RYODEN ENGINEERING CO LTD & ANOR v PAUL Y CONSTRUCTION CO LTD - [1994] 2 HKC 578

HIGH COURT
KAPLAN J

CONSTRUCTION LIST NO 2 OF 1991

31 July 1994

Building and Construction -- Building contract -- Right of sub-contractor to payment under architect's certificate -- Whether sub-contractor's right to deduct liquidated damages subject to issuance of architect's certificate -- Whether contract had effect of excluding defendant's common law right of set-off

Civil Procedure -- Interlocutory proceedings -- Plaintiffs' application for summary judgment -- Defendants' application for striking out -- Plaintiffs entitled to summary judgment where defendants' defence is misconceived or unsustainable -- Defendants not entitled to refer dispute to arbitration if they had no arguable defence to plaintiffs' O 14 application -- Rules of the Supreme Court O 14

A building contract was entered into between the plaintiffs as sub-contractors and the defendants as main contractors. The plaintiffs claimed payment under certain architect's certificates. Firstly, the defendants argued that the plaintiffs delayed in the completion of their sub-contract works and that caused the defendants to be late in completing the main contract works and as a result, the employer deducted HK$4.7m liquidated damages from its payment to the defendants. The defendants contended that as they had not received the HK$4.7m from the employer, they were not obliged to pay the plaintiffs the sums they claimed, which were less than HK$4.7m.

Secondly, the defendants alleged that cl 8 of the building contract gave them the right to set off liquidated damages against the sums claimed by the plaintiffs. Clause 8 stipulated that if the plaintiffs failed to complete their works within a certain period, the plaintiffs should pay or allow the defendants to retain a sum equivalent to the resulting loss caused to the defendants, provided the architect had issued to the defendants a written certificate stating the period of time within which the plaintiffs ought reasonably to have completed the works.No such certificate was obtained by the defendants.

Thirdly, the defendants argued that the plaintiffs had failed to give the architect the submission he needed in considering whether the architect's certificate should be granted under cl 8. The defendants relied on the ex turpi causa doctrine and argued that the plaintiffs should not be allowed to take advantage of their own wrongdoing.

Fourthly, the defendants also argued that they had a common law right to set off liquidated damages against the plaintiffs' claim.

The plaintiffs sought to enter summary judgment against the defendants by relying on certificates 21-23. The defendants applied to stay the proceedings in favour of arbitration by reason of the arbitration clause contained in the building

contract under s 6 of the Arbitration Ordinance (Cap 341). The plaintiffs conceded that if their O 14 application failed, the stay would follow.

Held, granting the defendants unconditional leave to defend:

(1) If the court is satisfied that the plaintiffs are clearly right in law, and that the defendants have no arguable defence in an O 14 application, the defendants cannot be heard to say that there was a dispute to be referred to arbitration.
(2) A plaintiff is entitled to a summary judgment where the defendant's only suggested defence is a point of law which the court can see is misconceived, or which is shown by relatively short argument to be plainly unsustainable.
(3) The ex turpi causa principle had no bearing here. There was no suggestion of illegality nor of immorality such that it would be an affront to justice to give judgment to the plaintiffs. *Euro-Diam v Bathurst* 1988 2 All ER 23 applied.
(4) It was a condition precedent to the deduction of liquidated damages against the plaintiffs that the architect should have certified under the provisions of cl 8 that the subcontract works 'ought reasonably to have been completed within the specified period or in any extended period or periods as the case may be'. *Brightside Kilpatrick v Mitchell Construction* 1975 2 Lloyd 's Rep 493 followed.
(5) Whether cl 8 had the effect of excluding the defendants' common law right of set-off was one of construction, and there was scope for argument here.

