Neutral Citation Number: [2013] EWHC 3413 (Comm)

Case No: 2013-208

IN THE HIGH COURT OF JUSTICE
QUEEN'S BENCH DIVISION
COMMERCIAL COURT

Royal Courts of Justice
Rolls Building, Fetter Lane London, EC4A 1NL

Date: 07/11/2013

Before:

MR JUSTICE HAMBLEN

- -

Between:

Guidance Investments Limited	**Claimant**
- and -	
Guidance Hotel Investment Company B.S.C (Closed)	**Defendant**

- -

- -

George Bompas QC and Tom Gentleman (instructed by **Clyde & Co LLP**) for the **Claimant**
John McCaughran QC and Conall Patton (instructed by **Norton Rose Fulbright LLP**) for the **Defendant**

Hearing dates: Friday 1 November 2013

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Judgment

Mr Justice Hamblen :

Introduction

1. There are two applications before the Court.

2. The first is an application by the Claimant for a stay of part of the Defendant's Counterclaim under section 9 of the Arbitration Act 1996 ("the Act") and/or pursuant to the court's inherent jurisdiction on the grounds that it relates to matters covered by an arbitration clause. In addition the Claimant seeks an order that the Defendant be debarred from relying on the like allegations by way of defence.

3. The second is a contingent cross-application by the Defendant for a stay of the Claimant's claim pursuant to the court's inherent jurisdiction in the event that it was minded to grant the Claimant's stay application.

Factual Background

4. The Defendant is incorporated in Bahrain and has carried on business since 2006 as an investment company investing in hotel properties and businesses. The Claimant is its investment manager.

5. The relationship between the parties is regulated by a Management Agreement originally made on 21 July 2006 and subsequently amended on 4 June 2008 and again on 14 October 2010. For present purposes, nothing turns on the amendments.

6. In these proceedings the Claimant contends that it is entitled to payment of Management Fees pursuant to clause 7 of the Management Agreement, calculated as a percentage of the sums invested by the Defendant's shareholders. It contends that these fees have accrued due on a quarterly basis since 31 December 2010 and that the sum currently outstanding is US$8,942,850.

7. The Defendant denies that any sums are due. It contends, in broad summary, that the accrual of any fees is dependent on the provision of commensurately valuable services by the Claimant, and that this has not occurred. The Defendant further contends that the Claimant has caused the Defendant substantial loss and damage as a result of its alleged mismanagement of a transaction for the purchase of a plot of land in Cairo for the construction of a hotel in 2007-09. The Defendant's case is that the Claimant caused expenditure of about US$24.9m to be incurred in relation to the Cairo property, including the cost of its purported acquisition, but without obtaining good title to the land and without promptly registering such title as may have been acquired and generally acting with gross negligence. The Defendant contends, *inter alia*, that the Claimant's conduct (a) was beyond the Claimant's contractual mandate (Defence, paras 24-5), (b) involved a failure to exercise reasonable care and skill (Defence, paras 26, 30, 31) and (c) amounted to gross negligence (ibid). The Defendant seeks to rely on these matters in support of a defence of set-off (Defence, para 45) and it has also counterclaimed for restoration of the expenditure incurred, damages and restitution of fees previously paid, together with interest.

8. In its Reply and Defence to Counterclaim, the Claimant has (*inter alia*) relied on certain provisions of the Management Agreement (clauses 11.1 and 11.2) as excluding its liability for simple negligence or breach of contract.

The Management Agreement

9. The most relevant terms of the Management Agreement are as follows:

> "9. Termination of the Manager's appointment
>
> 9.1 Pursuant to clause 7.4(b) Of the Shareholders' Agreement and subject to a prior arbitral award in favour of the Company where the existence of an Event of Default (defined below) is disputed, the Company shall be entitled to promptly terminate the Manager's appointment under this Agreement and, thereby, this Agreement on the occurrence of any of the following events (each an "Event of Default") by giving written notice to the Manager of such termination within 60 days after the Company and/or the Board becomes aware of such an Event of Default:
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> (a) the Manager has engaged in grossly negligent, reckless, fraudulent or wilful misconduct in the performances of it duties under this Agreement;
> (b) the Manager has committed a crime involving fraud and/or financial dishonesty; or
> (c) the Manager has committed a material breach of this Agreement and, in the case of a breach capable of being remedied has failed to remedy such breach within a period of 30 days after being required to do so in writing by the Company.
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> 13. Arbitration
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> 13.1 Any dispute arising out of or in connection with an Event of Default under clause 9 shall be referred to and finally resolved by arbitration under the rules of the London Court of International Arbitration ("LCIA") which rules are deemed to be incorporated by reference to this clause. The number of arbitrators shall be one who shall be an English barrister or solicitor who has practised as such for at least 15 years, unless the LCIA Court determines that in view of all the circumstances of the case a three-member tribunal is appropriate three. The place and seat of arbitration shall be London, England. The language to be used in the arbitration proceedings shall be English.
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> 17. Governing Law and Jurisdiction
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> 17.1 This Agreement and the rights, obligations and relationships of the parties hereto under this Agreement shall be governed by and construed in accordance with the laws of England and Wales and the parties irrevocably agree that the courts of England and Wales shall have non-exclusive jurisdiction to settle any disputes which may arise out of or in connection with this Agreement (subject to clause 13 (Arbitration) in relation to disputes under clause 9."

10. The Management Agreement also contains indemnities and exclusions of liability, at clause 11. The Claimant contends that, in broad outline, clause 11.1 provides that the Claimant shall have no liability for any loss to the Defendant, howsoever arising in connection with the services performed by the Claimant; and clause 11.2 provides for

the Defendant to grant extensive indemnities for losses suffered by the Claimant. The operation of those clauses is qualified by clause 11.3, which states (so far as material) as follows:

> "The provisions of clauses 11.1 and 11.2 shall not apply, the persons specified in clause 11.1 shall not be exculpated, and no Indemnified Party shall be indemnified in respect of any matter resulting from its fraud ... its gross negligence ...".

