Neutral Citation Number: [2019] EWHC 1526 (Ch)

Case No: C00SB001

IN THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS IN WINCHESTER
APPEALS (ChD)
ON APPEAL FROM THE COUNTY COURT AT SALISBURY
Order of Mr Recorder Norman dated 11th November 2016 (sealed 22nd November 2016)

Winchester Combined Court Centre
The Law Courts
Winchester SO23 9EL
Date: 27/06/2019

Before :

MR JUSTICE BIRSS

- -

Between :

THE SECRETARY OF STATE FOR DEFENCE	**Claimant**
- and -	
(1) CYRIL SPENCER	
(2) DAVID SPENCER	
(3) PETER FAULKNER	**Defendants**

- -
- -

Rebcca Cattermole (instructed by **BDB Pitmans LLP**) for the **The Secretary of State for Defence**

The defendants did not appear and were not represented

Hearing dates: 14th March 2019

- -

Judgment Approved by the court for handing down (subject to editorial corrections)

If this Judgment has been emailed to you it is to be treated as 'read-only'. You should send any suggested amendments as a separate Word document.

Mr Justice Birss :

Introduction

1. This is an appeal from the decision of Mr Recorder Norman given at the County Court at Swindon on 11 November 2016. The question for the Recorder was whether equitable set-off can be applied to the statutory procedure under Case D in Schedule 3 to the Agricultural Holdings Act 1986.

2. The claimant, the Secretary of State for Defence, is the freehold owner and landlord of an agricultural holding known as Choulston Farm, Wiltshire, of which the first and second defendants are the joint tenants under a yearly tenancy protected by the provisions of the AHA 1986. The second defendant has been retired for many years and has taken no active part in the dispute. I will refer to the first defendant as Mr Spencer.

3. This case arises out of a statutory arbitration to determine the validity of the claimant's notice to quit, served on 28 January 2005 under Case D, on the ground that the first and second defendants had failed to comply with a notice to pay rent due, dated 24 November 2004. The third defendant is the arbitrator in those arbitration proceedings.

4. Pursuant to the old case stated procedure under paragraph 26 of Schedule 11 of the AHA 1986, which was still in effect at the commencement of the arbitration proceedings, the arbitrator stated a case to be referred to the court. The matter was heard in the County Court at Salisbury on 15 September 2016. The Recorder, Mr Recorder Norman, was asked to address the following point of law:

> "whether the [first and second defendants] can rely upon equitable set-off of unliquidated claims for damages in order to invalidate the Notice to Pay, because it overstates the rent due, and so to invalidate the Notice to Quit."

5. The Recorder was not asked to make findings of fact (which are instead dealt with in the arbitration proceedings), but for the purpose of deciding the question of law was asked to assume the following proposition:

> "as at the date of the Notice to Pay… the [first and second defendants] had valid claims… which, if the [claimant] had issued a claim in this Court to recover the sum of £56,835 as a debt due from the [first and second defendants], they would have been able to set-off in reduction of the sum in respect of which the [claimant] would be entitled to judgment."

6. Having considered the parties' respective arguments and the relevant authorities, the Recorder gave a qualified "Yes" in response to the question of law of the special case, as follows:

> "the first and second defendants… can rely upon the equitable set-off of unliquidated claims for damages in order to invalidate the Notice to Pay dated 24th November 2004 because it

> overstates the rent due and so invalidate the Notice to Quit dated 28 January 2005, if, before the date of the Notice to Pay:
>
> 1. The claim to be set-off in equity has been asserted expressly in reduction or extinction of the rent claimed by the landlord in the Notice to Pay be due, and
>
> 2. The claim has been quantified, and
>
> 3. Both the assertion and the quantification of the claim were bona fide and on reasonable grounds.
>
> If these requirements are met the equitable set-off can be relied upon in reduction of the rent due as at the date of the Notice to Pay to the extent of the quantification of the claim and Case D paragraph (a) of the third Schedule to the Agricultural Holdings Act 1986 is to be so interpreted."

7. The Recorder gave both the Secretary of State and Mr Spencer permission to appeal his answer to the special case and in respect of costs. Since both parties are appellants I refer to them as the claimant and the first defendant.