Cases referred to

Acsim (Southern) v Dancon Danish Contracting & Development Co 47 BLR 55 58

Brightside Kilpatrick Engineering Services v Mitchell Construction [1975]2 Lloyd's Rep 493

British and Commonwealth v Quadrex Holdings [1989] 3 All ER 492

Euro-Diam v Bathurst [1988] 2 All ER 23

Gilbert-Ash (Northern) v Modern Engineering (Bristol) [1974] AC 689

Home & Overseas Insurance Co Ltd v Mentor Insurance Co (UK) [1989] 3 All ER 74

Hong Kong Teakwood Works v Shui On Construction Co [1984] HKLR 235

Larocque v Beauchemin [1897] AC 358

Miles v Bull [1969] 1 QB 258

Pyrock v Chee Tat Engineering Co [1988] 2 HKLR 472

RG Carter v Clarke [1990] 2 All ER 209

RN Douglas Construction v Bass Leisure 53 BLR 119

Schindler Lifts (Hong Kong) v Shui On Construction Co [1985] HKLR 118

Sethia v India Trading Co [1986] 1 WLR 1398

Spargo's Case [1873] 8 Ch App 407

Legislation referred to

(HK) Arbitration Ordinance (Cap 341) s 6

(HK) Rules of the Supreme Court O 14 r 3, O 18 r 19

Other legislation referred to

Mustill & Boyd Commercial Arbitration (2nd Ed) pp 123-124

Application

These were two summonses arising out of a building contract dispute. The plaintiffs sought summary judgment for sums due and owing under certain architect's certificates while the defendants denied liability and

sought a stay of the proceedings in favour of arbitration pursuant to s 6 of the Arbitration Ordinance (Cap 341) on the ground that the sub-contract provided for arbitration in the event of disputes or differences. The facts appear sufficiently in the following judgment.

Adrian Bell (Simmons & Simmons) for the plaintiffs.

Barrie Barlow (Masons) for the defendants.

KAPLAN J

I have before me two summonses in this construction contract dispute. The defendants were the main contractors for the Hong Kong Polytechnic (HKP) under an agreement in writing made in January 1989. By a sub-contract in writing dated 31 January 1989, the defendants sub-contracted the electrical works to the plaintiffs.

The plaintiffs seek summary judgment in the sum of $1,146,500, being the sum total of certificates 21-23.

The defendants deny liability and by their summons seek a stay of these proceedings in favour of arbitration pursuant to s 6 of the Arbitration Ordinance (Cap 341) on the grounds that cl 22 of the sub-contract provided for arbitration in the event of disputes or differences.

The plaintiffs oppose the stay on the grounds that, as they contend, they are entitled to summary judgment and there is no dispute or difference to go to arbitration.

The plaintiffs' case is simple. Certificates 21-23 in the respective sums of $382,000, $596,500, and $168,000 have been issued by LES Ltd to the plaintiffs and they say there is no reason in law why they should not receive these sums from the defendants.

The defendants say that the plaintiffs are not entitled to payment of the certificates by reason of the terms of cl 11(b) of the sub-contract which so far as is material provides as follows:

> Within 14 days of the receipt by the main contractor of payment from the employer against any certificate from the architect, the main contractor shall notify and pay to the sub-contractor the total value certified therein in respect of the sub-contract works ... less --
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> (i)retention money ... and
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> (ii)the amounts previously paid.

By a letter dated 6 September 1990, HKP wrote to the defendants informing them that because of delays to the completion of the contract works, HKP were deducting liquidated damages. Interim certificate 21 provided for payment of $5.49m but deducted therefrom by this letter were liquidated damages in the sum of $4.7m leaving the net sum of $790,000 due under the certificate.

The defendants contend that because $4.7m of liquidated damages were deducted from certificate 21, they have not received payment frown HKP of this sum, and thus under the provision of cl 11(b) are not obliged to pay the plaintiffs the sums claimed in this action which are less than $4.7m. This raises the familiar 'pay when paid' argument which the courts of Hong Kong have previously grappled with at an interlocutory stage but have never finally decided. It is a source of great debate and arises frequently in this sort of contract.

The plaintiffs' answer to this point is that the defendants have received payment by reason of the set-off between the liquidated damages and the sums otherwise due to the defendants.

It is the defendants' case that the reason why they were late in completing the main contract works was because of delays by the plaintiffs in the completion of their sub-contract works. Mr Barlow, who appeared for the defendants, frankly admitted that the defendants had a problem here because the architect had never

certified that the sub-contract works ought reasonably to have been completed within the agreed or extended time.