The court's power to stay proceedings

11. Section 9 of the Act provides for a mandatory stay of court proceedings, including proceedings brought by way of counterclaim, to the extent that they concern a matter which is to be referred to arbitration:

> "9. Stay of legal proceedings.
>
> (1) A party to an arbitration agreement against whom legal proceedings are brought (whether by way of claim or counterclaim) in respect of a matter which under the agreement is to be referred to arbitration may (upon notice to the other parties to the proceedings) apply to the court in which the proceedings have been brought to stay the proceedings so far as they concern that matter.
>
> (2) An application may be made notwithstanding that the matter is to be referred to arbitration only after the exhaustion of other dispute resolution procedures.
>
> (3) An application may not be made by a person before taking the appropriate procedural step (if any) to acknowledge the legal proceedings against him or after he has taken any step in those proceedings to answer the substantive claim.
>
> (4) On an application under this section the court shall grant a stay unless satisfied that the arbitration agreement is null and void, inoperative, or incapable of being performed.
>
> …"

12. In addition to powers under section 9 of the Act, the court may also grant a stay pursuant to its inherent jurisdiction and case management powers. This inherent jurisdiction is reflected in CPR Rule 3.1(2)(f), which states that the court may "stay the whole or part of any proceedings or judgement either generally or until a specified date or event".

The Issues

13. The principal issues which arise are:

    (1) Whether the relevant allegations in the Defence and Counterclaim are caught by the arbitration agreement.

(2) If they are, whether the Defendant is entitled to advance those allegations in these proceedings because they are relied on for the purposes of a defence of transaction set-off.

14. Further issues may then arise depending upon how those questions are determined.

Issue (1) - Whether the relevant allegations in the Defence and Counterclaim are caught by the arbitration agreement.

15. The general approach to the construction of arbitration agreements is that there is a presumption of one stop adjudication as was explained by Lord Hoffmann in *Fiona Trust v Privalov* [2007] UKHL 40, [2007] 4 All ER 951. The starting point is that the parties, as rational businessmen, are likely to have intended that any dispute arising out of the relationship should be decided by the same tribunal.

16. However, as was common ground, there is no presumption where, as in the present case, the parties have provided for some disputes to be litigated and others arbitrated. In *Barclays Bank PLC v Nylon Capital LLP* [2011] EWCA Civ 826, [2012] 1 All ER (Comm) 912, which concerned the construction of an expert determination clause, Thomas LJ said (at [27]):

> "In contradistinction expert determination clauses generally presuppose that the parties intended certain types of dispute to be resolved by expert determination and other types by the court (or if there is an arbitration clause by arbitrators). The rationale of the Fiona Trust case does not therefore apply, as the parties have agreed to two types of dispute resolution procedure for disputes which might arise under the agreement. The LLP agreement illustrates this: the parties agreed by cl 26.2 to submit to the exclusive jurisdiction of the English courts, but reserved specific disputes under cl 26.1 to the expert. They carved out of the exclusive jurisdiction of the English courts, to which they had submitted all disputes between the parties, a limited class of dispute. Therefore, quite unlike the position under agreements with arbitration clauses (as exemplified by the Fiona Trust case), the parties have chosen two alternative forms of dispute resolution. There is, therefore, no presumption in favour of giving a wide and generous interpretation to the jurisdiction of the expert conferred by the expert determination clause as the reasoning in the Fiona Trust case is inapplicable. The simple question is whether the dispute which has arisen between the parties is within the jurisdiction of the expert conferred by the expert determination clause or is not within it and is therefore within the jurisdiction of the English court. It is a question of construction with no presumption either way."

17. In relation to the arbitration clause in the present case, the Claimant stresses that the wording used in clause 13 is expansive – "any dispute arising out of or in connection with an Event of Default". It submits that it covers not just the narrow situation where one party alleges that there has been an Event of Default and seeks on that basis to terminate the current Management Agreement, but it also covers a claim made by the Defendant that it is entitled to damages or compensation by reference to a matter which qualifies, or potentially qualifies, within the definition of an Event of Default.

18. In this case the Defendant is claiming damages by reference to facts which qualify or potentially qualify as gross negligence. Since gross negligence is a specified Event of

Default the Claimant contends that it follows that such allegations must be referred to arbitration.

19. The Claimant further relies on clause 11 and what it submits is the scheme of clauses 9, 11 and 13 taken together. It submits that this is that the Claimant is not liable to the Defendant save in respect of the matters referred to in respect of clause 11.3, which include gross negligence on the part of the Claimant. Gross negligence constitutes an Event of Default under clause 9 and any dispute arising out of or in connection with such an Event of Default is to be referred to arbitration rather than being litigated in the High Court.

20. The Defendant's case is that clause 13 arbitration only applies where the Defendant has given notice of termination under clause 9 on the grounds of an alleged Event of Default. It is the giving of such notice that serves to elicit from the Claimant whether the existence of an Event of Default is disputed and, accordingly, whether the Defendant needs to secure a "prior arbitral award" in order to render its notice of termination effectual. It is only in those limited circumstances that there is a carve-out from the general position that disputes should be litigated in accordance with the non-exclusive jurisdiction clause, clause 17.

21. The Defendant relies in particular on the following:

    (1) Clause 13 does not simply refer to an Event of Default; it refers to an Event of Default "under Clause 9".

    (2) Clause 9, as its content make clear, is exclusively concerned with termination.

    (3) Clause 9 lays down a specific mechanism for termination whereby the Defendant as a first step gives notice of termination following an Event of Default. If the Claimant disputes the existence of an Event of Default, then the Defendant must, as a second step, obtain a "prior arbitral award" in its favour. It would appear that the notice of termination only takes effect once the arbitral tribunal has issued a favourable award.

    (4) The arbitration agreement in clause 13 is the means by which, as part of the second step, the Defendant may seek to obtain an arbitral award confirming the existence of an Event of Default.