8. This appeal was first listed to be heard in March 2017 by Mr Justice Newey, sitting in Winchester. A question arose about Mr Spencer's capacity. Directions were given for a doctor to examine Mr Spencer and prepare a report in order for the matter to be resolved. No progress was made in resolving the matter and no examination of Mr Spencer took place. In May 2018 I gave further directions, including arranging a further opportunity for Mr Spencer to be examined but also directing that the issue of Mr Spencer's capacity in relation to these proceedings would be resolved at a hearing to be fixed after 1st September 2018 on whatever evidence was available. That would occur whether or not a written report had been obtained. The matter came on on 16th October 2018. I concluded that on the evidence available Mr Spencer did have capacity to conduct the appeal proceedings. The substantive appeal hearing was listed.

9. In the event, Mr Spencer did not attend the appeal hearing. I accordingly only heard oral submissions from Ms Cattermole on behalf the Secretary of State. However grounds of appeal and a full skeleton argument had already been filed by counsel on Mr Spencer's behalf dated 1st December 2016. His case was advanced clearly there.

10. There are two issues on appeal: (i) whether equitable set-off can be applied to the statutory procedure under Case D (the Secretary of State's appeal); and (ii) if so, whether the Recorder was right to impose qualifications on his decision, regarding the circumstances in which equitable set-off can be relied upon (Mr Spencer's appeal, which I will refer to as the cross-appeal).

11. The argument advanced by counsel on behalf of the Secretary of State is that the Recorder erred in law in holding that the amount of rent stated as due in the notice to pay must be net of any claim against the landlord in equitable set-off. This is on the grounds that the Recorder failed to take into account, either adequately or at all, the following factors:

i) The express provision in section 17 of the AHA 1986 that set-off is taken into account in relation to the calculation of rent for the purposes of distraint.

ii) The absence of a statutory arbitrator's jurisdiction, when resolving a dispute as to the validity and effectiveness of a notice to quit under Case D, to determine a claim by the relevant tenant for damages against the relevant landlord.

iii) That the practical effect of such a finding would be to render the statutory procedure nugatory.

iv) Although the decision in Scotland of ***Alexander v Royal Hotel (Caithness) Ltd*** [2001] EGLR 6 runs counter to the Secretary of State's case, that decision has to be seen in the context of differing principles between Scots law and English law in the field of landlord and tenant.

v) The difference between the availability of equitable set-off as a defence to an action to recover a debt or rent arrears, and its availability as a 'self-help' remedy for suspension of a creditor's or landlord's rights pending action.

12. The argument on cross-appeal by Mr Spencer is that the Recorder was wrong to qualify his positive answer for the following reasons:

i) The first defendant had no, or no proper, opportunity to address the qualifications.

ii) By qualifying his opinion, the Recorder failed to express his opinion on the question of law.

iii) By qualifying his opinion by reference to criteria dependent on facts, the Recorder strayed into consideration of questions of fact which were the exclusive domain of the arbitrator.

iv) The facts of the special case referred to the Recorder were on the assumption that conditions for successful reliance on equitable set-off had been established in the context of court proceedings.

v) The qualifying criteria imposed upon successful reliance on equitable set-off in the context of the special case are unjustified.

13. Finally I will mention that in advance of the appeal hearing Mr Spencer (at times via his son, Mr James Spencer) presented a number of documents by email. I read those papers. The issues addressed in them are not relevant to the appeal.

The appeal

14. The Recorder conducted a detailed review of the relevant statutory background at paragraphs 18 to 29 of the judgment. Briefly, it is well established and not disputed by the parties, that notices to pay under Case D are strictly construed. That is because failure to comply with the notice gives the landlord a right to serve a notice to quit. Even if the rent due is overstated by a small amount, the notice to pay will be invalid: ***Dickinson v Boucher*** [1984] 1 EGLR 12. The reason for this is that termination by a notice to quit is a serious measure which greatly advantages the landlord and

disadvantages the tenant; strict construction of the statutory procedure provides the tenant with a degree of protection.

15. The Recorder also held (at paragraph 33) that as a matter of construction, the tenant's remedy of an equitable right of set-off is not excluded under the lease. There is no appeal on that point.

16. The question is therefore whether the words "rent due" stated in a notice to pay under Case D mean rent due taking account of any claim against the landlord in equitable set-off or rent due irrespective of any such set off. The Secretary of State contends that the Recorder wrongly concluded that the term takes equitable set off into account.

