Neutral Citation Number: [2020] EWHC 2697 (Comm)

Claim No: 3LS40050

IN THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS IN LEEDS
CIRCUIT COMMERCIAL COURT (QBD)

Leeds Combined Court Centre,
The Courthouse,
1 Oxford Row,
Leeds, LS1 3BG.

Date: 20/10/2020

Before:

HIS HONOUR JUDGE KLEIN SITTING AS A JUDGE OF THE HIGH COURT

- -

Between:

CLYDESDALE FINANCIAL SERVICES LIMITED	**Claimant**
- and -	
NESBIT LAW GROUP LLP (IN ADMINISTRATION)	**Defendant**
- and -	
ACASTA EUROPEAN INSURANCE COMPANY LIMITED	**Third Party**

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- -

Richard Chapman QC (instructed by **Ozon Solicitors Ltd.**) for the **Defendant**
Bridget Williamson (instructed by **Coyle White Devine Ltd.**) for the **Third Party**

Hearing date: 6 October 2020
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Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

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HIS HONOUR JUDGE KLEIN

Covid-19 Protocol: This judgment was handed down remotely by circulation to the parties or their representatives by email and release to BAILII. The date and time for hand-down is deemed to be Tuesday 20 October 2020 at 10.30 a.m.

HH Judge Klein:

1. This is the judgment following the hearing of two applications; namely (1) an application, by a notice dated 7 May 2020, by the Third Party ("Acasta") for permission to re-amend the most recent iteration of its statement of case ("the Amended Defence") and (2) an application, by a notice dated 18 May 2020, by the Defendant ("Nesbit") to strike out certain paragraphs of the Amended Defence or for summary judgment on the issues raised by those paragraphs.

2. The applications represent the latest procedural skirmish between Nesbit and Acasta in a long-running dispute, the origin of which can be traced to events in 2007. The claim and the Third Party proceedings were begun in 2013. My first substantive involvement in the proceedings was in April 2019 when I directed that there should be a case management conference in August 2019. That case management conference has not taken place and is unlikely now to take place before the early part of 2021.

3. Following my direction that there should be a case management conference, there was an opposed application by Nesbit to amend its statement of case. I gave a reserved judgment on that application, the neutral citation for which is [2019] EWHC 3304 (Comm). The background to the proceedings and the relevant procedural history is set out in [7] – [25] of that judgment. I do not propose to repeat what I said there. I will assume that any reader of this judgment has read that judgment too. Broadly, as can be seen from [54] – [61] of that judgment, I permitted Nesbit's Third Party claim against Acasta to proceed on a limited basis; namely, that Acasta has been in breach of a collateral contract between it and Nesbit.

4. I had hoped, but, as it turned out, correctly, did not expect, that, after Nesbit amended its statement of case, Acasta would make consequential amendments to its statement of case to which there would be no objection and that the long-adjourned case management conference could take place in May 2020.

5. Nesbit did amend its statement of case and filed its amended statement of case ("the Amended Particulars of Claim") in January 2020. Although running to 21 pages, most of the document is no more than background. Nesbit's claim can be effectively distilled to a small number of paragraphs of the Amended Particulars of Claim which I set out in Annex A to this judgment. In early February 2020, Acasta filed the Amended Defence. About a month later, Acasta sought Nesbit's consent to proposed re-amendments, principally because it had concluded that agreements which it contends that Nesbit[1] entered into, Solicitor Terms of Business Agreements ("STBAs"), supported its defence to Nesbit's claim and it wanted to plead in relation to the STBAs. The parties then corresponded and it became clear that Nesbit objected to certain paragraphs of the Amended Defence and did not consent to certain of Acasta's proposed re-amendments.

6. The result was that the adjourned case management conference, due to take place in May 2020, had to be further adjourned pending the resolution of the parties' pleading dispute. To allow the court to determine that dispute, the parties made the present

[1] In fact, the first of the contended-for STBAs will have been entered into (if at all) by Nesbit & Co. The parties did not distinguish between Nesbit & Co. and Nesbit at the hearing, because they did not need to do so. I propose to adopt the same approach and, for the rest of this judgment, do not distinguish between the two.

applications. In preparation for the hearing, Acasta produced a further iteration of its proposed re-amended statement of case ("the Re-amended Defence"). This incorporates in a single document (i) the paragraphs of the Amended Defence to which Nesbit takes objection and (ii) the disputed proposed re-amendments. The principal contested paragraphs (together with some other paragraphs of the Re-amended Defence, to provide context) are set out in Annex B to this judgment. The principal contested paragraphs are italicised in that annex. To the extent that Nesbit is successful now in objecting to the principal contested paragraphs, alterations may be required to further paragraphs of the Re-amended Defence.