Clause 8 of the sub-contract gives to the defendants the right to set off liquidated damages against sums otherwise due to the plaintiffs. The relevant part of cl 8 reads as follows:

> 8(a)The sub-contractor shall commence the sub-contract works within an agreed time or, if none is agreed, then within a reasonable time after the receipt by him of an order in writing under this sub-contract from the main contractor to that effect and shall proceed with the same with due expedition.
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> The sub-contractor shall complete the sub-contract works and each section thereof within the period specified in Pt II of the appendix to this sub-contract or within such extended period or periods as may be granted pursuant to the provisions hereinafter contained.

If a sub-contractor fails to complete a sub-contract works or any section thereof within the period specified or any extended period or periods as hereinafter provided, he shall pay or allow the main contractor to retain a sum equivalent to any loss or damage suffered or incurred by the main contractor and caused by the failure of the sub-contractor as aforesaid. The main contractor shall, at the earliest opportunity, give reasonable notice to the sub-contractor that loss or damage as aforesaid is being or has been suffered or incurred.

Provided that the main contractor shall not be entitled to claim any loss or damage under this clause unless the architect shall have issued to the main contractor (with a duplicate copy to the sub-contractor) a certificate in writing stating that in his opinion the sub-contract works in the relevant section thereof ought reasonably to have been completed within a specified period or within any extended period or periods as the case may be.

It is common ground that the architect has not given the certificate provided for by the provisions of cl 8. He has been asked to do so but apparently is still requesting further information.

Mr Bell, for the plaintiffs, submits that the absence of the certificate is fatal to the defendants' contention that they can set off any sums for delay. He also points out that all of the liquidated damages claim against the defendants were in fact a set-off against certificate 21, and thus, there is no set-off against the sums claimed under certificates 22 and 23.

Mr Barlow submits that cl 8 does not have the effect of excluding the defendants' common law right of set-off upon which he maintains the defendants are entitled to rely.

In addition to the 'pay when paid' and common law set-off points, he raises two other points. Firstly, he submits that the defendants have a defence based upon the ex turpi causa doctrine because the plaintiffs have failed to give the architect the submission he needs to consider granting the certificate of delay. He submits that a party cannot by his own breach of contract put himself into a position to claim damages from a defendant for breach of contract. This, he submits, will permit the plaintiff to benefit from, and take advantage of, his own wrongdoing.

Secondly, Mr Barlow submits that leave to defend should be given on the *Miles v Bull* default ([1969] 1 QB 258) principle, namely that there is some other reason for trial. (See O 14 r 3.)

Before considering these points, it is necessary to have regard to the interrelationship of these two summonses. Mr Barlow submits that all these points should be decided by arbitration being the method of dispute resolution chosen by the parties. Both Mr Bell and Mr Barlow reminded me of the well known passage in the judgment of Kerr LJ in *Sethia Ltd v India Trading Co Ltd* 1986 1 WLR 1398 at 1401:

> The submissions of both parties have proceeded on the basis that the summonses under O 14 and s 1 are the reverse sides of the same coin, and we have been referred to Mustill & Boyd *Commercial Arbitration* (1932), pp 90 -92. Without expressing any concluded view on everything which is stated there, it seems to me that the position can be summarized as follows. If a point of law is raised on behalf of the defendants, which the court feels able to consider without reference to contested facts simply on the submissions of the parties, then it is now settled that in applications for summary judgment under O 14, the court will do so in order to see whether there is any substance in the proposed defence. If it concludes that, although arguable, the point is bad, then it will give judgment for the plaintiffs. This course

> will also be adopted where there is a counter-application for a stay of the action. If the contract between the parties contains an arbitration clause to which s 1 of the Act of 1975 applies, then the court is not thereby precluded from considering whether there is any arguable defence to the plaintiffs' claim. If the court concludes that the plaintiffs are clearly right in law then it will still give judgment for the plaintiffs. In the same breath, as it were, it will then have decided that, in reality, there was not in fact any dispute between the parties. If the court is satisfied that the plaintiffs are clearly right in law, and that the defendants have no arguable defence, then it will not avail the defendants to have raised a point of law which the court can see is in fact bad. In those circumstances, the defendants cannot be heard to say
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> *[1994] 2 HKC 578 at 583*
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> that there was a dispute to be referred to arbitration. But if the court concludes that the plaintiffs are not clearly entitled to judgment because the case raises problems which should be argued and considered fully, then it will give leave to defend, and it is therefore then bound to refer the matter to arbitration under s 1 of the Act of 1975.

