JUDGMENT : Mr Justice PETER SMITH: Chancery Division. 26th February 2003.

INTRODUCTION

1. This is the hearing of an application by Lomax Leisure Limited (the "Company") for an Order pursuant to CPR part 24, that the Defendant is liable to indemnify it in relation to a claim made against it by Marpaul (Southern) Limited ("Marpaul"). The relief sought is for declarations as to liability only. If successful, the quantum of such indemnity would be sought to be determined on a separate occasion.

2. The issue raises a point of construction of an agreement (the "Agreement") being an asset sale agreement dated 13 May 1999 and made between the (1) the Company, (2) Nicholas John Miller (the Company's Administrator appointed pursuant to section 8 Insolvency Act 1986) (3) the Defendant (then known as Stylecrown Limited) and (4) Keith Reilly (who was a director of both the Company and the Defendant).

BACKGROUND

3. The Company was formed to acquire the lease (the "Lease") of premises at 66/67, and 77A Charterhouse Street, London, EC I (the "Property"). The acquisition was with the view to fitting out and developing the same as a nightclub. For these purposes in or about 5 May 1998 it entered into a building contract (the "Building Contract") with Marpaul who was engaged as contractor to carry out the construction work for the development.

4. Thereafter, various problems arose. First, disputes arose between the Company and Marpaul. On 8 February 1999 Marpaul entered into a Company Voluntary Arrangement ("CVA"). As a consequence of the CVA and pursuant to clause 27.3.4 of the Building Contract on 11 February 1999 the Company terminated Marpaul's employment. It is suggested by Mr Shaw who appears for the Company, that the effect of that was not to terminate the Building Contract.

5. That to my mind is not a correct analysis. It should be noted that the termination under 27.3.4 is not a termination upon ***preach.*** It is an exercise of a right to terminate the contract on account of the insolvency of, in this case Marpaul.

6. Once that notice is validly served the Building Contract is terminated and the only matters that are then left outstanding are the secondary consequences. Under clause 27.5 the Company's employer is no longer obligated to make any payment and Marpaul as contractor is no longer bound to continue to carry out and complete the work. What happens then is that the value of the works being carried out by Marpaul before the termination are valued and if the value of the works exceeds the payments made, Marpaul is entitled to a payment. Against that if the costs of finishing the Building Contract by another contractor is greater than the amounts that would have been payable to Marpaul, had the Building Contract not been terminated, that sum is claimable from Marpaul or can be used to reduce any amount due to Marpaul in valuing the works it had carried out before the termination.

7. Finally, clause 27.8 preserves all other remedies available to the contractor.

8. It seems to me therefore, self evident that the Building Contract was terminated subject to finalising the account (assuming the notice on 11 February 1999 was valid).

9. In March 1999 the Company engaged substitute contractors Blenheim House Contractors ("Blenheim") to complete the development: On 14 April 1999 Rat Holdings Limited ("Rat") the landlord of the Property peaceably re-entered there being substantial arrears of rent then outstanding as well as a number of breaches of covenant.

10. Neuberger J. made an Administration Order in respect of the Company on 22 April 1999, the judgment being reported at [I999] 3 *All ER 22.* He held that if the Company was able to obtain relief from forfeiture it would have a valuable asset, namely the Lease, and would have the opportunity of continuing the Building Contract with Blenheim. The granting of an Administration Order would give the Company breathing space with which to agree to assign the Lease with the benefit of the Building Contact as a result of which there would be a substantial sum to realise for the benefit of creditors.

11. Following the making of the Administration Order, Mr Miller entered into negotiation with a number of interested parties, with a view to disposing of the Company's assets. This culminated in the Agreement between the Company and the Defendant. It was formed by Mr Reilly (who was a director and

shareholder of the Company) with the support of a Mr Munding (who was a director of Rat and a shareholder of the Company). The dispute between the parties primarily is in respect of the terms of the Agreement.

12. Following the Agreement the Company entered into a members' voluntary liquidation. A statutory declaration of solvency was sworn which will not survive critical examination. This has an impact on the Agreement and the rationale behind it, Mr Shaw submits on behalf of the Company.

SUBSEQUENT DISPUTE BETWEEN THE COMPANY AND MARPAUL

13. As a result of the liquidation, Marpaul submitted a claim in September 1999, which was then referred to an Arbitration pursuant to the Building Contract in which it sought £727,309.00 (Seven Hundred and Twenty-seven Thousand, Three Hundred and Nine Pounds). The Company also counterclaimed. The Arbitrator made three Awards. All of these Awards postdated the Agreement.