7. As explained to me by Ms Williamson, who appeared for Acasta at the hearing, Acasta defends Nesbit's claim broadly on the following bases:

   i) Acasta denies that, in fact, the contended-for collateral contract was ever made, in part because it would be inconsistent with STBAs it contends Nesbit entered into from 2007.

   ii) If a collateral contract existed, Acasta does not admit that any sum has been payable under it.

   iii) Alternatively, if a collateral contract existed, the collateral contract contained a number of implied terms (implied as a matter of obvious inference), including one or more of the following:

      a) that Nesbit would carry out preliminary assessments of the lay clients' claims to ensure that they appeared to have reasonable prospects of success or at least a 51% prospect of success;

      b) that those preliminary assessments would be carried out with reasonable care and skill;

      c) that Nesbit would supply the documentation which under the lay clients' legal expenses insurance policies Acasta was entitled to demand before making a payment under those policies;

      d) if no STBAs were entered into:

         i) that a comprehensive risk assessment would be carried out before Nesbit sought a legal expenses insurance policy for the particular lay client from Acasta;

         ii) that that comprehensive risk assessment would demonstrate at least a 51% prospect of success;

         iii) that Nesbit would report to Acasta whenever there was a material change of fact likely to affect the lay client's prospects of success or where the lay client was not co-operating;

         iv) that Nesbit would carry out these obligations in a timely manner using appropriately qualified personnel exercising reasonable care and skill;

e) that it was a condition precedent for any payment for Nesbit's benefit that it complied with the STBAs;

f) that Nesbit could be in no better position in relation to those payments than the lay clients might have been.

iv) Nesbit entered into the STBAs (which contained the terms I have summarised at paragraph 7(iii)(d)(i)-(iv) above or similar terms).

v) If a collateral contract existed, Nesbit breached the contended-for implied terms. In any event, Nesbit breached the terms of the STBAs. Acasta claims to set off, against any sums otherwise due from it, the sums which Nesbit would otherwise be liable to pay for those breaches.

vi) In any event, Nesbit has owed Acasta a duty of care to undertake, with reasonable care and skill, preliminary assessments of the lay clients' claims to ensure that they appeared to have reasonable prospects of success or at least a 51% prospect of success. Nesbit has breached that duty of care and, if a collateral contract existed, thereby caused Acasta loss because it has become liable to pay sums which it would not otherwise have had to pay, which sums Acasta claims to set off against any sums otherwise due from it.

8. A careful reader of Annex B will have deduced that what is currently pleaded in the Re-amended Defence is not precisely the case that I have just summarised. During the hearing, Ms Williamson accepted that some further drafting is required to make Acasta's case wholly clear. Mr Chapman QC, who appeared for Nesbit at the hearing, responded pragmatically to this. It was entirely right and proper for him to do so. He accepted that I should determine the broad issues of principle raised by Nesbit's objections to the principal contested paragraphs of the Re-amended Defence and that, once the parties know the extent to which I am likely to permit or disallow certain pleas, Ms Williamson should have a further short opportunity to refine her drafting and Nesbit should have a further short opportunity to consider whether or not to consent to the amendments. Only if Nesbit and Acasta cannot reach agreement about the precise form of the Re-amended Defence, should the applications be restored for me to determine, word by word or line by line, what pleas in the Re-amended Defence should continue to have life. As Ms Williamson pointed out, this is very much the course that needed to be taken when I had to determine Nesbit's amendment application in 2019. Whilst I would normally be reluctant to adopt this approach, both Mr Chapman and Ms Williamson have demonstrated that they can collaborate to give effect to my "in principle" decisions, which is entirely consistent with their duties to the court and in their clients' best interests, and so I am content to adopt the approach to the applications which I have just set out (which seems to me to be consistent with the overriding objective).

9. Nesbit's objections in principle to the Re-amended Defence can be summarised as follows:

i) Acasta does not have a real prospect of establishing that any of the contended-for implied terms were implied in the collateral contract because:

a) they are inconsistent with the express terms of the collateral contract as pleaded in the Amended Particulars of Claim;

b) there is no room for them in the collateral contract, which is part and parcel of a highly regulated arrangement comprising a series of comprehensive agreements between the Claimant, Nesbit and Acasta;

c) to the extent that they depend on the STBAs, Acasta does not have a real prospect of establishing that Nesbit entered into any of the STBAs.

ii) Acasta does not have a real prospect of establishing that Nesbit entered into the STBAs. Mr Nesbit has provided clear and comprehensive evidence which puts beyond doubt that he did not sign any of the STBAs. If Nesbit had entered into them, only he could have signed them.

iii) In any event, Acasta's claim to set off any sums due for any breaches of the implied terms or the STBAs are new claims within the meaning of section 35(2) of the Limitation Act 1980 ("the 1980 Act"), being "claims by way of set off", but are not original set offs within the meaning of section 35(3) of the 1980 Act. The time limits for bringing claims for those breaches have expired and so, by virtue of sections 35(3), (8) of the 1980 Act, Acasta's set off case can only be pleaded if the requirements of CPR 17.4(2) are satisfied. In this case, to the extent that Acasta relies on the STBAs, that case does not satisfy the requirements of CPR 17.4(2).

iv) Acasta does not have a real prospect of establishing that Nesbit owed it a duty of care, in circumstances where there was no equivalent contractual obligation and where the relationship between the parties was highly regulated by a series of comprehensive agreements. Pragmatically, Mr Chapman accepted that, if Acasta is permitted to plead that there was an implied term in any collateral contract requiring Nesbit to exercise reasonable care and skill, Nesbit will not object to the continued pleading by Acasta of a duty of care.