    (5) Clause 9 says that gross negligence (among other things) is a ground for termination, but it does not purport to deal with claims for damages based, amongst other things, upon allegations of gross negligence, which do not arise in the context of a disputed notice of termination. Thus, a dispute about whether the Claimant must pay damages for its grossly negligent conduct, and in what amount, is not a dispute arising out of or in connection with an Event of Default "under clause 9" at all.

    (6) That the cross-reference in clause 13 to "clause 9" was deliberate is supported by the fact that clause 17 makes a similar cross-reference: the carve-out for arbitration is expressed using the words "subject to clause 13 (Arbitration) in relation to disputes under clause 9".

22. I prefer the Defendant's construction of the agreement for the reasons given by it and in particular:

(1) The starting point is that clause 13 only applies in relation to disputes in connection with an Event of Default.

(2) An Event of Default is a defined term for the purpose of clause 9, and for that purpose only.

(3) Clause 9 is concerned with termination and the only contractual circumstance in which it is necessary to establish an Event of Default is for the purpose of exercising a right of termination under that clause.

(4) In the present case no right of termination is being claimed and no allegation or averment of an Event of Default needs to be or is being made.

(5) Since no Event of Default is being alleged, there is and can be no dispute in connection with an Event of Default.

(6) There is accordingly no dispute within the meaning of clause 13.1.

23. I agree with the Defendant that clause 13 is concerned with resolving disputes about the right to terminate under clause 9. I also agree that such a carve-out makes good commercial sense. It enables an important but defined dispute to be dealt with by a relatively speedy means (LCIA arbitration) with no right of appeal in law. It avoids the resolution of that dispute being caught up with other disputes which may arise between the parties generally.

24. The Claimant's construction involves rewriting the clause. On their case clause 13 covers not disputes in connection with an Event of Default, but rather disputes in connection with allegations which might support a claim that there has been an Event of Default, even though it is not being asserted or claimed that there has been any Event of Default.

25. In support of its case the Claimant submits that on the Defendant's construction the arbitration provision could be circumvented because the Defendant could, for example, bring and establish claims for gross negligence and, having done so, immediately terminate, there then being no need to arbitrate since its right would already be established. However, as the Defendant points out, this scenario is most unlikely to arise as under clause 9 the Defendant is required to give notice of termination within 60 days of becoming aware of an Event of Default.

26. The Claimant further submits that the Defendant's construction would leave it free to bring, for example, gross negligence damages claims in court and gross negligence termination claims in arbitration, a duplication which cannot sensibly have been intended. However, in a case where the Defendant is asserting a disputed right to terminate on the grounds of an Event of Default it may well be that disputed claims for damages arising out of that same Event of Default would be regarded as arising in connection with an Event of Default. However, that is not this case.

27. The Defendant's construction results in a coherent contractual scheme whereby there is a limited and defined carve-out to arbitration of the specific issue of disputes in connection with whether there has been an Event of Default for the purpose of termination under clause 9. All other disputes are covered by the jurisdiction clause.

28. By contrast, the Claimant's construction produces incoherence and confusion. In many cases, as the present case illustrates, a claim by the Defendant may be based on

allegations of breach, some of which would amount to an Event of Default within clause 9 and some of which would not. As the present case also illustrates, the same facts may found those differing allegations of breach. On the Claimant's case, some of those claims have to be arbitrated, but others do not.

29. The Claimant suggests that there are unlikely to be claims for breaches of contract or duty that do not involve gross negligence or serious misconduct by reason of the clause 11 exclusions. However, the ambit of that clause is very much in issue and the present case illustrates that other claims may indeed be brought. Further, on any view such claims may be brought by way of set-off. In any event this does not avoid the problem that they are not covered by the arbitration clause.

30. To seek to mitigate such difficulties the Claimant suggests that claims in ordinary negligence also have to be arbitrated because such claims would be encompassed in gross negligence claims. However, that is not their pleaded case. In their Reply clause 13 is only said to apply to allegations of gross negligence, fraudulent or wilful misconduct. As the pleading recognises, even if clause 13 covers allegations which would amount to an Event of Default (were that being alleged) that would still not cover claims in simple negligence or simple breach of contract, or, for that matter, breach of mandate.

31. It would, as the Defendant submits, be unworkable if these different allegations had to be artificially disentangled and separately adjudicated. This was indeed acknowledged by the Claimant in its supporting evidence and was the basis of its application for a stay under the inherent jurisdiction of the court. As was stated:

> "The allegations of gross negligence form part of the Defendant's breach of contract case. They are inextricably linked with the allegations of negligence, and the breach of contract, more generally. In the circumstances, it would be unworkable for the allegations of breach of contract to be litigated in court, with the specific part of those allegations concerning gross negligence stripped out and addressed in a different forum…"

32. This all serves to reinforce the conclusion that clause 13 was never intended to apply to any allegation of gross negligence, howsoever arising, but only to an allegation of gross negligence relied upon as an Event of Default to justify a notice of termination.

33. As the Defendant further submits, insofar as clause 13 may be open to more than one construction, its construction is more consistent with business common sense and should be preferred: *Rainy Sky SA v Kookmin Bank* [2011] UKSC 50, [2012] 1 All ER 1137.

34. For all these reasons I conclude that clause 13 does not apply to the claims made by the Defendant in this case and therefore no question of stay arises.

Issue (2) - whether the Defendant is entitled to advance those allegations in these proceedings because they are relied on for the purposes of a defence of transaction set-off.

35. This only arises for decision if I am wrong on issue (1).

36. The general position in relation to defences of transaction set-off is summarised by Professor Merkin's *Arbitration Law* (2012) at para 8.29(b):

> "If C has a claim against D which is not governed by an arbitration clause, and D has a counterclaim against C which is governed by an arbitration clause and which gives rise to a transaction set-off, C is not entitled to a stay of D's counterclaim in any proceedings brought by C. Instead, the court is entitled to resolve the dispute which gave rise to the counterclaim in order to allow D's defence to be recognised. The effect is to override C's right to insist upon arbitration in respect of the counterclaim."