14. In the first Award he held that Marpaul were entitled to an extension of time of 16 weeks (which was 8 weeks more than allowed by the Company) and the purported termination of the Building Contract by Marpaul on 8 February 1999 was invalid, but that the Company directly determined Marpaul's employment under the Building Contact by the notice referred to above on 11 February 1999.

15. In the second Award he held that Marpaul were entitled to payment of a further sum of £130,486.83 (One Hundred and Thirty Thousand, Four Hundred and Eighty-six Pounds and Eighty-three pence) from the Company. He also held the Company was obliged to reimburse Marpaul its one half share of the adjudicators fee which sum was £2,382.50 (Two Thousand, Three Hundred and Eighty-two Pounds and Fifty Pence) (net of VAT). This amount is due to Marpaul based on a valuation of the works carried out by it to the date of termination but for which it had not by then been paid.

16. In the third Award, he held that Marpaul had not repudiated the Building Contract, that the Company was entitled to £40,980.00 (Forty Thousand, Nine Hundred and Eighty Pounds) from Marpaul in respect of matters arising out of the termination of its employment and that such sum was to be set off against the Award in favour of Marpaul. This latter claim arises out of the extra costs of finishing the Building Contract. This represented a substantial defeat for the Company. Under head 4 for example, (loss of value due to non completion) it sought £1,737,632.00 (One Million, Seven Hundred and Thirty-seven Thousand, Six Hundred and Thirty-two Pounds). It is of course difficult to see how any effective recovery could have been made given the insolvency of Marpaul.

17. The costs of the final Arbitration are yet to be determined. However, the Company's expenses including liquidator's costs, fees and expenses are stated to be at least £592,346.23 (Five Hundred and Ninety-two Thousand, Three Hundred and Forty-six Pounds and Twenty-three Pence) in resisting Marpaul's claim. I suspect (although this is a matter for any assessment) that the bulk of those costs were actually incurred in the failed claim for loss occasioned by the failure to complete. The other claims are relatively modest.

18. Thus, the Company is faced with a net Award against it of £91,888.73 (Ninety-one Thousand, Eight Hundred and Eighty-eight Pounds and Seventy-three Pence), a prospective claim for costs by Marpaul and its own expenses of at least £592,346.23 (Five Hundred and Ninety-two Thousand, THree Hundred and Forty-six Pounds and Twenty-three pence). It seeks to establish as a matter of principle the liability of the Defendant to indemnify it in respect of these potential liabilities. Mr Shaw concedes that in so far as any costs are due to the Counterclaim of the Company, they cannot properly be claimed on the indemnity.

19. This claim for the indemnity arises under the terms of the Agreement to which I shall now make reference. I refer to the recitals.

20. Recital (6) recites that the Company "has entered into a building contract with Marpaul", but the same had not yet been completed. Recital (7) recited that it "engaged Fothergill & Co Quantity Surveyors, to provide services to it in connection with the Building Contract ("the QS Contract")".

21. Recital (8) recites that creditors connected with the Defendant being those listed in part 2 of schedule 1 have agreed to wave their entitlement to receive repayment of sums lent by them to the Company in the manner set out.

22. Clause 1 is an interpretation clause with a number of relevant provisions. First "the Assignment" is defined as the Legal Rights in the form set out in schedule 3. The Assignment was an Assignment of all rights to apply for relief against forfeiture. In the events that have happened as I understand it that application enabled the Defendant to obtained a new lease of the premises and the nightclub has opened and traded successfully.

23. *"**The Assets**"* are defined as the assets agreed to be sold by the Company to the Defendant.

24. *"**The Contracts**"* means the benefit (subject always to the burden) of the Building contact and all other contracts orders and engagements (other than contracts of employment with employees of the Vendor) entered into by the Vendor prior to the Transfer Date which then remain to be performed in whole or in part".

25. There is an immediate difficulty about that. As I have already observed, the Building Contract, which is expressly referred to, had already ended 3 months before the Agreement. That was of course a matter of dispute, but the dispute was not over whether or not the agreement had ended, but how the agreement had ended. The reason for that, is that when one examines the matters raised in the Arbitration, neither side was suggesting that the Building Contract was in force but the arguments were that it had terminated either by acceptance or repudiatory breach or termination consequent upon insolvency of Marpaul. All that was left therefore in the Building Contact was a netting of liabilities consequent upon the termination or potential damages. Of course the Defendant obtains the benefit of the fruits of the Building Contact because it obtains the building together with the right to apply for relief against forfeiture. That might reflect the amount of money already expended by the Company, but the clear wording of the definition of the contracts shows that there was a potential obligation assumed by the Defendant.

26. Mr Croall, who appears for the Defendant, submits that the key words are those *"**which then remain to be performed in whole or in part**"*. *His* submission therefore is that as the Building Contract had been terminated by the Company's notice there were no obligations, which remained to be performed in whole or in part so there was no significance in the reference to the Building Contract.