10. Nesbit brings its strike out application not only on the ground that parts of the Re-amended Defence disclose no reasonable grounds for defending the claim but also on the ground that those parts of the Re-amended Defence are an abuse of the court's process or are otherwise likely to obstruct the just disposal of the proceedings. Nesbit also brings a summary judgment application in the alternative, as I have indicated. Commendably pragmatically (and rightly, in my view), Mr Chapman accepted that, however Nesbit's application is framed, putting to one side the limitation dispute, the question is the same in practice (even if the question of who has the burden of proof turns on whether the plea in issue is or is not already in the Amended Defence); namely, whether there is a real prospect of Acasta establishing the matters which Nesbit contends Acasta has no real prospect of establishing. Mr Chapman also suggested (and Ms Williamson did not dispute) that, in answering this question, I should be guided by what Asplin LJ said in *Elite Property Holdings Ltd. v. Barclays Bank plc* [2019] EWCA Civ 204 at [41] – [42]:

> "For the amendments to be allowed the Appellants need to show that they have a real as opposed to fanciful prospect of success which is one that is more than merely arguable and

> carries some degree of conviction: *ED & F Man Liquid Products Ltd. v. Patel* [2003] EWCA Civ 472. A claim does not have such a prospect where (a) it is possible to say with confidence that the factual basis for the claim is fanciful because it is entirely without substance; (b) the claimant does not have material to support at least a prima facie case that the allegations are correct; and/or (c) the claim has pleaded insufficient facts in support of their case to entitle the Court to draw the necessary inferences: *Three Rivers District Council v. Bank of England (No3)* [2003] 2 AC 1.
>
> The court is entitled to reject a version of the facts which is implausible, self-contradictory or not supported by the contemporaneous documents and it is appropriate for the court to consider whether the proposed pleading is coherent and contains the properly particularised elements of the cause of action relied upon…"

Does Acasta have a real prospect of establishing that Nesbit entered into relevant STBAs?

11. Mr Chapman comprehensively set out, in paragraph 20 of his skeleton argument, Nesbit's reasons for contending that Acasta has no real prospect of establishing that Nesbit entered into any STBAs. For present purposes, Mr Chapman's key points can be summarised as follows:

    i) Acasta has not disclosed a copy of any relevant STBA.

    ii) It is fanciful to suggest that the STBAs would not have been referred to at the earlier trial which related to the Financial Guarantee Insurance policies.

    iii) The STBAs are not referred to in any of the written agreements between the parties.

    iv) When opposing Nesbit's amendment application in 2019, Acasta argued that Nesbit and it were not direct contracting parties.

    v) Mr Nesbit says that he did not enter into any relevant STBA.

    vi) At least one STBA includes an arbitration clause which Acasta has not relied on.

12. Lynn Thorne, on Acasta's behalf, explains, in two witness statements, the grounds on which Acasta will invite the trial judge to infer that Nesbit did enter into relevant STBAs. In summary, she says that the STBAs were an integral part of the group of documents which were created for the purposes of the scheme which the Claimant and Acasta operated with approved solicitors, that it is inherently probable that Nesbit would have signed STBAs in order to join and remain in the scheme and that the STBAs were referred to in an email which was contemporaneous with the events which Nesbit says give rise to the collateral contract.

13. On the very limited evidence before me I cannot say with confidence that a trial judge would not infer that Nesbit entered into relevant STBAs and so I conclude that Acasta does have a real prospect of establishing that Nesbit entered into the relevant STBAs.

14. Ms Thorne's witness statements do provide support for that inference and she supports her evidence by reference to standard documentation and to what Acasta's solicitor has told her Mr Sayers will say.

15. The points Mr Chapman makes in response may be very good ones for trial but they do not mean that Acasta's case has no real prospect of success. The fact that Acasta has not disclosed any STBAs does not mean that they could not have been entered into. It is arguable, at least, that there was no need to refer to the STBAs at the earlier trial. The Financial Guarantee Insurance policies which were the subject of the earlier trial effectively recorded warranties by Nesbit that the underlying personal injury claims to be insured had a reasonable prospect of success. It does not follow from the fact (if it is a fact) that the STBAs were not referred to in other documents that they were not entered into. The fact that Acasta may have contended, in 2019, that there was no contractual relationship between it and Nesbit does not mean that there was no such relationship. Acasta's position is that its present legal team did not appreciate the significance of the STBAs until early 2020. There is no material before me which calls into question that claim. It is not appropriate for me, on the present applications, to conclude that Mr Nesbit's evidence is bound to be accepted. Ms Thorne's contrary evidence is not implausible. Indeed, as I explain below, it is sufficiently arguable that a term was implied in any collateral contract that Nesbit would carry out, with reasonable care and skill, preliminary assessments of the lay clients' claims to ensure that they appeared to have reasonable prospects of success or at least a 51% prospect of success. A similar obligation is, on Acasta's case, found in the STBAs, so that, for the same reason that the implication of this term is sufficiently arguable, Ms Thorne's evidence is sufficiently plausible for present purposes. Just because Acasta has not sought to rely on any arbitration clause does not mean that the STBAs were not entered into.

The implication of terms in any collateral contract

16. There remain two objections in principle to Acasta's case that terms were implied in any collateral contract. Those objections are that:

    i) the proposed implied terms are inconsistent with the express terms of the collateral contract as pleaded in the Amended Particulars of Claim;

    ii) there is no room for the proposed implied terms in the collateral contract which is part and parcel of a highly regulated arrangement comprising a series of comprehensive agreements between the Claimant, Nesbit and Acasta.