37. This reflects the authorities. In *Aectra Refining v Exmar NV* [1995] 1 All ER 641, the issue was whether, on a claim to enforce an arbitral award, the award debtor could set off sums which it contended to be due under a separate contract and which was subject to a separate arbitration. The award creditor argued that, in order to be available as a set-off, the cross-claim had to be capable of being litigated in the court in which the set-off was pleaded.

38. Hoffmann LJ said it was necessary to distinguish between "independent set-off" and "transaction set-off": the former does not require any relationship between the transactions out of which the cross claims arise, whereas transaction set-off is a cross-claim arising out of the same transaction or one so closely related that it operates in law or in equity as a complete or partial defeasance of the claim.

39. In the case of transaction set-off, Hoffmann LJ observed that that the authorities favoured allowing the set-off to be pleaded; notwithstanding its submission to arbitration and that this obviously makes good sense. As he stated at 685c-g:

> "In the case of transaction set-off, the authorities are in favour of allowing the set-off to be pleaded, notwithstanding its submission to arbitration or a different jurisdiction. *Modern Engineering (Bristol) Ltd. v. Gilbert-Ash (Northern) Ltd. [1974] A.C. 689* concerned the question of whether a *Mondel v. Steel*, 8 M. & W. 858 abatement for defective work could be pleaded as a defence to a claim by a builder for payment under an architect's certificate. The House of Lords decided that it could, notwithstanding that the contract provided for arbitration on the question of whether the work was defective. Lord Diplock *[1974] A.C. 689*, 720 said that the contractor could apply for the stay of his own action pending arbitration but if he did not "the court would have to decide on the evidence adduced before it whether the defence was made out." Lord Salmon said, at p. 726, that it would "emasculate" the right of set-off if the courts were to say to the defendant, "Pay up now and arbitrate later." Likewise in *Meeth v. Glacetal S.a.r.l. (Case 23/78) [1978] E.C.R. 2133* the Court of Justice of the European Communities decided that a German buyer of glass, sued for the price in a German court by the French seller, could plead a set-off for delays and defaults by the seller notwithstanding a choice of jurisdiction clause valid under article 17 which said that each party could be sued only in his own jurisdiction.
>
> In cases of transaction set-off, this obviously makes good sense. *Mondel v. Steel (1841) 8 M. & W. 858* is, as Lord Diplock emphasised in *Modern Engineering (Bristol) Ltd. v. Gilbert-Ash (Northern) Ltd. [1974] A.C. 689* , 717, "no mere procedural rule designed to avoid circuity of action but a substantive defence at common law." The same is true of set-off in equity. The defendant is pleading a confession and avoidance to the plaintiff's claim. He is

> saying that, although the facts alleged by the plaintiff entitle him to judgment for the amount claimed, a wider examination of related facts would show that the claim is wholly or partly extinguished. It would be quite unreasonable for a plaintiff who has chosen to sue in one forum to rely upon an arbitration or jurisdiction clause to confine the court to the facts which he chooses to prove and prevent it from examining related facts as well."

40. It may be that the reason why there is no mandatory stay under s.9 in such a case is that the deployment of a set-off by way of substantive defence does not involve the bringing of legal proceedings within the meaning of s. 9, whether by way of claim or counterclaim, even though the set-off may be pleaded within the confines of a pleading described as a counterclaim: *Prekons Insaat Sanayi v Rowlands Castle Contracting Group* [2006] EWHC 1367 (Comm) at [11].

41. In the present case the defence of set-off invoked by the Defendant is one of transaction set-off, and not an independent set-off. The Claimant acknowledges that if there is a right of transaction set off then it may be relied upon as a defence. It disputes, however, that any such right arises in this case.

42. The Defendant contends that it has a right of equitable set-off, a form of transaction set-off. It relies on the explanation of equitable set-off set out by Rix LJ in his judgment in *Geldof Metaalconstructie v Simon Carves* [2010] EWCA Civ 667, [2010] 4 All ER 847. At [43] he states that the test for an equitable set-off has a formal and a functional requirement: the formal requirement is of a close connection between claim and cross-claim and the functional requirement is that it needs to be unjust to enforce the claim without taking into account the cross-claim.

43. These requirements may be satisfied even though the claim and cross-claim do not arise from the same contract or transaction: see *Bim Kemi AB v Blackburn Chemicals Ltd* [2001] EWCA Civ 457, [2001] 2 Lloyd's Rep 93. Where, as in the present case, they do arise from the same contract, then the Defendant submits that they are likely to be and in this case are met. In this connection the Defendant relies in particular on Rix LJ's statement in *Geldof* at 848j that "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". The Defendant also relies on *Derham on Set-Off* at 4.91 where it is stated:

> "Under more modern formulations of the principle governing equitable set-off approved by English courts, cross claims arising out of the same contract ordinarily would give rise to a set-off. Nevertheless, it is still the case that there is no universal rule that claims arising out of the same contract may be set against each other in all circumstances." (emphasis added)

44. The Claimant submits that in this case neither the formal nor the functional requirements are satisfied. It points out that its claim for fees is based on services provided from the last quarter of 2010 onwards. The Defendant's cross-claim relates to matters which occurred some years before that and has no, or no sufficient connection, with the Claimant's claim for fees so as to give rise to the injustice necessary to found a right of equitable set-off. It relies by analogy on cases in which employees have been held entitled to claim wages notwithstanding allegations of earlier misconduct, such as *Miles v Wakefield MBC* [1987] ICR 368; *Sim v Rotherham*

MBC [1990] ICR 383*; New Centurion Trust Ltd. V Welch and Another* [1990] ICR 383.

45. The Defendant disputes the relevance of the wages cases and points out that they are mainly concerned with a failure or refusal to work as opposed to a cross claim for damages. In any event it submits that they are a special case and involve a legislative background. I consider, however, that there is force in the Claimant's fundamental point that they cannot be required to go on providing services for no fee on the grounds of alleged misconduct which is long past. On the Defendant's case, given the quantum of its counterclaim, not only has the Claimant been obliged so to do, but it is obliged to go on doing so indefinitely.

