ENTRINT ZAMBIA LIMITED v PRAGO LIMITED (FORMERLY CALLED PRAGO BUILDERS LIMITED) (1979) Z.R. 3 (H.C.)

HIGH COURT
HADDEN, J.
9TH JANUARY, 1979
1976/HP/303

Flynote
Company - Winding up - Set - off and counterclaim - Application where mutual dealings between the Parties - Money set up for a specific purpose - Necessity for such purpose to come to an end - Bankruptcy Act, s. 34 and Companies Act, s. 204.

p4

Headnote
The plaintiff made a claim of K40,000 being the balance due to it as sub-contractor to the defendant following the construction of a school. The defendant claimed to set-off this amount from a claim it had against the plaintiff in respect of the breach of another contract to the defendant and counterclaimed a sum of K266,367. The plaintiff submitted that the defendant could not set-off its counterclaim of K266,367 against the claim of K40,000 because the two contracts were independent contracts and it was never the intention of the parties that they should follow a course of mutual dealings.

Held:

(i) Section 204 of the Companies Act (Cap. 686) stipulates for the application of s. 34 of the Bankruptcy Act (Cap. 190) in cases of this nature.

(ii) A right to set-off arises only where there has been mutual dealings between the parties within the terms of s. 34 of the Bankruptcy Act.

(iii) On the evidence before the court, it was the intention of the parties that the monetary outcome should be separately settled and the two contracts were intended to be and were treated as separate and distinct contracts and not as mere items on one side or the other of a running account. The defendant could not therefore set-off its claim against that of the plaintiff.

(iv) Emphasis should be placed on the concept of mutual dealings and consequentially regarding the debts and credits referred to as such mutual debts and mutual credits as arise from mutual dealings.

(v) The right to set-off cannot apply where money has been handed over for a specific purpose unless an end has been put to such specific purpose by agreement between the parties Re City Equitable Fire Insurance Company Limited (2), applied.

(vi) The quality and nature of specific purpose for which the money was held continued and continues to be attached to it; there being no consent to it being held for any other purpose, it cannot be set-off against a claim the defendant might have against the plaintiff for damages arising from a breach of another contract.

Cases referred to:

(1) Rolls Razor Limited v Cox, [1967] 1 All E.R. 397

(2) Re City Equitable Pare Insurance Company Limited [1930] All E.R.

(3) Rose v Hart (1818) 8 Taunt 499 2 Moore C.P. 547 129 E.R. 477 4 Digest 403 3672

(4) Elberle's Hotels and Restaurant Company v Jonas (1887) 18 Q.B.D. 459 56 L.J.Q.B. 278 35 W.R. 467 3 T.L.R. 421 C.A.; 10 Digest (Repl) 990 6815

p5

(5) Re Pollitt Ex parte Minor [1893] 1 Q.B. 455 62 L.J.Q.B. 236; 68 L.T. 366; 41 W.R. 276; 9 T.L.R. 195; 37 Sol. Jo. 217; 10 Morr. 35; 4R 253 C.A.;, 4 Digest 395, 3612.

(6) Re Mid - Kent Fruit Factory [1896] 1 Ch. 567; 65 L.J. Ch. 250; 74 L.T. 22; 44 W.R. 284; Jo Sol. Jo. 211; 3 Mans, 59; 10 Digest (Repl.) 989, 5 6811.

Legislation referred to:

Companies Act, Cap. 686, s. 204.

Bankruptcy Act, Cap.190, fit. 34

For the plaintiff: N. Mavrokefalos D.H. Kemp & Co.

For the defendant: G.F. Patel, Martin & Co.

Judgment

HADDEN, J.: The plaintiff claims the sum of K40,000 being the balance due to it as sub-contractor to the defendant following the construction of the Pemba Secondary School. The defendant claims to set-off this amount from a claim it has against the plaintiff in respect of the breach of another contract, called the Group L contract, wherein the plaintiff was again the sub-contractor to the defendant, and counterclaims the sum of K266,367.

On the 24th October, 1972, the plaintiff and defendant signed an agreement which provided, *inter alia,* that the defendant would submit a tender, prepared by the plaintiff, for the construction of the Pemba Secondary School. If the tender was successful the plaintiff would perform the greater part of the contract although the defendant would supervise the carrying out of the works and perform certain other functions as set out in the agreement. If the contract was awarded to the defendant the agreement provided that a formal contract between the parties would be executed. The formal contract was executed by the parties and is dated the 15th April, l 973.