17. As a matter of logic, Nesbit must be right that, if a trial judge accepts that there was a collateral contract and s/he also accepts that the terms of the collateral contract were as Nesbit has pleaded them, the collateral contract will not contain the contended-for implied terms, because Nesbit has not pleaded that the collateral contract contained those terms. But it does not follow that the trial judge must either accept Nesbit's collateral contract case or conclude that there was no collateral contract at all. As a matter of principle, a trial judge is entitled to conclude that, contrary to Acasta's case,

there was a collateral contract, but that, contrary to Nesbit's case, the collateral contract contained implied terms, if those conclusions are supported by the evidence at trial. As a matter of principle, a trial judge is not obliged to either wholly accept or reject Nesbit's case.

18. So it does not follow, just because the contended-for implied terms are inconsistent with the express terms of the collateral contract as pleaded in the Amended Particulars of Claim, that Acasta does not have a real prospect of establishing that the implied terms were implied in any collateral contract.

19. Nesbit's argument that there is no room for implied terms in any collateral contract because there were a number of comprehensive agreements between the Claimant, Nesbit and Acasta is a striking one. If the agreements were so comprehensive, surely, it may be asked rhetorically, there can be no room for the collateral contract Nesbit contends for?

20. To conclude that Acasta has no real prospect of establishing that any of the contended-for implied terms were implied in any collateral contract on this second ground would require a detailed consideration of each and every one of the comprehensive agreements to which Nesbit refers. I was not taken to any of them on the present applications. Nor would it have been appropriate for Mr Chapman to have taken me to those agreements in the detail required. Had he done so, the result would have been that the dispute between the parties would not have turned on a short point of law or construction and so would not have been suitable for a pre-trial (summary) determination (see, by analogy, what I said in paragraph 73 of my earlier judgment). In any event, as Nesbit's argument acknowledges, whether the contended-for implied terms were implied in any collateral contract will turn in part on the factual background against which any collateral contract was made. That factual background is not limited just to the comprehensive agreements as Nesbit's argument presumes and will require investigation at trial. There is therefore insufficient material for me to say that, on this second ground, Acasta does not have a real prospect of establishing that any of its contended-for implied terms were implied in any collateral contract.

21. I can go somewhat further. I am satisfied that Acasta has a real prospect of establishing that there was implied in any collateral contract at least an obligation that Nesbit would carry out, with reasonable care and skill, preliminary assessments of the lay clients' claims to ensure that they appeared to have reasonable prospects of success or at least a 51% prospect of success. I remind myself that the "real prospects" threshold is a low one. A real prospect is only a prospect which is not a fanciful prospect. The collateral contract suggested by Nesbit (see, in particular, paragraph 18.5 of the Amended Particulars of Claim) would require Acasta to make payment in relation to any underlying personal injury claim, so long as Nesbit had determined that it should be insured, whether or not Nesbit had made any assessment of its prospects of success or even if Nesbit had concluded, from the outset, that it had no prospect of success. Acasta is an insurer. It is not a personal injury lawyer. The lay clients were not Acasta's lay clients. Nesbit (or any predecessor) was the personal injury law specialist. Against this background, the implication of a term effectively requiring Nesbit only to propose for insurance those underlying personal injury cases which had been assessed as having sufficient prospects of success is not fanciful and so it must follow that Acasta has a real prospect of establishing that a term to this effect was implied in any collateral contract.

Limitations

22. Ms Williamson argued that Acasta's set off defences are not "claims by way of set off" within the meaning of the 1980 Act. It was not disputed that, if she is right about that, Acasta is not required to satisfy CPR 17.4 (in addition to establishing that its amendments have a real prospect of success) before it can be given permission to amend.

23. Ms Williamson relied, in support of her argument, on the judgment of Lord Denning MR in *The Brede* [1974] 1 QB 233, in which Lord Denning considered the same phrase in the Limitation Act 1939. It was not suggested that Lord Denning's analysis in that case might not be correct.

24. In that case, after a detailed exploration of the history of set offs, both before and following the coming into force of the Judicature Act 1873, Lord Denning concluded that equitable set offs were not claims by way of set off for the purposes of the Limitation Act 1939.

25. Lord Denning's conclusion was strictly obiter and was not positively supported by the other Lords Justices in that case. Cairns LJ said at page 254G:

> "Lord Denning MR has taken the view that in section 28 of the Limitation Act the word "set off" means only a set off as permitted by the statutes of set off and that no such set off can arise from a cross-claim arising from the same transaction as the claim. No argument to this effect was presented at the Bar and I am not to be taken to accede to this interpretation of the statute. But it does not affect the result of this appeal."

Roskill LJ went somewhat further, at page 264B, where he said:

> "Since writing this judgment I have had the opportunity of reading in draft the judgment of Lord Denning MR and in particular the passage in which he expresses the view that section 28 of the Limitation Act 1939 does not apply to equitable set off. I express no final opinion upon this, although, as at present advised, I would respectfully disagree with Lord Denning MR and would accept as correct Mr. Lloyd's submission that section 28 applies to all forms of set off. In these circumstances it is not necessary for me to do more than express my agreement with what Cairns LJ has said on this point at the end of his judgment."

However, as I have said, it was not suggested that Lord Denning's conclusion might be wrong.