46. I am reluctant finally to decide this issue as it involves determination of whether or not there is a particular right of defence and it is likely to require a consideration of issues of fact. In particular, it is the Defendant's case that there has been an ongoing breach of contract by the Claimant in failing to inform it of the matters which give rise to its claim. But for that breach of duty the claim might well have been raised when there was a co-incidence in time between the fees claimed and the events founding the counterclaim. This may well be relevant to considerations of justice and the functional requirement. I am inclined to the view that this is the type of case in which the mere fact that the cross-claim arises out of the same contract is unlikely to be sufficient to establish the injustice necessary to found a right of equitable set-off and that further facts will need to be established. However, since it is not necessary to express a final view on the matter, I do not propose to do so.

47. In the light of my conclusions on Issue (1) it is not necessary to consider either side's application for a stay under the court's inherent jurisdiction.

Conclusion

48. In conclusion, for the reasons outlined above, the allegations made in the Defence and Counterclaim are not caught by the arbitration agreement and the Claimant's application for a stay is accordingly to be dismissed.

Introduction

49. There are two applications before the Court.

50. The first is an application by the Claimant for a stay of part of the Defendant's Counterclaim under section 9 of the Arbitration Act 1996 ("the Act") and/or pursuant to the court's inherent jurisdiction on the grounds that it relates to matters covered by an arbitration clause. In addition the Claimant seeks an order that the Defendant be debarred from relying on the like allegations by way of defence.

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Factual Background

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54. In these proceedings the Claimant contends that it is entitled to payment of Management Fees pursuant to clause 7 of the Management Agreement, calculated as a percentage of the sums invested by the Defendant's shareholders. It contends that these fees have accrued due on a quarterly basis since 31 December 2010 and that the sum currently outstanding is US$8,942,850.

55. The Defendant denies that any sums are due. It contends, in broad summary, that the accrual of any fees is dependent on the provision of commensurately valuable services by the Claimant, and that this has not occurred. The Defendant further contends that the Claimant has caused the Defendant substantial loss and damage as a result of its alleged mismanagement of a transaction for the purchase of a plot of land in Cairo for the construction of a hotel in 2007-09. The Defendant's case is that the Claimant caused expenditure of about US$24.9m to be incurred in relation to the Cairo property, including the cost of its purported acquisition, but without obtaining good title to the land and without promptly registering such title as may have been acquired and generally acting with gross negligence. The Defendant contends, *inter alia*, that the Claimant's conduct (a) was beyond the Claimant's contractual mandate (Defence, paras 24-5), (b) involved a failure to exercise reasonable care and skill (Defence, paras 26, 30, 31) and (c) amounted to gross negligence (ibid). The Defendant seeks to rely on these matters in support of a defence of set-off (Defence, para 45) and it has also counterclaimed for restoration of the expenditure incurred, damages and restitution of fees previously paid, together with interest.

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> (d) the Manager has engaged in grossly negligent, reckless, fraudulent or wilful misconduct in the performances of it duties under this Agreement;

(e) the Manager has committed a crime involving fraud and/or financial dishonesty; or

(f) the Manager has committed a material breach of this Agreement and, in the case of a breach capable of being remedied has failed to remedy such breach within a period of 30 days after being required to do so in writing by the Company.

13. Arbitration

13.1 Any dispute arising out of or in connection with an Event of Default under clause 9 shall be referred to and finally resolved by arbitration under the rules of the London Court of International Arbitration ("LCIA") which rules are deemed to be incorporated by reference to this clause. The number of arbitrators shall be one who shall be an English barrister or solicitor who has practised as such for at least 15 years, unless the LCIA Court determines that in view of all the circumstances of the case a three-member tribunal is appropriate three. The place and seat of arbitration shall be London, England. The language to be used in the arbitration proceedings shall be English.

17. Governing Law and Jurisdiction

17.2 This Agreement and the rights, obligations and relationships of the parties hereto under this Agreement shall be governed by and construed in accordance with the laws of England and Wales and the parties irrevocably agree that the courts of England and Wales shall have non-exclusive jurisdiction to settle any disputes which may arise out of or in connection with this Agreement (subject to clause 13 (Arbitration) in relation to disputes under clause 9."

58. The Management Agreement also contains indemnities and exclusions of liability, at clause 11. The Claimant contends that, in broad outline, clause 11.1 provides that the Claimant shall have no liability for any loss to the Defendant, howsoever arising in connection with the services performed by the Claimant; and clause 11.2 provides for the Defendant to grant extensive indemnities for losses suffered by the Claimant. The operation of those clauses is qualified by clause 11.3, which states (so far as material) as follows:

> "The provisions of clauses 11.1 and 11.2 shall not apply, the persons specified in clause 11.1 shall not be exculpated, and no Indemnified Party shall be indemnified in relation to any matter resulting from its fraud ... its gross negligence ...".

The court's power to stay proceedings

59. Section 9 of the Act provides for a mandatory stay of court proceedings, including proceedings brought by way of counterclaim, to the extent that they concern a matter which is to be referred to arbitration:

> "9. Stay of legal proceedings.

(1) A party to an arbitration agreement against whom legal proceedings are brought (whether by way of claim or counterclaim) in respect of a matter which under the agreement is to be referred to arbitration may (upon notice to the other parties to the proceedings) apply to the court in which the proceedings have been brought to stay the proceedings so far as they concern that matter.

(2) An application may be made notwithstanding that the matter is to be referred to arbitration only after the exhaustion of other dispute resolution procedures.

(3) An application may not be made by a person before taking the appropriate procedural step (if any) to acknowledge the legal proceedings against him or after he has taken any step in those proceedings to answer the substantive claim.

(4) On an application under this section the court shall grant a stay unless satisfied that the arbitration agreement is null and void, inoperative, or incapable of being performed.