27. This seems to me to be totally at variance with the commercial purpose behind the Agreement. The object of the Agreement (and the Defendant's self evident desire) was to obtain the benefit of the Building Contract. It did not under the terms of the Agreement acquire assets. It could have been drawn that way but it was not. Under the recital it has obtained the benefit and burden of the Building Contract expressly.

28. As at the date of the Agreement, the outstanding liabilities under the Building Contract remain to be resolved. Parts of those obligations involve the secondary obligations, which arise in consequence of termination or payment of damages consequent upon acceptance of repudiatory breach. It seems to me that by the definition of the contracts any obligations which arise under the Building Contract that remain to be performed including those are the subject matter of the Agreement. I therefore reject Mr Croall's submission as to the effect of this definition. The result is that the Defendant takes the risk of any liabilities, which arise under the Building Contract.

29. Now that might expose it to claims, but that is not necessarily contrary to what the parties intended. As I shall set out below the desire on the part of Mr Miller was to transfer assets and to secure sufficient sums by that to pay off the creditors of the Company. The desire of the Defendant was to obtain the benefit of the works. If the costs of those works, when all the obligations under the Building Contract are finally determined, it is not unreasonable that it also assumes a liability to discharge those obligations. It has obtained the benefit of those works.

30. It follows therefore that it is not unreasonable to my mind for it to be liable to indemnify under the clause which I shall set out below in respect of the balance sum due to Marpaul for the works that it has carried out. The benefit of those works has been transferred to the Defendant. The costs to my mind are an entirely different issue, as I shall set out further in this Judgment.

31. Continuing with the definitions "the Reserved Contracts" are defined as "the Building Contract and the QS Contract or either of them".

32. Those to my mind are the provisions in relation to the working out of any liabilities, as I shall set out below.

33. Under clause 2.1 the Company sold and the Defendant bought such right, title and interest as the Company might have in the legal rights and the contracts. Under the definition to which I have made reference above that includes expressly the benefit and burden of the Building Contract.

34. The price paid under clause 3.3 was £983,780.65 (Nine Hundred and Eighty-three Thousand, Seven Hundred and Eighty Pounds and Sixty-five Pence) inclusive of VAT. The contracts were given a nominal apportionment price of £2.00 (Two Pounds). That does not reflect any attempt to place a value on those assets. It is simply the amount of the creditors claims as can be seen by the schedule attached to the Agreement, which has the same figure (less £2.77 (Two Pounds and Seventy seven Pence)).

35. Thus the object of the exercise was to transfer the assets and to secure sufficient sums to discharge the creditors as identified.

36. As an additional security in the form of a contingency sum of £200,000.00 (Two Hundred Thousand Pounds), was obtained to be applied for settlement of creditors (clause 5.1.2). Mr Reilly warranted that the aggregate amount of sums adjoined to the creditors as at the transfer date did not exceed the contingency sum and agreed to indemnify and keep the Company and Mr Miller indemnified against any breach by them of the breaches of this clause by payment on the demand of any amount of which the total of the amount exceeds the contingency sum. Now it follows from that, that it appears that the Company has a claim against Mr Reilly for any extra liability it has incurred to Marpaul over and above the stated creditors. No such claim has been intimated for reasons that were not explained. Further I have already observed Mr Reilly is a director and shareholder of the Defendant, but Mr Croall made it clear he did not appear for Mr Reilly in these proceedings.

37. The claim brought by the Company arises under clause 8, which I shall now set out. Clause 8.1 provides: *"The Purchaser shall carry out and complete the Contracts with effect from the Transfer Date for its own account and shall keep the Vendor and the Administrator indemnified against all actions claims costs proceedings and demands in respect of the Contracts and/or the Assets or made against or incurred by the Vendor and/or the Purchaser and/or the Administrator".*

38. Now there are some odd aspects to this clause. There was no prospect of the Purchaser carrying out and completing (for example) the Building Contract because it was terminated as I have said above. Further the Defendant never became a party to the Building Contract by novation or otherwise and was not in a position to carry out the completion of the works. Those were already being carried out by Blenheim, as I have set out above. This part of the clause does not appear at first sight to make sense.