I must add two points to that quotation. Firstly, the citation to Mustill and Boyd is now to pp 123-124 of the second edition where *Sethia* is referred to. Secondly, in the case before me, I am not dealing with a non-domestic arbitration, and therefore, I do have a discretion under s 6 of the Arbitration Ordinance. However, apart from the points canvassed before me, no other reasons were given as to why I should not grant a stay if I considered that there was a dispute and thus a triable issue. Mr Bell accepted that if I was not with him on the O 14 summons, the stay would follow ineluctably.

Mr Barlow, while accepting the above statement of the law, reminded me that lower down the same page and over on to p 1402, Kerr LJ said this:

> I should add, for the sake of completeness, that in relation to applications for summary judgment which raise a bare issue of law, the parties may of course agree to ask the court to decide this as a preliminary, or as the only, issue in the action. But if they do not do so and the court does not consider that the plaintiffs are entitled to summary judgment, then the court should not investigate a clearly arguable defence by going further in order to decide whether the defendant's contention is in fact correct, and then give leave to defend. That course was emphatically rejected by this court in *Pinemain Ltd v Welbeck International Ltd* default (1984) 129 SJ 66; Court of Appeal (Civil Division) Transcript No 363 of 1984. The proper course, if the court considers that the plaintiffs are not or may not be right, is simply to give leave to defend, and accordingly, in cases where there is an arbitration clause, to refer the whole dispute to arbitration. I say that because both counsel before us, without any agreement having been concluded between the parties to abrogate the arbitration clause, told us that they and their clients would wish this court finally to decide the question of construction raised in this case, to which I turn in a moment. That would mean, or could mean, that if the court were not satisfied that the buyers were right, it would give a ruling on the legal position between the parties in favour of the sellers, but would then be bound to refer the remainder of the dispute to the arbitration tribunal in a situation where that tribunal would be bound by what, ex hypothesi, the court would already have decided on the question of construction.

I would say for myself as strongly as I can that such a course would create an impossible position. It would result in a dispute and by 'dispute' I mean a bona fide and real dispute which is governed by an arbitration clause-- being decided as to the law in the court, and the remainder being referred to arbitration, to be dealt with by an award. That would appear to create problems under s 1 of the Arbitration Act 1975, and possibly also under the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. It would certainly be contrary to the legislation and practice under the Arbitration Act

[1994] 2 HKC 578 at 584

1979. In the absence of agreement waiving the right to arbitration, such disputes must prima facie go to arbitration, whether they be disputes as to fact or law, or mixed fact and law. Apart from such 'special cases' as remain under the pre-1979 procedure, it is only in a limited number of cases and situations, governed partly by the Act of 1979 and partly by the decisions of the House of Lords in *Pioneer Shipping Ltd v BTP Tioxide Ltd* default *(The Nema)* default [1982] AC 724, and*Antaios Compania Naviera SA v Salen Rederierna AB* default [1985] AC 191, that the court will now be concerned with issues of law arising under contracts containing arbitration clauses, even though the sole dispute may turn on an issue of law.

In *Home & Overseas Insurance Co Ltd v Mentor Insurance Co (UK) Ltd* default *(in liquidation)* default[1989] 3 All ER 74, the English Court of Appeal, without having *Sethia* default cited to them, put the matter in the following terms which I quote solely from the headnote:

> The purpose of the summary judgment procedure under RSC O 14 is to enable a plaintiff to obtain a quick judgment where there is plainly no defence to his claim. Accordingly, the plaintiffs are entitled to the judgment where the defendant's only suggested defence is a point of law which the court can see is misconceived or which although at first sight apparently arguable, is shown by relatively short argument to be plainly unsustainable. However, the court should not on O 14 applications determine points of law which may take hours or even days and the citation of many authorities

> before it is in a position to arrive at a final decision, thereby allowing such proceedings to become a means for obtaining in effect, an immediate trial of an action.