26. As far as I have been able to establish, there is no more recent authority which calls into question Lord Denning's conclusion. To the contrary, Hobhouse J said, at first instance, in *Westdeutsche Landesbank Girozentrale v. Islington London Borough Council* [1994] 4 All ER 890, 945:

> "In the textbooks the view expressed by Lord Denning MR is generally accepted. Having heard the argument in the present case, I also consider it to be correct. I reach this conclusion both as a matter of the construction of the actual wording of the statute and as a matter of principle where the set-off raised is truly a matter of defence, as explained in the *Aries Tanker* case. If a plaintiff, in equity, is not entitled to assert his cause of action without at the same time giving credit to the defendant for the relevant matters, no question of any claim being made by a defendant against the plaintiff arises and the sole question is what is the proper claim that the plaintiff should make against the defendant. In the present case, as I have held, Sandwell has no claim in respect of the first swap against Kleinwort Benson so on any view section 35 of the 1980 Act cannot have any application."

Hobhouse J's decision was appealed but, as far as I am aware, neither the Court of Appeal nor the House of Lords expressly considered whether an equitable set off was a claim by way of set off for the purposes of section 35 of the 1980 Act. In fact, Jonathan Parker J adopted Hobhouse J's conclusion in *Philip Collins Ltd. v. Davis* [2000] 3 All ER 808.

27. Taking into account what I have said, I proceed on the basis that equitable set offs do not fall within section 35 of the 1980 Act, and so are not subject to CPR 17.4.

28. In *Geldof Metaalconstructie NV v. Simon Carves Ltd.* [2010] EWCA Civ 667, Rix LJ (with whom Patten and Maurice Kay LJJ agreed) explained, at [43], having reviewed authorities on equitable set off:

> "In my judgment, this jurisprudence allows the following conclusions:
>
> (i) The impeachment of title test, although derived from the leading case of *Rawson v. Samuel* and still stated by Lord Denning in his formulation in *The Nanfri*, even if it is there immediately glossed by his "so closely connected…that it would be manifestly unjust" test, should no longer be used: *The Dominique* and *Bim Kemi*. It is an unhelpful metaphor in the modern world. In the light of the emphasis put on it by Hobhouse J in *The Leon* and the reliance sought to be placed on it by the charterers in *The Dominique*, it made sense for the House of Lords to go out of its way to downplay its significance.
>
> (ii) There is clearly a formal requirement of close connection. All the modern cases state that, whether *Hanak v Green*, *The Nanfri*, *The Dominique* (by reference to the *Newfoundland Railway* case), *Dole Dried Fruit* or *Bim Kemi*. The requirement is put in various ways in various cases. Morris LJ in *Hanak v. Green* spoke of a "close relationship between the dealings and transactions which gave rise to the respective claims". Lord

Denning in *The Nanfri* spoke of claims and cross-claims which are "closely connected". How closely? "[S]o closely connected with his demands that it would be manifestly unjust to allow him to enforce payment without taking into account the cross-claim". *The Dominique* adapted the *Newfoundland Railway* test and spoke of a cross-claim "flowing out of and inseparably connected with the dealings and transactions which also give rise to the claim". *Dole Dried Fruit* returned to Lord Denning's test in *The Nanfri* but also spoke of a claim and cross-claim which was so "inseparably connected that the one ought not to be enforced without taking into account the other". *Bim Kemi* expressed a preference for the test in *The Dominique*, while warning against being caught up in the nuances of different formulations.

(iii) Thus the *Newfoundland Railway* test of "inseparable connection" is one formulation of the close connection test, but it is not the only one. Potter LJ wisely referred to the wise refusal of the courts to become bogged down in the nuances of formulation. Oddly enough, both the *Newfoundland Railway* case and *The Dominique* were single contract cases, and therefore probably rather unhelpful contexts in which to judge what is meant by "inseparable connection". In truth, where separate contracts (or dealings or transactions) are concerned, the metaphor of inseparability is not all that helpful. Ex hypothesi, the contracts are separate (as in *Bankes v. Jarvis*, the case about the veterinary surgeon's practice discussed by Morris LJ in *Hanak v. Green*). I am not aware of the "inseparable connection" test being used to exclude a set-off, where some other formulation of the close connection requirement would have allowed it. It was not used to exclude a set-off in either the *Newfoundland Railway* case, nor in *The Dominique* nor in *Bim Kemi*. Nor is the test all that helpful in single contract cases: as Potter LJ remarked in *Bim Kemi*, where a case concerns a claim and cross-claim arising out of the same contract, although that fact is not in itself enough to ensure an equitable set-off, it is on the whole likely to take a special rule excluding set-off, such as the rules about freight, rent and cheques (and now direct debits, see *Esso v. Milton*), to prevent a set-off. In this connection, *Modern Engineering (Bristol) Ltd. v. Gilbert-Ash (Northern) Ltd.* [1974] AC 689 emphasises that an equitable set-off for defective work is not easily excluded even in building contracts where sums are payable under an architect's certificate. On the other hand, *The Nanfri* itself shows that in the context of maritime adventures and time charter hire, and against the background of the rule as to freight, a special regime of limited but not general set-off has been fashioned for cross-claims under the charterparty.