17. The meaning of "rent due" in the context of Case D, AHA 1986 is not subject to any binding authority in the courts of England and Wales. However, in the Scottish case of ***Alexander***, the meaning of "rent due" was considered in the context of the equivalent Scottish statutory provision, section 22(2)(d) of the Agricultural Holdings (Scotland) Act 1991, which is same for these purposes. In ***Alexander***, Lord Gill held (at paragraphs 11M-12A):

> "…the starting point is that before the landlord can serve a valid demand to pay, the rent must be due…
>
> In my opinion, rent is not due if a tenant is entitled to retain it. A sum of money can be said to be due only if the debtor is under an enforceable obligation to pay it. The logic behind the service of a statutory demand to pay a sum of rent is that, at the date of the demand, the landlord is entitled to recover that sum by legal proceedings if it is not paid. If the landlord is in material breach of his obligations, his claim for rent is not liquid… In such a case the tenant is not obliged to pay… Therefore, in my view, the rent cannot be said to be due."

18. Lord Gill then went on (at paragraph 12M) to find support in the judgment of Balcombe LJ in ***Sloan Stanley Estate Trustees v Barribal*** [1994] 2 EGLR 8, an Court of Appeal case regarding a Case D notice to quit. In ***Sloan Stanley***, the issue for the court was whether a tenant was entitled to set-off a contingent liability to pay the landlord's drainage rate, to reduce the amount of "rent due" stated in the notice to quit. On the facts, the tenant failed in asserting equitable set-off because the liability was contingent; he had not actually paid the drainage rate and therefore there were no sums to set-off. However, Balcombe LJ expressed the view obiter that, in the Case D context, it is possible to rely on equitable set-off against rent if the tenant has an existing debt "or at least a claim which sounds in possibly unliquidated damages" (paragraph 11J-K). Commenting on ***Sloan Stanley***, Lord Gill noted that:

> "That dictum raises specialities of English law, but it is plainly incompatible with the idea that, whatever the circumstances, the landlord is entitled to serve a demand under section 22(2)(d) for the rent payable under the lease whenever the date of payment has come and gone…

> In my view, the sheriff principal should have held that while the landlord was in material breach of his obligations to renew, he was not entitled to enforce the tenant's performance of his obligations to repair, and, accordingly, that the demand to remedy was not one that the landlord was entitled to serve."

19. These two cases support the proposition that the landlord ought not to be entitled to claim sums as rent due under the statutory procedure if he or she would not be entitled to recover such sums by way of legal proceedings. Applied to this case it would follow that the amount of rent due stated in a Case D notice to pay should be reduced by any sums which the landlord could not take legal action to recover.

20. The Secretary of State highlights the differences between the landlord and tenant law in the two jurisdictions in the context of ***Alexander***. The point is that in contrast to English law, Scots law is founded on the principle of mutuality of obligations and there the tenant has an automatic entitlement to retain rent where the landlord is in breach. In my judgment that distinction does not make a sufficient difference to justify reaching a different conclusion from the one in ***Alexander***. Under English law an equitable set-off would have the same ultimate effect in that it would prevent the landlord from recovering rent which was otherwise due. Accordingly, in my judgment the reasoning in ***Alexander*** is applicable and the Recorder was correct to hold (at paragraph 37) that:

> "If, then, an analysis of the English law of equitable set-off leads to the conclusion that at the date of the demand there was a substantive defence of set-off, to the extent that the set-off operated to render unrecoverable the rent that had accrued, there was no enforceable obligation to pay it."

21. If there was not an enforceable obligation to pay the money said to be due as rent in the Case D notice, as a result of an equitable set off, then that sum was not the "rent due" as a matter of ordinary language.

22. The Secretary of State submits that this interpretation of Case D cannot be correct as a matter of statutory interpretation. In particular, it relies on section 17 of the AHA 1986, which refers expressly to set-off in the context of distraint, as strong internal evidence that Parliament intended that no set-off (whether equitable or otherwise) should be taken into account for the calculation of rent due in a Case D notice to pay. The relevance of section 17 AHA 1986 was considered and dismissed by the Recorder at paragraph 38.4 of the judgment. I agree with his reasoning. The reference to set-off in section 17 AHA 1986 is applicable to liquidated claims which are capable of legal set-off. However the distinction between legal and equitable set-off is important. Without the express reference in section 17, legal set-off would only be available in the context of legal proceedings as a procedural rather than a substantive defence. In contrast, equitable set-off is a substantive defence which, if properly asserted, can operate as an immediate answer to a demand for rent. I am therefore not persuaded that the express reference to legal set-off in section 17 implies that Parliament intended to exclude equitable set-off from Case D.