In cases where there is an arbitration clause and a fortiori in commercial arbitrations (especially when the dispute turns on construction or the implication of terms or trade practice) the court should not, on an application made to it prior to the arbitration, permit full scale argument on the terms of the agreement between the parties, since the parties have agreed on their chosen tribunal and the defendant is entitled, prima facie, to have the dispute decided by that tribunal in the first instance, to be free from the intervention of the courts until it has been so decided and thereafter, if it is in his favour, to hold it unless the plaintiffs obtain leave to appeal and successfully appeals.

So I have to consider the points raised to see whether they are misconceived or can be shown by relatively short argument to be unsustainable. If any one of Mr Barlow's points meets this threshold test, then I should give unconditional leave to defend, and in the circumstances of this case, grant the stay in the exercise of my discretion.

(Since the argument concluded in this case, I have come across two cases, namely, *RG Carter Ltd v Clarke* 1990 2 All ER 209 and *British and Commonwealth v Quadrex Holdings* 1989 3 All ER 492. In the latter case, Sir Nicolas Browne-Wilkinson VC warned against devoting too much time to the interlocutory stage by entertaining large or difficult O 14 applications. This has a knock on effect on other litigants waiting to be heard. In the former case, Lord Donaldson MR, while recognizing the

qualifications stated by the learned Vice Chancellor, appears to be encouraging judges to decide points of law under O 14 provided they are not dependent on undecided issues of fact, However, neither of these cases had the arbitration element which this does. I have also noted that in England, the new O 14A gives the court wide powers to decide issues of law or construction at the O 14 stage (or at the O 18 r 19 stage). On the assumption that a similar provision will be introduced in Hong Kong, judges can look forward to a very useful addition to their judicial armoury. I did not feel it necessary to invite counsel back to make further submissions on these two cases as neither dealt with arbitration, and neither is, in reality, inconsistent with *Sethia*.)

I can dispose quite quickly with two of Mr Barlow's points which do not impress me. I do not think that the ex turpi causa principle has any bearing here. If this were the only point relied on by the defendants I would have given summary judgment. I bear in mind the principles cited in Chitty and the recent exposition of the law by Kerr LJ in *Euro-Diam v Bathurst* 1988 2 All ER 23. There is no suggestion of illegality nor of immorality such that it would be an affront to justice to give judgment to the plaintiffs.

There is no suggestion of any illegality here, nor is there any suggestion of immorality. I find it difficult to see how it can be contended that it would be an affront to the public conscience to permit the plaintiffs to recover under the certificates.

The second of Mr Barlow's points which does not impress me is that leave to defend should be granted because there is some 'other reason for trial'.In a sense, this is tied up with the last point because it is said that the plaintiffs were in breach of cl 8(b) of the agreement, yet nevertheless, they relied upon the defendants' failure so far to obtain the necessary architect's certificate. In essence it is argued that by refusing summary judgment and ordering a stay, the court will be giving the defendants more time for them to obtain the necessary certificate. I do not think that this point adds much to the ex turpi causa point which I have not accepted. I do not think there is anything in this point to justify further consideration.

Pay when paid

This point was considered by Hunter J (as he then was) in *Hong Kong Teakwood Works Ltd v Shui On Construction Co Ltd* default [1984] HKLR 235 and by the Court of Appealin *Schindler Lifts (Hong Kong) Ltd v Shui On Construction Co Ltd* default [1985] HKLR 118.

In *Teakwood,*Hunter J expressed the preliminary view that 'receipt of payment' meant exactly what it says, namely that the main contractor would only be liable to the sub-contractor when he had actually received payment from the employer, and he was not disposed to conclude that payment was received by reason of the set-off of liquidated damages

against the sums due. However, these were preliminary views expressed in an O 14 application. Unfortunately, the case could not go on appeal, but there is no reason to believe that the Court of Appeal would have given any more guidance than they did when the same point came up in *Schindler*. In that case, all the Court of Appeal said was that they were disposed to agree with Hunter J in *Teakwood,* although no reasons were given.