…"

60. In addition to powers under section 9 of the Act, the court may also grant a stay pursuant to its inherent jurisdiction and case management powers. This inherent jurisdiction is reflected in CPR Rule 3.1(2)(f), which states that the court may "stay the whole or part of any proceedings or judgement either generally or until a specified date or event".

The Issues

61. The principal issues which arise are:

(1) Whether the relevant allegations in the Defence and Counterclaim are caught by the arbitration agreement.

(2) If they are, whether the Defendant is entitled to advance those allegations in these proceedings because they are relied on for the purposes of a defence of transaction set-off.

62. Further issues may then arise depending upon how those questions are determined.

Issue (1) - Whether the relevant allegations in the Defence and Counterclaim are caught by the arbitration agreement.

63. The general approach to the construction of arbitration agreements is that there is a presumption of one stop adjudication as was explained by Lord Hoffmann in *Fiona Trust v Privalov* [2007] UKHL 40, [2007] 4 All ER 951. The starting point is that the parties, as rational businessmen, are likely to have intended that any dispute arising out of the relationship should be decided by the same tribunal.

64. However, as was common ground, there is no presumption where, as in the present case, the parties have provided for some disputes to be litigated and others arbitrated. In *Barclays Bank PLC v Nylon Capital LLP* [2011] EWCA Civ 826, [2012] 1 All ER

(Comm) 912, which concerned the construction of an expert determination clause, Thomas LJ said (at [27]):

> "In contradistinction expert determination clauses generally presuppose that the parties intended certain types of dispute to be resolved by expert determination and other types by the court (or if there is an arbitration clause by arbitrators). The rationale of the Fiona Trust case does not therefore apply, as the parties have agreed to two types of dispute resolution procedure for disputes which might arise under the agreement. The LLP agreement illustrates this: the parties agreed by cl 26.2 to submit to the exclusive jurisdiction of the English courts, but reserved specific disputes under cl 26.1 to the expert. They carved out of the exclusive jurisdiction of the English courts, to which they had submitted all disputes between the parties, a limited class of dispute. Therefore, quite unlike the position under agreements with arbitration clauses (as exemplified by the Fiona Trust case), the parties have chosen two alternative forms of dispute resolution. There is, therefore, no presumption in favour of giving a wide and generous interpretation to the jurisdiction of the expert conferred by the expert determination clause as the reasoning in the Fiona Trust case is inapplicable. The simple question is whether the dispute which has arisen between the parties is within the jurisdiction of the expert conferred by the expert determination clause or is not within it and is therefore within the jurisdiction of the English court. It is a question of construction with no presumption either way."

65. In relation to the arbitration clause in the present case, the Claimant stresses that the wording used in clause 13 is expansive – "any dispute arising out of or in connection with an Event of Default". It submits that it covers not just the narrow situation where one party alleges that there has been an Event of Default and seeks on that basis to terminate the current Management Agreement, but it also covers a claim made by the Defendant that it is entitled to damages or compensation by reference to a matter which qualifies, or potentially qualifies, within the definition of an Event of Default.

66. In this case the Defendant is claiming damages by reference to facts which qualify or potentially qualify as gross negligence. Since gross negligence is a specified Event of Default the Claimant contends that it follows that such allegations must be referred to arbitration.

67. The Claimant further relies on clause 11 and what it submits is the scheme of clauses 9, 11 and 13 taken together. It submits that this is that the Claimant is not liable to the Defendant save in respect of the matters referred to in respect of clause 11.3, which include gross negligence on the part of the Claimant. Gross negligence constitutes an Event of Default under clause 9 and any dispute arising out of or in connection with such an Event of Default is to be referred to arbitration rather than being litigated in the High Court.

68. The Defendant's case is that clause 13 arbitration only applies where the Defendant has given notice of termination under clause 9 on the grounds of an alleged Event of Default. It is the giving of such notice that serves to elicit from the Claimant whether the existence of an Event of Default is disputed and, accordingly, whether the Defendant needs to secure a "prior arbitral award" in order to render its notice of termination effectual. It is only in those limited circumstances that there is a carve-

out from the general position that disputes should be litigated in accordance with the non-exclusive jurisdiction clause, clause 17.

69. The Defendant relies in particular on the following:

(1) Clause 13 does not simply refer to an Event of Default; it refers to an Event of Default "under Clause 9".

(2) Clause 9, as its content make clear, is exclusively concerned with termination.

(3) Clause 9 lays down a specific mechanism for termination whereby the Defendant as a first step gives notice of termination following an Event of Default. If the Claimant disputes the existence of an Event of Default, then the Defendant must, as a second step, obtain a "prior arbitral award" in its favour. It would appear that the notice of termination only takes effect once the arbitral tribunal has issued a favourable award.

(4) The arbitration agreement in clause 13 is the means by which, as part of the second step, the Defendant may seek to obtain an arbitral award confirming the existence of an Event of Default.

(5) Clause 9 says that gross negligence (among other things) is a ground for termination, but it does not purport to deal with claims for damages based, amongst other things, upon allegations of gross negligence, which do not arise in the context of a disputed notice of termination. Thus, a dispute about whether the Claimant must pay damages for its grossly negligent conduct, and in what amount, is not a dispute arising out of or in connection with an Event of Default "under clause 9" at all.

(6) That the cross-reference in clause 13 to "clause 9" was deliberate is supported by the fact that clause 17 makes a similar cross-reference: the carve-out for arbitration is expressed using the words "subject to clause 13 (Arbitration) in relation to disputes under clause 9".

70. I prefer the Defendant's construction of the agreement for the reasons given by it and in particular:

(1) The starting point is that clause 13 only applies in relation to disputes in connection with an Event of Default.

(2) An Event of Default is a defined term for the purpose of clause 9, and for that purpose only.

(3) Clause 9 is concerned with termination and the only contractual circumstance in which it is necessary to establish an Event of Default is for the purpose of exercising a right of termination under that clause.

(4) In the present case no right of termination is being claimed and no allegation or averment of an Event of Default needs to be or is being made.

(5) Since no Event of Default is being alleged, there is and can be no dispute in connection with an Event of Default.