23. Further, the Secretary of State contends that the practical implications of interpreting "rent due" in Case D to mean "rent due net of any claims in equitable set-off" would

render the statutory procedure nugatory. This is asserted on the basis that most agricultural holdings are in various states of disrepair, and therefore in almost all circumstances tenants would be able to rely on equitable set-off to invalidate a landlord's Case D notice to quit. The Secretary of State supported this by reference to Muir Watt & Moss on Agricultural Holdings (14th edition) (at paragraph 12.58), which comments on the principle in ***Alexander***:

> "if any element of over-demand in the Case D notice to pay rent is sufficient to vitiate it and unliquidated damages can be set-off the availability of Case D may be restricted almost to vanishing point…
>
> There must be hardly a farm in England and Wales where no landlord's disrepair is to be found."

24. This point is also reiterated in the 15th edition of Muir Watt & Moss (paragraph 15.118):

> "The draconian penalty imposed by the Case D procedure on a tenant if rent is not paid suggests that landlords were intended to enjoy considerable protection in relation to rent (in contrast with the serious restrictions on a landlord's abilities to serve notice to quit for other reasons); and a right to set-off unascertained, unliquidated damages against rent due does not sit wholly happily alongside this. The set-off of a liquidated debt may be in a different and more acceptable category for these purposes…"

25. I am not persuaded by this argument. The Secretary of State's submissions and reasoning in Muir Watt & Moss appear to be directed at claims to equitable set-off which are vague and improperly asserted. Those concerns are not a reason for ruling out a clear claim which is properly asserted. The concerns can be adequately addressed in the criteria required for a tenant to successfully rely on equitable set-off. These arise under the cross-appeal but it is convenient to address this aspect now.

26. At paragraph 49 of the judgment, the Recorder set out three criteria necessary for equitable set-off to apply. These were derived from the case of ***Fearns v Anglo-Dutch Paint and Chemical Co Ltd*** [2010] EWHC 2366 (Ch). In summary:

    i) the set-off must be properly asserted (at 21 and 30);

    ii) it must be quantified (at 27 to 30); and

    iii) the assertion and quantification must be made reasonably and in good faith (at 21 and 30).

27. The criteria in ***Fearns*** draw on the judgment of Lord Denning MR in ***Federal Commerce & Navigation Co Ltd v Molena Alpha Inc*** [1978] QB 927 regarding quantification of set-off. Lord Denning MR held that if a charter party "*quantifies his loss by a reasonable assessment made in good faith – and deducts the sums quantified – then he is not at fault*". Although Goff J dissented, concluding that it should be

open to the charterer to assert the claim as "an immediate answer to the liability to pay" "before ascertainment", Lord Denning MR's view has since been adopted as the preferred one (in ***SL Sethia Liners Ltd v Naviagro Maritime Coprn (The Kostas Melas)*** [1981] 1 Lloyd's Rep 18; and ***Santiren Shipping Ltd v Unimarine SA (The Chrysovalandou-Dyo)*** [1981] 1 All ER 340).

28. Accordingly, in my view, the Recorder was correct to adopt the limiting criteria from ***Fearns*** and apply them to the availability of equitable set-off in the context of "rent due" under Case D.

29. The limiting criteria also provide a short answer the Secretary of State's submissions regarding the difference between the availability of equitable set-off as a defence to an action to recover a debt or rent arrears, and its availability as a 'self-help' remedy for suspension of a creditor's or landlord's rights pending action. The Secretary of State contends that equitable set-off as a 'self-help' remedy is unworkable in the context of Case D, as it does not require the tenant to actually bring a claim against the landlord for the sums to be set-off. Equitable set-off could therefore be used to frustrate the Case D procedure indefinitely, which cannot have been intended by Parliament. I am not persuaded by this point; a tenant attempting to set-off unmeritorious and/or disingenuous claims would fail, as they would not meet the criteria from ***Fearns***.