(iv) There is also clearly a functional requirement whereby it needs to be unjust to enforce the claim without taking into account the cross-claim. This functional requirement is emphasised in all the modern cases, viz. *Hanak v. Green*, *The Aries*, *The Nanfri*, *Dole Dried Fruit*, *Esso v. Milton*, and *Bim Kemi*. The only modern authority cited above which does not in terms refer to the functional requirement of injustice is Lord Brandon's discussion in *The Dominique*. This has led Potter LJ in *Bim Kemi* (at para.38) to remark on the absence of reference to "manifest injustice" by Lord Brandon: but nevertheless it did not lead him to dispense with that requirement (ibid). It seems to me impossible to do so: it is not coherent to have a doctrine of equitable set-off which ignores the need for consideration of aspects of justice and fairness. Mr David Friedman QC, on behalf of SCL, has submitted that the test of "inseparable" connection contains inherently within it the need for a requirement of manifest injustice. That is what, he submits, "inseparable" means. In my judgment, such lack of transparency in a test would be undesirable, and I do not believe that it is as Mr Friedman submits. But I do not in any event think that Lord Brandon was intending to use the *Newfoundland Railway* formulation as an exclusive test for equitable set-off. Rather, he was using it to dethrone the concept of impeachment.

(v) Although the test for equitable set-off plainly therefore involves considerations of both the closeness of the connection between claim and cross-claim, and of the justice of the case, I do not think that one should speak in terms of a two-stage test. I would prefer to say that there is both a formal element in the test and a functional element. The importance of the formal element is to ensure that the doctrine of equitable set-off is based on principle and not discretion. The importance of the functional element is to remind litigants and courts that the ultimate rationality of the regime is equity. The two elements cannot ultimately be divorced from each other. It may be that at times some judges have emphasised the test of equity at the expense of the requirement of close connection, while other judges have put the emphasis the other way round.

(vi) For all these reasons, I would underline Lord Denning's test, freed of any reference to the concept of impeachment, as the best restatement of the test, and the one most frequently referred to and applied, namely: "cross-claims…so closely connected with [the plaintiff's] demands that it would be manifestly unjust to allow him to enforce payment without taking into account the cross-claim". That emphasises the importance of the two elements identified in *Hanak v. Green*; it defines the necessity of a close connection by reference to the rationality of justice and the avoidance of injustice; and its

> general formulation, "without taking into account", avoids any traps of quasi-statutory language which otherwise might seem to require that the crossclaim must arise out of the same dealings as the claim, as distinct from vice versa. Thus, if the *Newfoundland Railway* test were applied as if it were a statute, very few of the examples of two-contract equitable set-off discussed above could be fitted within its language. I note that in Chitty on Contracts (30th ed., 2008), vol. II, at 37-152, the test for equitable set-off is formulated in terms of Lord Denning's test."

Although the parties did not refer me to *Geldof*, I think that this extract is uncontroversial as between them.

29. As it happens, Mr Chapman may not have disputed, or seriously disputed, that, if Acasta does benefit from a set off, that set off is an equitable set off. Rightly, in my view, he did not suggest, or, at least, I did not understand him to suggest, that any set off from which Acasta might benefit would be a legal set off.

30. I think I can legitimately go further, if necessary. Nesbit effectively claims to be entitled to the benefit of the lay client's legal expenses insurance policies. Acasta effectively cross-claims, that, in those circumstances at least, Nesbit has had obligations to it to guard against it writing or maintaining policies inappropriately, which obligations Nesbit has breached. Acasta's cross-claims are closely connected to Nesbit's claims so that, if Acasta is entitled to the benefit of, and must rely on, a set off at all, that set off will be an equitable set off, because the trial judge will have decided that to allow Nesbit's claim to succeed without Nesbit giving credit for Acasta's cross-claim would be unjust.

31. Acasta's set off defences are therefore not claims by way of set off within the meaning of section 35 of the 1980 Act and so do not engage that section or CPR 17.4.

Duty of Care

32. Because I have already concluded that Acasta has a real prospect of establishing that there was implied in any collateral contract an obligation that Nesbit would carry out, with reasonable care and skill, preliminary assessments of the lay clients' claims to ensure that they appeared to have reasonable prospects of success or at least a 51% prospect of success, I can deal with Nesbit's objection in principle to Acasta's plea of a duty of care briefly. As I have said, Mr Chapman accepted that, in these circumstances, Nesbit does not object to the duty of care plea proceeding to trial, because the contended-for duty of care is no wider than the (arguable) contractual obligation.

Disposal

33. In summary:

    i) I am not satisfied that Acasta does not have a real prospect of establishing that terms were implied in the collateral contract Nesbit contends for;

ii) I am satisfied that Acasta has a real prospect of establishing that there was implied in such a collateral contract an obligation that Nesbit would carry out, with reasonable care and skill, preliminary assessments of the lay clients' claims to ensure that they appeared to have reasonable prospects of success or at least a 51% prospect of success;

iii) I am satisfied that Acasta has a real prospect of establishing that Nesbit entered into relevant STBAs;

iv) I am satisfied that Acasta has a real prospect of establishing that Nesbit owed it the disputed duty of care;

v) Acasta's proposed set off defences rely on equitable set offs and so are not subject to section 35 of the 1980 Act;

vi) Acasta does not need to satisfy CPR 17.4 before the court can permit its proposed re-amendments pleading its set off defences.

34. I will need to hear further from counsel about the appropriate form of order giving effect to this judgment and about the procedure for finally determining the approved wording of the Re-amended Defence. They will also need to deal with consequential matters.