It is fair to point out that in *Teakwood,* neither *Spargo's Case* (1873) 8 Ch App 407, nor *Larocque v Beauchemin* [1897]AC 358 (PC) were cited. However, they were cited in *Schindler* and are referred to in the judgment of the Court of Appeal without any analysis of their effect.

I would very much like to decide this point so that, if I were with Mr Bell and in the event of the inevitable appeal from that decision, the point would be clarified once and for all.

I am sure that such a course of action would be in the interest of the construction industry in Hong Kong, because this point does crop up very frequently, and it is highly desirable that the point should be decided once and for all. However, I must resist the temptation to engineer a result which would have this effect, as I must apply the above stated principles, having full regard to all the points made by Mr Barlow in resisting the O 14 application and to the fact that the parties have agreed to have their differences resolved by arbitration.

I should only embark upon a detailed analysis of the 'pay when paid' argument, if I am satisfied that there is nothing in the other points. It is also necessary to bear in mind that if I refuse this application for summary judgment, all these points will have to go to arbitration and I would not want the arbitrator to be influenced by anything I might say during the course of this interlocutory judgment. So before deciding whether I should embark upon a detailed analysis of the arguments and cases cited under this head of claim, I ought first to consider whether there was anything in the final point raised by Mr Barlow.

The certificate and the common law set-off

I am quite satisfied that it is a condition precedent to the deduction of liquidated damages against the plaintiffs in this case, that the architect should have certified under the provisions of cl 8 that the sub-contract works 'ought reasonably to have been completed within the specified period or in any extended period or periods as the case may be'.

Support for this view comes from the English Court of Appeal in *Brightside Kilpatrick Engineering Services v Mitchell Construction* 1975 2 Lloyd 's Rep 493. The clause under consideration in that case was identical to the provision contained in cl 8(a) in the present case. The architect did not certify.Buckley and Orr LJJ held that:

> Under cl 8(a) of that form, it was clear that the issue of an architect's certificate was a condition precedent to any right in the contractor to claim damages for delay for a sub-contractor.

At p 496, Buckley LJ said:

> Under that sub-clause of the green form of contract, it is, in my judgment, clear that the issue of an architect's certificate is in truth a condition precedent to any right in the contractor to claim damages for delay from a sub-contractor.

In the present case, the architect has hitherto, at any rate, declined to make any certificate of delay relating to delay by the plaintiff company and consequently, at the present time, in my judgment, the defendants cannot make out the case for saying that they have a good claim in damages against the plaintiff company for delay in completing the sub-contract works.

In this jurisdiction, Godfrey J (without the benefit of having *Brightside* cited to him) came to an identical conclusion in *Pyrock v Chee Tat Engineering Co Ltd* default [1988] 2 HKLR 472.

Whilst not suggesting that either *Brightside* or *Pyrock* were wrongly decided, Mr Barlow contended that neither of them dealt with the issue as to whether the effect of the clause in question was, as a matter of construction, wide enough to exclude the defendants' common law right of set-off. Mr Bell contended that it was wide enough to exclude this right.

Mr Barlow based this argument on various passages in the speeches of the House of Lords in *Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd* [1974] AC 689 . At p 696 F-G Lord Reid said this:

> It is now admitted, and in my view properly admitted, that at common law there is a right of set-off in such circumstances; but that right can be excluded by contract. So the sole question in the appeal is whether, by their contract with the sub-contractors, the contractors have agreed that sums which they received from the employers earmarked as due to the sub-contractors on architects' interim certificates must be paid over immediately without any right of set-off.

At p 712 A-B, Viscount Dilhorne said this:

> I can see no ground for holding that in those proceedings, the contractor cannot seek to deduct from the amount claimed from him the amounts bona fide claimed by him from the sub-contractor. Even if the sub-contract does not gives, as it does, an express right to make such deduction, I can see nothing in it that excludes the contractor's common law and equitable rights to set off and counterclaim ... there is no doubt that unless the appellants' right to do so was excluded by the terms of the sub-contract, they are entitled to set off and to counterclaim the amounts of their cross claims. In my opinion, their right to do so is not excluded.