39. Clause 8.3 provides: *"The Purchaser acknowledges that some or all of the Contracts may already have been breached or may be terminable upon the appointment of an Administrator of the Vendor. Accordingly the fact that the Purchaser may wish to continue any of the Contracts does not necessarily mean that the Purchaser can require any other party to the Contracts to continue with the Contracts either on the same terms or at all nor does it necessarily mean that rights of set off or counterclaim are not available to that other party against the Purchase. All risks inherent in all relating to the Contracts are for the Purchaser alone and the Purchaser shall not in any circumstances be entitled to any compensation or reduction of the price payable hereunder in whole or in part in respect thereof".*

40. Now that addresses the fact that the Company might have contracts terminated because of *its* administration and subsequent liquidation. It does not address the factual situation that appertains to the Building Contract, namely that the Company's case was that that contract had already effectively been terminated as regards Marpaul because of *Marpaul's CVA.*

41. Under clause 8.5 it is provided that: *"If any amounts shall be received by the Purchaser in respect of any overpayment made by the Vendor during the employment of Marpaul Southern Limited under the Building Contract the Purchaser shall forthwith on receipt of the same pay such sums to the Vendor".*

42. Now in the circumstances of the case set out above it is difficult to see under what basis the Defendant would ever receive any overpayment due to Marpaul.

43. Under clause 8.6 it is provided as follows: *"The Vendor shall be entitled at its own cost and expense to bring any claim and to have the conduct of any proceedings arising out of the Reserved Contracts and the Purchaser shall provide the Vendor with all such assistance as it may reasonably require for the purpose of enabling the Vendor to bring any such claim or commence any such proceedings. Any sums recovered pursuant to any such proceedings shall belong to the Vendor".*

44. Clause 8.7 provides *(inter alia) as follows: "The Purchaser shall inform the Vendor in writing of any event which comes to its notice whereby it appears that the Vendor is or is likely to become liable under the Reserve Contracts as soon as such event comes to the notice of the Purchaser. The Purchaser shall take such action and give such information and assistance in connection with the affairs of the Purchaser or as the Vendor may reasonably request in writing to avoid, dispute, resist, mitigate,* ***compromise, defend or appeal*** against any ***claim in respect thereof or*** any ***adjudication with respect thereto. ...".***

45. The Company's claim for an indemnity is under clause 8.1. Having already expressed a view as to the effect of the definition of the Contracts it seems to me that it is entitled to an indemnity for all actions, claims, costs, proceedings and demands "made against the Vendor". It seems to me self evident that the Marpaul claim is a claim made against it. It is entitled to the costs of defending a claim brought against it by Marpaul and any subsequent adjudication against it of a sum due to Marpaul.

46. There is a logic to this, which favours the Company's construction as the Defendant has obtained the benefit of the Building Contract as I have set out above.

47. The Company and the Defendant then agreed that any sums due under the Building Contract would belong to the Company. The Company had an obligation however to claim these sums at its cost and expense under clause 8.6.

48. As I have set out above, Marpaul sought to prove in the liquidation for the sums, which are ultimately determined at £130,000.00 (One Hundred and Thirty Thousand Pounds). It seems to me that the costs attributable ***solely*** to defending that are recoverable under clause 8.1. That extends to the primary liability also.

49. There is then a difficulty over the sums due arising out of the Counterclaim. The Counterclaim of course also operates as a set off. I cannot conceive of any possibility of the Company and the Defendant entering into an agreement whereby under clause 8.6 the Company would have to seek sums at its own cost if it sued, but if it was sued and sought to raise the same matters that it would be entitled to an indemnity under clause 8.1.

50. It seems to me that the dividing line is to be drawn between costs incurred in evaluating and defending Marpaul's claim, but not extending beyond any matters, which would form a set off in respect of a Counterclaim. I say that because of course if the set off operates the Company has the benefit of the fruits of the set off because the amount therefore provable in its liquidation by Marpaul is reduced thereby conferring the benefit to the other creditors as making a larger dividend available to them. The Counterclaim self evidently cannot to my mind be anything other than a cost and expense exercise assumed by the Company under clause 8.6. Anything else would lead to a nonsensical result. I cannot see how it would make commercial sense for the Defendant to agree to provide an indemnity for a counterclaim or claim where it has no interest in the result and all the proceeds go to the Company in any event.

51. It seems to me therefore, that under the terms of the Agreement the Defendant is bound to indemnify the Company under clause 8.1 in respect of its liability to Marpaul and any costs solely attributable to the Marpaul claim. However, it also seems to me that under the Agreement the Defendant is not liable to indemnify the Company in respect of any costs which are attributable to the Counterclaim it brought and including any part of those costs which were used as a set off against Marpaul's claim.

52. I accordingly determine that the Company is entitled to declaratory relief in respect of those items which I have adjudicated, it is entitled to an indemnity from the Defendant under clause 8.1, but not in respect of the items where I determine they are properly its liability under clause 8.b.

Mr Peter Shaw (instructed by Penningtons) for the Claimant
Mr Simon Croall (instructed by TNW Solicitors) for the Defendant : Hearing date: 7th February 2003