On the 25th January 1974, the parties signed another agreement, this time regarding the Group L contract. The defendant was to submit the tender and, if accepted, the plaintiff was to carry out part of the work as sub-contractor to the defendant. In order to enable the plaintiff to purchase materials and meet certain other initial expenses when starting the Group L contract the defendant agreed to advance to the plaintiff the sum of K40,000 provided the plaintiff obtained an assurance from a third party, referred to in evidence as a performance bond, that such third party would carry out the performance of the plaintiff's obligations under the contract should the plaintiff fail to do so, or pay to the defendant the sum of K40,000. The sum of K20,000 was paid to the plaintiff on the 8th April, 1974, before the performance bond had been received, and the plaintiff agreed that if the performance bond was not issued, the sum of K20,000 could be deducted from payments, due to the plaintiff in respect of the Pemba contract. The performance bond, which was dated the 1st April

1974, then became available and the second payment of K20,000 was made by the defendant to the plaintiff

p6

on the 14th May 1974. These two payments totalling K40,000 were to enable the plaintiff to purchase materials to be used in the Group L contract.

Sometime prior to September 1974, a provisional liquidator of the plaintiff was appointed by the court; in September Mr B.L. Gadsden was appointed Chairman of the Committee of Management which was to operate a Scheme of Arrangement. A meeting of creditors of the plaintiff was held on the 15th October 1974, at which the defendant voted in favour of the scheme and the scheme was subsequently sanctioned by the court. Work on the Pemba contract was held up in September because of the plaintiff 's financial difficulties, and following a meeting on the 17th October, the defendant the next day agreed, *inter alia*, that Prestige Construction Limited would complete the Pemba contract.

The plaintiff had abandoned the Group L contract when the provisional liquidator was appointed and approximately K9,000 was subsequently deducted from monthly valuation payments on the Pemba contract by the defendant in reduction of the K40,000 advanced to the plaintiff when work on the Group L contract commenced. The Group L contract was completed by the defendant. Mr Gadsden received a claim from the defendant for the loss incurred in performing the Group L contract and requested that the defendant submit a proof of debt together with further details of the claim; some further information was subsequently provided but not enough to enable the claim to be either admitted or rejected.

Payments in respect of work done on the Pemba contract were made to Prestige Construction Limited through Mr Gadsden by the defendant but by a letter dated the 31st December, 1975, the defendant informed Mr Gadsden that a final payment of K58,100 could not be made to the plaintiff as the sum of K40,000, due under the performance bond, had not been paid, and the defendant had other claims against the plaintiff totalling K31,590. However on the 9th January 1976, all moneys due in respect of the Pemba contract were paid save for the amount of K40,000.

In evidence Mr J.H. Cruickshank, the senior partner of Peat Marwick Mitchell and Co., auditors of the defendant, said that the defendant in completing that part of the Group L contract that had been abandoned by the plaintiff, had incurred a loss of K266,367. Mr S Vladimir, the defendant's Contract Manager, testified that the original value of the Group L contract was about K930,000 but that the final figure was increased by about 10 per cent principally because of extra work and variations requested by the client. The plaintiff had completed about 10 per cent of the contract before it ceased work on it. Only a small part of the increase resulted from an increase in the cost of materials and under the contract this increase would be met by the employer.

p7

There was no increase in the wages of workmen. Since the institution of these proceedings the sum

of K40,000 had been paid to the defendant by the Zambia State Insurance Corporation in accordance with the terms of the performance bond.

As Mr Vladimir pointed out, the association between the plaintiff and the defendant with regard to the tendering for and carrying out of the Pemba and Group L contracts, was similar in both cases in both contracts the plaintiff was sub-contractor to the defendant and had to be approved by the employer. The harmonious relationship between the two companies was illustrated by the witness when he said that the defendant frequently bought materials for the plaintiff for which payment was made by way of deduction from the amounts due to the plaintiff on monthly valuation certificates. As the witness did not approve of this arrangement it was later discontinued.

The defence to the plaintiff's claim for the sum of K40,000 reads:

> "2. The Defendant denies that the sum of Forty thousand kwacha (K40,000.00) or any sum at all remains owing to the Plaintiff because the Defendant is entitled to set off against the Plaintiff the sum of at least Three hundred and six thousand three hundred and sixty-seven kwacha (K306,367.00) being the loss incurred by the Defendant because of the breach by the Plaintiff of another contract dated the 1st day of April, 1974 and made between the Defendant of the one part and the Plaintiff of the other part whereby the Plaintiff was to supply materials and complete certain works as sub-contract, or to the Defendant for the Zambia World Bank Education Project (Secondary Schools) Group 'L' at Monze, Namwala and Chipepo together with moneys advanced to the Plaintiff it having been agreed between the Plaintiff and the Defendant that they should follow a course of mutual dealing by acting as sub-contractor respectively in all projects of the Zambia World Bank Education Scheme and the contracts for which might be awarded to the Plaintiff."

