should be approached as one of "title" bearing in mind that section 124(1) of the 1986 Act uses the term "contingent creditor", as distinct from "person holding a contingent debt". In order to apply the rule that a petition for liquidation "*will not be entertained*" if the debt is disputed on substantial grounds, the courts appear to have taken the approach that where there is such a dispute the petitioner will not be regarded as qualified as a creditor for the purposes of section 124(1). Whether that is to be regarded as undermining his title, or simply removing a qualification, is open to debate, and it may be, curiously, that as a matter of law a person who is a "*contingent creditor*" in the normal sense may not be a contingent creditor for the purposes of section 124(1).

24. Be that as it may the real question in any proceedings is whether the debt founded on is the subject of a substantial dispute; if it is, the court may conclude that the petitioning creditor cannot be said to have a qualifying right to insist on the summary remedy of liquidation. In extreme cases the petition will be regarded as an abuse of process (eg ***Baker Hughes***); in other cases it will be dismissed (eg ***Jacob***). There are, however, indications in certain of the English authorities that the court will at least consider an application to stay the proceedings whilst the issue over the debt is resolved elsewhere, an approach which in itself tends to suggest that this is not truly an issue of title.

25. It follows that the argument before the Sheriff ought to have focussed on the nature of the dispute and whether it was genuine and substantial. That issue appears to me to have been addressed only obliquely. The Sheriff records that "*it was submitted that it was an abuse of process where a claim was disputed to seek to put a company into liquidation. In an action for debt it would not be competent to do diligence on the dependence where the debt was a contingent one*". There is passing reference to ***Baker Hughes***. The Sheriff's decision is primarily based upon the view that the petitioners' debt was contingent in the general sense and does not embrace the question of whether it fell to be regarded as qualifying the respondents as contingent creditors for the purposes of section 124(1). That, of course, is hardly surprising given the argument presented to the Sheriff.

26. It is well recognised that an appellate court will not alter the decision on a question of expenses on the basis of a point which was not argued at first instance (***Aird v School Board of Tarbert*** 1907 SC 22). This cannot be said to be a case in which the essential issue was not embraced in the argument before the Sheriff, but the limited focus of the discussion before her leaves me reluctant to intervene. I consider, however, that there are further reasons for not allowing this appeal. It is, I accept, open to debate whether the letter of 13 December 2005 truly contained a representation that the appellants were insolvent. I can see force in the argument that it represented no more than a contention that they would be unable to pay anything to the petitioners should their debt be established. However, standing the terms of that letter, it is difficult to see what action the present respondents could have taken other than to present a petition for liquidation. What they had been told was that there was no point in proceeding with any other form of process for recovery of the debt, which they maintained was due, because they would not be able to recover it. Put another way that meant that there were no funds available to meet the petitioners' debt which, on their argument, was due immediately.

27. In that situation it could not be said to be an unreasonable exercise of the Sheriff's discretion to arrive at the conclusion that the present respondents were justified in bringing the petition and that it was not until late disclosure of the appellants' financial position that it became clear that the petition could not proceed. In all these circumstances, despite an attractive and forceful argument presented by counsel for the appellants, the situation is not one in which I am prepared to interfere.

Act: Malone, Solicitor, Bell & Scott
Alt: McColl, Advocate, instructed by McRoberts