ANNEX A: EXTRACT FROM THE AMENDED PARTICULARS OF CLAIM

6. In or about March 2007, the Second Defendant met with Mrs Judith Turnbull of the Claimant and Mr Colin Sayer of the Third Party in order to discuss the arrangements under the CFS/Focus Scheme and the potential for participation by the Former Partnership therein.

7. In the course of the said meeting, Mrs Turnbull on behalf of the Claimant and Mr Sayer on behalf of the Third Party represented to the Former Partnership and the Second Defendant [(Mr Nesbit – Nesbit & Co.'s ("the Former Partnership's") principal)] that the CFS/Focus Scheme operated as follows:-

   7.3 The Claimant would…provide a loan to the Former Partnership so that the Former Partnership may fund or pay disbursements reasonably and properly incurred by the Former Partnership on behalf of its lay clients and that were recoverable between the parties in the underlying personal injury proceedings including, inter alia, the cost of acquiring legal expenses insurance, in the form of the premium, from the Third Party (the "Recoverable Disbursements" and the "Recoverable Disbursements Loan" respectively). The Recoverable Disbursements Loan would…be repayable by the Former Partnership, notwithstanding that it was for the benefit of its lay clients.

   7.6 The Third Party would provide post event LEI [(legal expenses insurance)] to each of the lay clients of the Former Partnership whereby the Third Party would indemnify the lay clients in respect of adverse costs incurred by the lay clients in the underlying personal injury proceedings and/or in respect of the amount of Recoverable Disbursements or proportion thereof that were not recovered by the Former Partnership on behalf of the lay clients between the parties in the underlying personal injury proceedings (the "LEI Policy").

   7.8. … [Nevertheless,] Mrs Turnbull on behalf of the Claimant and Mr Sayer on behalf of the Third Party assured the Former Partnership and the Second Defendant and impressed upon him that:- …(c) in the event that the underlying personal injury proceedings concluded unsuccessfully, the Third Party would repay to the Claimant any sums outstanding under the Recoverable Disbursements Loans…[T]hereby whilst the Former Partnership would be liable in principle to discharge the said loans, no demand would be served upon the Former Partnership and the Former Partnership would incur no outlay by virtue of the indemnity afforded under…the LEI Policy (the "First Assurance").

9. [In an email dated 10 April 2007]…

   9.5 …Mrs Turnbull and Mr Sayer further assured the Second Defendant that…the LEI Policy would indemnify the sums outstanding under Recoverable Disbursements Loans in the event that the underlying personal injury proceedings of the lay clients concluded unsuccessfully (the "Second Assurance").

10. In reliance upon the First Assurance and the Second Assurance, the Former Partnership and the Second Defendant agreed to participate in the CFS/Focus Scheme and the Former Partnership agreed to obtain loans from the Claimant and insurance from the Third Party in accordance with the terms of the Draft Agreement as varied by the April 2007 Email (the "Litigation Funding Agreement").

18. In March 2007 and/or April 2007, the Former Partnership and the Third Party entered into a collateral agreement ("the Collateral Agreement") in the following circumstances:

18.4. The First Assurance and the Second Assurance (together "the Assurances") were intended to have contractual effect and/or constituted contractual offers which the Former Partnership duly accepted and agreed to.

18.5 In the premises, the following were express terms of the Collateral Agreement insofar as the same related to Recoverable Disbursements, Recoverable Disbursements Loans and the LEI Polices:

(1) The Third Party would abide by the LEI Policies.

(2) The Third Party would make payment of the Recoverable Disbursements pursuant to (or alternatively in the same sums as provided for in) the LEI Policies in the event of cases being unsuccessful.

(3) The Recoverable Disbursements would be paid by the Third Party to the Claimant on behalf of the Former Partnership as repayment of the Recoverable Disbursements Loans.

(4) The Former Partnership would incur no outlay by virtue of the indemnity afforded under the LEI Policy.

18.6. In the alternative, the terms set out above were implied terms of the Collateral Agreement by virtue of the same being obvious inferences in all the circumstances and/or by virtue of the same being necessary in order to give business efficacy to the Collateral Agreement.

18.7. The consideration for the Collateral Agreement was the Former Partnership's entry into the Litigation Funding Agreement and/or the Former Partnership agreeing to obtain and/or obtaining Recoverable Disbursements Loans and Irrecoverable Costs Loans from the Claimant and/or the Former Partnership agreeing to obtain and/or obtaining insurance from the Third Party by way of the FGI Policies and/or the Former Partnership agreeing to procure and/or procuring their clients' entry into the LEI Policies.

23. In breach of the Collateral Agreement, the Third Party has failed to make any payment pursuant to the LEI Policies or at all.

24. By reason of the matters aforesaid, the First Defendant has suffered loss and damage or is entitled to equitable compensation [in the sum of] £256,762.41.

ANNEX B: EXTRACT FROM THE RE-AMENDED DEFENCE

17. …the existence of the alleged Collateral Agreement is denied and it is Acasta's case that the existence of such an agreement is inconsistent with the Solicitor Terms of Business Agreement pleaded in paragraphs 28 and 29 below or its predecessors…

22. *Alternatively, if, contrary to Acasta's primary case, it is held that the alleged Collateral Agreement did come into existence,*

22.1 such agreement was subject to implied terms, to be implied as a matter of obvious inference, requiring the Defendant to act in accordance with the duties and obligations set out in paragraphs 32 and 34 below, alternatively in accordance with the Solicitors Terms of Business Agreement referred to in paragraph 28 below;

22.2 such agreement was subject to further implied terms, also to be implied as a matter of obvious inference,

22.2.1 that enforcement by the Defendant of any LEI Policy was conditional upon compliance with the said Solicitors Terms of Business Agreement in relation to the LEI Policy concerned;

22.2.2 that the Defendant could be in no better position in relation to the enforcement of the LEI Policies than the Insured could be.