At p 720E, Lord Diplock said:

> I therefore conclude that there is no provision in a main contract in a standard RIBA form which excludes the common law remedy of the employer to set up breaches of warranty by the contractor in diminution or extinction of any
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> *[1994] 2 HKC 578 at 588*
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> instalments of the price, notwithstanding that such instalment has been certified as due from him to the contractor in the certificate issued by the architect.

At p 722H, Lord Salmon said this:

> This type of contract, however, clearly belongs to the class of contract for the sale of goods and work and labour at a price payable by instalments. In the thousands of cases in which such contracts had been litigated prior to 1971, it had never been questioned that the defendants were entitled to set off any damages which they bona fide claimed to have suffered as a result of the plaintiff's breach of the contract under which the price was claimed.

The parties to building contracts or sub-contracts, like the parties to any other type of contract are, of course, entitled to incorporate in their contract any clause they please. There is nothing to prevent them from extinguishing, curtailing or enlarging the ordinary rights of set-off, provided they do so expressly or by clear implication.

It is clear from the above citations that the question comes down to one of construction. In *RN Douglas Construction Ltd v Bass Leisure Ltd* default 53 BLR 119, Bowsher J sitting as an official referee had to consider a similar point, said this:

> ... notwithstanding the decision in *Gilbert-Ash* default , it is perfectly possible for a contract to provide that there shall be no set-off allowed against any certificate at all, but that the paying party must pay up first and then argue about recovery of any counterclaim afterwards; it is common ground that that is not the contractual situation here. It would equally be possible for a contract to provide that no counterclaim shall be set off against any one certificate unless that counterclaim related to that certificate; I have not been shown any contractual term in this contract designed to achieve that effect and I believe that there is none. As a matter of law, it seems to me that if the defendants have a counterclaim arising out of any breach of this contract, the defendants were entitled to set off that counterclaim against any claim made under the contract, even though there is machinery provided by the contract for dealing with that counterclaim in a different way. The point against the plaintiffs is that the contract does not expressly and clearly provide that the contractual machinery is to be the only way of dealing with such a counterclaim, although such a result could be achieved by contract and it may well have been the intention of some of the members of the committee which drafted this contract that that should be the effect of the contract.

Mr Barlow also referred me to the case of *Acsim (Southern) Ltd v Danish Contracting Co* default 47 BLR 55 and 59, a decision of the English Court of Appeal in 1989. This was a building contract subject to the blue form, cl 15 of which read as follows:

> (2)The contractor shall be entitled to set off against any money (including any retention money) otherwise due under this sub-contract the amount of any claim for loss and/or expense which has actually been incurred by the
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> *[1994] 2 HKC 578 at 589*

> contractor by reason of any breach of, or failure to observe the provisions of, this sub-contract by the sub-contractor, provided:
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> (a)the amount of such set-off has been quantified in detail and with reasonable accuracy by the contractor;
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> (b)the contractor has given to the sub-contractor notice in writing specifying his intention to set off the amount quantified in accordance with proviso (a) of this sub-clause and the grounds on which such set-off is claimed to be made. Such notice should be given not less than 17 days before the money from which the amount is to be set off becomes due and payable to the sub-contractor ...
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> (4)The rights of the parties to this sub-contract in respect of set-off are fully set out in these conditions and no other rights whatsoever shall be implied as terms of this sub-contract relating to set-off.

Acsim sent an interim application for £221,018 and that should have been paid under the terms of this contract by 15 September 1988. It was not so paid and none of the matters required by cl 15 had been raised 17 days before the money had become due and payable to Acsim. However, on 3 October 1988, Dancon claimed to be entitled to withhold the sums due on various other grounds, including delay on the part of Acsim. Acsim issued a writ claiming that £221,018 and went by O 14. On 14 November 1988, the summons came before Lewis Hawser J QC, at which hearing solicitors for Dancon asked for an adjournment in order that they could file evidence to show that the work carried out by Acsim had not been properly executed and they had a valid defence. The learned judge took the view that, since none of these matters had been raised as a ground of set-off within the time specified in cl 15, such evidence would be irrelevant. He refused the application for an adjournment and gave summary judgment during the course of which he said this:

> For reasons already stated, namely, that because the defendant did not give notice of set-off in accordance with cl 15 of the standard blue form of sub-contract between the parties, I do not consider that the defendants have a defence to the plaintiffs' claim and see no reason to adjourn the hearing to enable further evidence, including expert evidence, to be submitted.