30. Finally, the Secretary of State relies upon the absence of a statutory arbitrator's jurisdiction, when resolving a dispute as to the validity and effectiveness of a notice to quit under Case D, to determine a claim by the relevant tenant for damages against the relevant landlord. Whilst I appreciate that this may cause procedural delay to a landlord wishing to exercise a right to terminate, I do not agree that it automatically renders equitable set-off unavailable in the context of Case D. Equitable set-off is a substantive defence which impugns the creditor's right to claim sums due. It is therefore not necessary for the statutory arbitrator to determine the set-off as a cross-claim. Provided the equitable set-off is properly asserted, quantified, and asserted in good faith, it is sufficient to invalidate a notice to pay which does not take it into account.

31. The issues debated in argument covered more ground that I have addressed here but I believe the reasons set out above are sufficient to decide this case. I agree with the Recorder's decision that, provided the criteria are satisfied, Mr Spencer can rely upon equitable set-off of unliquidated claims for damages in order to invalidate the Notice to Pay, because it overstates the rent due, and so to invalidate the Notice to Quit. The Secretary of State's appeal fails.

The cross-appeal

32. I turn to the cross-appeal. The question is whether the Recorder was correct to impose limiting criteria on Mr Spencer's ability to rely upon equitable set-off.

33. On Mr Spencer's behalf it is submitted that the Recorder was wrong to impose qualifications on his decision in circumstances where Mr Spencer had no, or no proper opportunity to address those qualifications. This is plainly incorrect. On 14 October 2016, the Recorder invited the parties' submissions as to whether it was open to him to rule on the existence and scope of the criteria. Both parties responded and

the Recorder took those further submissions into account in finalising his decision of 11 November 2016.

34. A second argument is that due to the limiting criteria qualifying the answer, the Recorder failed to express an opinion on the special case stated. On the contrary, I am satisfied that the Recorder's answer to the question of law was a proper expression of opinion on the case stated. The special case stated procedure under paragraph 26 of Schedule 11 to the AHA 1986 provides for "…the opinion of the county court on any question of law arising in the course of the arbitration…". There is no requirement for the court to give a binary, 'yes or no' answer to the question of law. To hold the Recorder to such a requirement would be not be workable, nor would it be reflective of the nuanced and often fact-specific nature of such cases.

35. A third argument is that by qualifying his opinion by reference to criteria dependent on facts, the Recorder strayed into consideration of questions of fact which were the exclusive domain of the arbitrator. That is not correct; the Recorder did not consider questions of fact. The qualifications are founded on principles of law drawn from the authorities. The extent to which the criteria are met by the first and second defendant is a matter of fact, to be determined by the arbitrator.

36. Fourth, is the point that the Recorder was wrong to impose limiting criteria on the availability of equitable set-off because the facts of the special case assumed that conditions for successful reliance on equitable set-off had been established in the context of court proceedings. However, this misconstrues the wording of the assumed proposition in the stated case. The assumed proposition is summarised at paragraph 10 of the judgment:

> "…"as at the date of the Notice to Pay… "the [first and second defendants] had valid claims" of the nature contended for "which, if the Landlord had issued a claim in this court to recover the sum of £56,835 as a debt due from the [first and second defendants], they would have been able to set-off in reduction of the sum in respect of which the Landlord would be entitled to judgment."

37. Accordingly, the Recorder was not asked to assume that Mr Spencer had established claims in court proceedings. Instead the assumption was that they would have been able to rely on set-off in the context of court proceedings. This is an important distinction: the assumed proposition does not indicate whether or not the limiting criteria would be satisfied on the facts. The Recorder was therefore correct to limit himself to the question of law before him and qualify his answer as he did.

38. Fifth, it is submitted that the limiting criteria are unjustified in the context of the special case. I am not persuaded. The limiting criteria form a proper part of the correct answer to the question of law. As explained above, the criteria are clearly drawn from and are consistent with the authorities regarding the availability of equitable set-off.

39. Finally, there is an objection to a reference to ***Aries Tanker Corporation v Total Transport Ltd*** [1977] 1 WLR 185 at paragraph 55 of the judgment, on the basis that it may influence the arbitrator to wrongly impose a one-year limitation period on these

facts. The reference to ***Aries Tanker*** is clearly a reference to the principles of limitation addressed in that case, rather than to the specific limitation period. I seriously doubt whether the arbitrator would have been misled in the manner suggested, but have addressed the point nonetheless to avoid any misunderstanding.

Conclusion

40. The Recorder was right to hold that the tenant could rely upon equitable set of for unliquidated damages to invalidate the Notice to Pay (and therefore the Notice to Quit), subject to the limiting criteria set out.

41. The appeal and cross-appeal are dismissed.