27. Further and in any event, if, which is denied, the Defendant is entitled to enforce the terms of the LEI Policies by reason of the Collateral Agreement (the existence of which is denied) or otherwise, it is not admitted that any sums are recoverable by the Defendant, for any or all of the following reasons set out in paragraphs 30 to 36 below, and the Defendant is put to strict proof of, and required properly to particularise, all alleged claims for payment under the LEI Policies and the enforceability of such claims.

28. *On or about 23rd March 2010. the Defendant and Acasta entered into an agreement referred to as the "Solicitor Terms of Business Agreement" ("the STBA") setting out the terms and conditions upon which Acasta would provide ATE insurance to the Defendant's lay clients. It is Acasta's understanding that the STBA superseded an earlier agreement on the same or similar terms entered into in or about April/May/June 2007 with the Former Partnership and it is Acasta's case that…the Defendant was and remains bound by the terms of any predecessor agreement to the STBA as if it were a party thereto. Acasta will refer to the STBA and any predecessor agreement at trial for their full terms and effect.*

29. The following were, inter alia, express terms of the STBA:

…Prior to the issue of a Policy, the Scheme Solicitor must:

…[e]nsure before requesting a Policy from the Insurers, that a comprehensive risk assessment has been undertaken (which is available in hard copy format detailing same) which demonstrates that…[t]he Claim pursued has at least a 51% prospect of success...

> …be in a position, if requested, to provide case risk analysis to the Insurer for each Client Claim requiring a Policy which gives risk details and the risk assessment processes that have taken place.
>
> Once a Policy has been issued to a Client, the Scheme Solicitor must…
>
> report by Monthly Schedule to the Insurer in relation to any individual Policy and act according to the Policy where it so prescribes, in the following circumstances…
>
> - where there has been a material change of fact that is likely to affect prospects of success…
>
> - [where there has been] Insured non-cooperation…
>
> at any stage in the life of a Claim be prepared to discontinue the Claim should prospects fall below 51%...
>
> The Scheme Solicitor shall discharge their duties and exercise their powers under the terms of this Agreement in a timely manner using sufficient appropriately qualified personnel exercising due care, diligence and skill...

30. *Without prejudice to Acasta's contention that the Defendant has no standing to submit any claim pursuant to the LEI Policies, it is Acasta's case that it is not obliged to entertain any claim under an LEI Policy…relation to which the Defendant or the Former Partnership failed to comply with the terms of the STBA or its predecessor.*

31. *Further or alternatively, in any instance where the Defendant has purported to submit a claim under an LEI Policy in relation to which it or the Former Partnership has failed to comply with the terms of the STBA or any predecessor agreement the Defendant is liable to Acasta in damages and Acasta will rely upon any such loss by way of set-off in defence of the claim. Acasta is unable to quantify such loss in the absence of properly particularised claims under the LEI Policies.*

32. *Yet further or alternatively to paragraphs 22 and 28 to 31 above, it is Acasta's case that when submitting an application to Acasta for LEI insurance, the Defendant owed Acasta a duty of care, such duty requiring the Defendant to undertake with reasonable care and skill a preliminary assessment of the relevant client's claim to ensure that the claim appeared to have at least a reasonable prospect of success, alternatively, a prospect of success not less than 51 percent.*

33. *In any instance where, in breach of the duty set out in paragraph 32 above, the Defendant submitted an application to Acasta for legal expenses insurance without having conducted such an assessment or having conducted such an assessment without reasonable care and skill or having assessed the prospects of success as less than reasonable, the Defendant is liable to Acasta in damages. The loss caused to Acasta is the amount that Acasta would otherwise be liable to pay under the LEI Policy concerned and Acasta will rely upon such loss by way of set-off in defence of the claim.*

34. Without prejudice to the foregoing, in any instance where the Defendant seeks to recover sums allegedly payable under an LEI Policy, Acasta is entitled to require the Defendant to submit to Acasta all such supporting documentation to establish a valid

claim as it would have been entitled to require from the client insured, pursuant to paragraph (m) of the Terms and Conditions of the LEI Policy or otherwise, such as (but without limitation):

34.1 where the claim was unsuccessful, a copy of the order giving judgment against the lay client;

34.2 where the claim had not been proceeded with because, on reconsideration of the merits, the Defendant determined that it had low or no prospects of success (whether by reason of an allegation of fraud or otherwise), a copy of the Defendant's internal re-assessment or correspondence with the client notifying the client accordingly;

34.3 where the claim had been discontinued or withdrawn, a copy of Acasta's approval thereto in accordance with paragraph (1) of the Terms and Conditions of the LEI Policy.

36. *Without prejudice to paragraphs 17 and 22 above, it is Acasta's belief that each of the cases set out in the Schedules submitted to it by the Defendant or the vast majority thereof falls/fall into one or other of the categories set out in paragraphs 28 to 35 above and that the Defendant is accordingly disentitled from recovering any sums thereunder.*