Dancon appealed to the Court of Appeal. Counsel for Dancon submitted that cl 15 did not amount to 'clear express words' excluding the common law right to set off and that his client had not evinced an intention to abandon a remedy arising by operation of law, to pay no more than the proper value of the work done. The Court of Appeal, consisting of Slade, Neill, and Ralph Gibson LJJ, allowed the appeal on 27 October 1989 and held:

> (1)The words of cl 15 ... do not affect the right of a contractor to defend the claim for an interim payment by showing the sum claimed includes sums to which the sub-contractor is not entitled under the terms of the contract
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> *[1994] 2 HKC 578 at 590*
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> or to defend by showing that by reason of the sub-contractor's breaches of contract, the value of the work is less than the sum claimed under the ordinary right of defence established in *Mondel v Steel* default : per Ralph Gibson LJ.
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> (2)One starts with the presumption that neither party intends to abandon any remedies for its breach arising by operation of law and clear express words must be used in order to rebut this presumption: observation of Lord Diplock in *Gilbert-Ash* default v *Modern Engineering* default [1974] AC 689.
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> (3)Clause 15 of the ... blue form does not contain 'clear express words' excluding the common law right of set-off.
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> (4)There was no term to be implied in the contract that the common law right of set-off represented by *Mondel v Steel* default should be exercised promptly.
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> (5) An assertion that the work had not been properly executed is capable of being a matter of pure defence rather than of counterclaim or set-off: per Neill LJ.

Thus, in the light of these authorities, Mr Barlow contends that whether or not the defendants can avail themselves of the contractual right of set-off (and here he recognizes the lack of a certificate is a problem) it can avail itself of the common law right of set-off. He says that this has been done in this case.The defendant's affidavit is not really contradicted, and had it been so, it would have been a matter of fact to be decided

by the arbitrator. He makes the point that neither *Pyrock* default nor *Brightside* default dealt with this aspect of the case.

In my judgment, the question whether the common law right of set-off is excluded by the terms of the contract in this case is not an easy point.Initially, I was inclined to the view that it must be so excluded, or else what was the point of the condition precedent that there must be an architect's certificate? However, the passages from *Gilbert-Ash* make it clear that it is a matter of construction and if cl 15(4) in the *Acsim* case did not achieve the required result, it seems to me that there is scope for some argument here.

This summons was argued succinctly during the course of a morning. This was not the only point canvassed. I do not feel that I have had the sort of detailed argument on this clause which would enable me to decide the point with any confidence. I am sure that there are other authorities which would assist. I would like to consider the commentaries in the relevant text books on clauses such as this. I hasten to add that I make no criticism of counsel for not embarking on such an exercise. Had they done so, it would only have underscored the fact that there was an arguable point which short argument could not show to be unsustainable.

I therefore feel obliged to give unconditional leave to defend. The 'pay when paid' point will also have to be considered by the arbitrator, and in those circumstances, I feel it would be wise to say no more about it. Having concluded that leave to defend should be given, it is accepted that the stay in favour of arbitration must follow. I so order.

[1994] 2 HKC 578 at 591

Although I would have liked to have decided these points with the confidence that my judgment would be appealed, I feel no real dissatisfaction in making an order which has the result of ensuring that all points in controversy between these parties will be decided by the method of dispute resolution chosen by them in their contract. The arbitrator may have to decide who was responsible for delay and he is likely to be better suited for that task, endowed, as he is with greater powers than the court. If this matter goes its full length and if the arbitrator decides these points, there may well be an application for leave to appeal, which will be considered on its merits and on the prevailing principles at the appropriate time.

I therefore give the defendants unconditional leave to defend. I propose to make a costs order nisi giving the costs of the O 14 summons to the defendants. I grant the defendants the stay which they seek and I make a costs order nisi in favour of the defendants in respect of the application for, and the hearing of, the stay.