(6) There is accordingly no dispute within the meaning of clause 13.1.

71. I agree with the Defendant that clause 13 is concerned with resolving disputes about the right to terminate under clause 9. I also agree that such a carve-out makes good commercial sense. It enables an important but defined dispute to be dealt with by a relatively speedy means (LCIA arbitration) with no right of appeal in law. It avoids the resolution of that dispute being caught up with other disputes which may arise between the parties generally.

72. The Claimant's construction involves rewriting the clause. On their case clause 13 covers not disputes in connection with an Event of Default, but rather disputes in connection with allegations which might support a claim that there has been an Event of Default, even though it is not being asserted or claimed that there has been any Event of Default.

73. In support of its case the Claimant submits that on the Defendant's construction the arbitration provision could be circumvented because the Defendant could, for example, bring and establish claims for gross negligence and, having done so, immediately terminate, there then being no need to arbitrate since its right would already be established. However, as the Defendant points out, this scenario is most unlikely to arise as under clause 9 the Defendant is required to give notice of termination within 60 days of becoming aware of an Event of Default.

74. The Claimant further submits that the Defendant's construction would leave it free to bring, for example, gross negligence damages claims in court and gross negligence termination claims in arbitration, a duplication which cannot sensibly have been intended. However, in a case where the Defendant is asserting a disputed right to terminate on the grounds of an Event of Default it may well be that disputed claims for damages arising out of that same Event of Default would be regarded as arising in connection with an Event of Default. However, that is not this case.

75. The Defendant's construction results in a coherent contractual scheme whereby there is a limited and defined carve-out to arbitration of the specific issue of disputes in connection with whether there has been an Event of Default for the purpose of termination under clause 9. All other disputes are covered by the jurisdiction clause.

76. By contrast, the Claimant's construction produces incoherence and confusion. In many cases, as the present case illustrates, a claim by the Defendant may be based on allegations of breach, some of which would amount to an Event of Default within clause 9 and some of which would not. As the present case also illustrates, the same facts may found those differing allegations of breach. On the Claimant's case, some of those claims have to be arbitrated, but others do not.

77. The Claimant suggests that there are unlikely to be claims for breaches of contract or duty that do not involve gross negligence or serious misconduct by reason of the clause 11 exclusions. However, the ambit of that clause is very much in issue and the present case illustrates that other claims may indeed be brought. Further, on any view such claims may be brought by way of set off. In any event this does not avoid the problem that they are not covered by the arbitration clause.

78. To seek to mitigate such difficulties the Claimant suggests that claims in ordinary negligence also have to be arbitrated because such claims would be encompassed in gross negligence claims. However, that is not their pleaded case. In their Reply clause 13 is only said to apply to allegations of gross negligence, fraudulent or wilful misconduct. As the pleading recognises, even if clause 13 covers allegations which

would amount to an Event of Default (were that being alleged) that would still not cover claims in simple negligence or simple breach of contract, or, for that matter, breach of mandate.

79. It would, as the Defendant submits, be unworkable if these different allegations had to be artificially disentangled and separately adjudicated. This was indeed acknowledged by the Claimant in its supporting evidence and was the basis of its application for a stay under the inherent jurisdiction of the court. As was stated:

> "The allegations of gross negligence form part of the Defendant's breach of contract case. They are inextricably linked with the allegations of negligence, and the breach of contract, more generally. In the circumstances, it would be unworkable for the allegations of breach of contract to be litigated in court, with the specific part of those allegations concerning gross negligence stripped out and addressed in a different forum…"

80. This all serves to reinforce the conclusion that clause 13 was never intended to apply to any allegation of gross negligence, howsoever arising, but only to an allegation of gross negligence relied upon as an Event of Default to justify a notice of termination.

81. As the Defendant further submits, insofar as clause 13 may be open to more than one construction, its construction is more consistent with business common sense and should be preferred: *Rainy Sky SA v Kookmin Bank* [2011] UKSC 50, [2012] 1 All ER 1137.

82. For all these reasons I conclude that clause 13 does not apply to the claims made by the Defendant in this case and therefore no question of stay arises.

Issue (2) - whether the Defendant is entitled to advance those allegations in these proceedings because they are relied on for the purposes of a defence of transaction set-off.

83. This only arises for decision if I am wrong on issue (1).

84. The general position in relation to defences of transaction set off is summarised by Professor Merkin's *Arbitration Law* (2012) at para 8.29(b):

> "If C has a claim against D which is not governed by an arbitration clause, and D has a counterclaim against C which is governed by an arbitration clause and which gives rise to a transaction set-off, C is not entitled to a stay of D's counterclaim in any proceedings brought by C. Instead, the court is entitled to resolve the dispute which gave rise to the counterclaim in order to allow D's defence to be recognised. The effect is to override C's right to insist upon arbitration in respect of the counterclaim."

85. This reflects the authorities. In *Aectra Refining v Exmar NV* [1995] 1 All ER 641, the issue was whether, on a claim to enforce an arbitral award, the award debtor could set off sums which it contended to be due under a separate contract and which was subject to a separate arbitration. The award creditor argued that, in order to be available as a set-off, the cross-claim had to be capable of being litigated in the court in which the set-off was pleaded.

86. Hoffmann LJ said it was necessary to distinguish between "independent set-off" and "transaction set-off": the former does not require any relationship between the transactions out of which the cross claims arise, whereas transaction set-off is a cross-

claim arising out of the same transaction or one so closely related that it operates in law or in equity as a complete or partial defeasance of the claim.

87. In the case of transaction set-off, Hoffmann LJ observed that that the authorities favoured allowing the set-off to be pleaded; notwithstanding its submission to arbitration and that this obviously makes good sense. As he stated at 685c-g:

> "In the case of transaction set-off, the authorities are in favour of allowing the set-off to be pleaded, notwithstanding its submission to arbitration or a different jurisdiction. *Modern Engineering (Bristol) Ltd. v. Gilbert-Ash (Northern) Ltd. [1974] A.C. 689* concerned the question of whether a *Mondel v. Steel*, 8 M. & W. 858 abatement for defective work could be pleaded as a defence to a claim by a builder for payment under an architect's certificate. The House of Lords decided that it could, notwithstanding that the contract provided for arbitration on the question of whether the work was defective. Lord Diplock *[1974] A.C. 689*, 720 said that the contractor could apply for the stay of his own action pending arbitration but if he did not "the court would have to decide on the evidence adduced before it whether the defence was made out." Lord Salmon said, at p. 726, that it would "emasculate" the right of set-off if the courts were to say to the defendant, "Pay up now and arbitrate later." Likewise in *Meeth v. Glacetal S.a.r.l. (Case 23/78) [1978] E.C.R. 2133* the Court of Justice of the European Communities decided that a German buyer of glass, sued for the price in a German court by the French seller, could plead a set-off for delays and defaults by the seller notwithstanding a choice of jurisdiction clause valid under article 17 which said that each party could be sued only in his own jurisdiction.
>
> In cases of transaction set-off, this obviously makes good sense. *Mondel v. Steel (1841) 8 M. & W. 858* is, as Lord Diplock emphasised in *Modern Engineering (Bristol) Ltd. v. Gilbert-Ash (Northern) Ltd. [1974] A.C. 689* , 717, "no mere procedural rule designed to avoid circuity of action but a substantive defence at common law." The same is true of set-off in equity. The defendant is pleading a confession and avoidance to the plaintiff's claim. He is saying that, although the facts alleged by the plaintiff entitle him to judgment for the amount claimed, a wider examination of related facts would show that the claim is wholly or partly extinguished. It would be quite unreasonable for a plaintiff who has chosen to sue in one forum to rely upon an arbitration or jurisdiction clause to confine the court to the facts which he chooses to prove and prevent it from examining related facts as well."

88. It may be that the reason why there is no mandatory stay under s.9 in such a case is that the deployment of a set-off by way of substantive defence does not involve the bringing of legal proceedings within the meaning of s. 9, whether by way of claim or counterclaim, even though the set-off may be pleaded within the confines of a pleading described as a counterclaim: *Prekons Insaat Sanayi v Rowlands Castle Contracting Group* [2006] EWHC 1367 (Comm) at [11].

89. In the present case the defence of set-off invoked by the Defendant is one of transaction set-off, and not an independent set-off. The Claimant acknowledges that if there is a right of transaction set off then it may be relied upon as a defence. It disputes, however, that any such right arises in this case.

90. The Defendant contends that it has a right of equitable set off, a form of transaction set off. It relies on the explanation of equitable set off set out by Rix LJ in his judgment in *Geldof Metaalconstructie v Simon Carves* [2010] EWCA Civ 667, [2010] 4 All ER 847. At [43] he states that the test for an equitable set-off has a formal and a functional requirement: the formal requirement is of a close connection between claim and cross-claim and the functional requirement is that it needs to be unjust to enforce the claim without taking into account the cross-claim.

91. These requirements may be satisfied even though the claim and cross-claim do not arise from the same contract or transaction: see *Bim Kemi AB v Blackburn Chemicals Ltd* [2001] EWCA Civ 457, [2001] 2 Lloyd's Rep 93. Where, as in the present case, they do arise from the same contract, then the Defendant submits that they are likely to be and in this case are met. In this connection the Defendant relies in particular on Rix LJ's statement in *Geldof* at 848j that "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, such as the rules about freight, rent and cheques". The Defendant also relies on *Derham on Set Off* at 4.91 where it is stated:

> "Under more modern formulations of the principle governing equitable set-off approved by English courts, cross claims arising out of the same contract ordinarily would give rise to a set-off. Nevertheless, it is still the case that there is no universal rule that claims arising out of the same contract may be set against each other in all circumstances." (emphasis added)

92. The Claimant submits that in this case neither the formal nor the functional requirements are satisfied. It points out that its claim for fees is based on services provided from the last quarter of 2010 onwards. The Defendant's cross-claim relates to matters which occurred some years before that and has no, or no sufficient connection, with the Claimant's claim for fees so as to give rise to the injustice necessary to found a right of equitable set off. It relies by analogy on cases in which employees have been held entitled to claim wages notwithstanding allegations of earlier misconduct, such as *Miles v Wakefield MBC* [1987] ICR 368; *Sim v Rotherham MBC* [1990] ICR 383*; New Centurion Trust Ltd. V Welch and Another* [1990] ICR 383.

93. The Defendant disputes the relevance of the wages cases and points out that they are mainly concerned with a failure or refusal to work as opposed to a cross claim for damages. In any event it submits that they are a special case and involve a legislative background. I consider, however, that there is force in the Claimant's fundamental point that they cannot be required to go on providing services for no fee on the grounds of alleged misconduct which is long past. On the Defendant's case, given the quantum of its counterclaim, not only has the Claimant been obliged so to do, but it is obliged to go on doing so indefinitely.

94. I am reluctant finally to decide this issue as it involves determination of whether or not there is a particular right of defence and it is likely to require a consideration of issues of fact. In particular, it is the Defendant's case that there has been an ongoing breach of contract by the Claimant in failing to inform it of the matters which give rise to its claim. But for that breach of duty the claim might well have been raised when there was a co-incidence in time between the fees claimed and the events founding the counterclaim. This may well be relevant to considerations of justice and the functional requirement. I am inclined to the view that this is the type of case in

which the mere fact that the cross-claim arises out of the same contract is unlikely to be sufficient to establish the injustice necessary to found a right of equitable set off and that further facts will need to be established. However, since it is not necessary to express a final view on the matter, I do not propose to do so.

95. In the light of my conclusions on Issue (1) it is not necessary to consider either side's application for a stay under the court's inherent jurisdiction.

Conclusion

96. In conclusion, for the reasons outlined above, the allegations made in the Defence and Counterclaim are not caught by the arbitration agreement and the Claimant's application for a stay is accordingly to be dismissed.

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