The defendant counterclaims for the sum of K266,367 being the loss it allegedly incurred in completing that part of the Group L contract that should have been performed by the plaintiff the sum of K40,000 having been paid to it since the commencement of these proceedings, together with interest thereon from the 19th August, 1974, and costs. The defence to the counterclaim reads:

"*Defence to Counterclaim*

2. The plaintiff does not admit the defendant sustained a loss in the sum of Three hundred and six thousand three hundred and sixty-seven kwacha (K306,367.00) as alleged in paragraph 2 of the Defence and Counterclaim and puts the defendant to strict proof thereof.

3. The contract dated 1st April 1974 referred to in paragraph 2 of the defence and counterclaim was in respect only of the Zambia World Bank Education Projects and in no way relates and is

therefore irrelevant proceedings herein; the Pemba Secondary School project being an independent contract between the defendant of the one part and the Government of the Republic of Zambia of the other part. Further, it may be implied by an agreement dated 17th October, 1974 and made between the Committee of Management of the Plaintiff of the one part and the Defendant of the other part that it was never the intention of the parties that they

should follow a course of mutual dealing in projects for which the plaintiff acted as sub-contractor to the Defendant.

4. The plaintiff was ordered by this court on 26th September 1974 to convene separate meetings of its preferential and ordinary creditors for the purpose of considering, and if thought fit, approving a Scheme of Arrangement to be made between the plaintiff and its preferential and ordinary creditors pursuant to the provisions of Section 101 of the Companies Act (Cap. 686 of the Laws of Zambia). The defendant by its representative attended a meeting convened on the 16th October 1974 of the ordinary creditors of the plaintiff and as such a creditor voted in favour of the said Scheme. The said Scheme, as amended at the said meeting was sanctioned by this court on 14th March 1975. A copy of the Court Order and the said modified and amended Scheme was delivered to the Registrar of Companies on 21st March, 1975.

5. The plaintiff denies that the defendant is entitled to claim the sum of two hundred and sixty-six thousand three hundred and sixty-seven Kwacha (266,367.00) as alleged in paragraph 3 of the counterclaim for the reason that the defendant is a moratorium creditor of the plaintiff and therefore bound by the said Scheme of Arrangement. As such a moratorium creator the defendant is entitled upon, filing a proof of debt with the Chairman The Committee of Management of the plaintiff, only to dividends on such dates and in such manner as the Committee of Management of the plaintiff from time to time decides. The said Scheme of Arrangement will be referred to at the trial for its full terms and effect."

The plaintiff submits that the defendant cannot put-on its counterclaim of K266,367 against the plaintiff's claim of K40,000 because the Pemba and Group L contracts were independent contracts and it was never the intention of the parties that they should follow a course of mutual dealings; and that as the defendant voted in favour of the Scheme which was subsequently sanctioned by the court, it is a creditor bound by the Scheme.

Section 204 of the Companies Act (Cap. 686) provides:

> "In the proof or claim of debts against any company, or in the payment of debts by the liquidator of any company in course of being wound up under this Act, the principles regulating the proof, claim, and payment of debts in case of the bankruptcy of any individual shall be followed."

p9

Section 34 of the Bankruptcy Act (Cap. 190) reads:

> "Where there have been mutual credits, mutual debts or other mutual dealings, between a debtor against whom a receiving order shall be under this Act and any other person proving or claiming to prove a debt under the receiving order, an account shall be taken of what is due from the one part to the other in respect of such mutual dealings, and the sum due from the one party shall be set off against any sum due from the other party, and the balance of the account, and no more, shall be claimed or paid on either side respectively; but a person shall not be entitled under this section to claim the benefit of any set-off against the property of a debtor in any case where he had, at the time of giving credit to the debtor, notice of an

act of bankruptcy committed by the debtor and available against him."

In considering this section, which is the same as s. 31 of the Bankruptcy Act, 1914, Winn, L.J., in Rolls Razor Limited v Cox (1), at p. 406 said:

> "Notwithstanding the relative order in which the section refers first to 'credits', then to 'debts', and thirdly to 'dealings', I am of the opinion that the proper construction of the section and the true guide to its applicability to any particular set of circumstances involves placing emphasis primarily on the concept of mutual dealings and consequentially regarding the debits and credits referred to as such mutual debits and mutual credits as arise from mutual dealings: by the triple use of the word 'mutual', Parliament seems to me subtly to have indicated that mutuality is the dominant characteristic of the matters in respect of which it enacted this section.What dealings are 'mutual' within the meaning of the section appears to me to be determined by the intention of the parties to those dealings, expressed to each other or to be inferred from the character of the dealings. Thus, the relationship of banker and customer on a current account implies from its very nature an intention on the part of both parties that debits and credits arising between them shall be brought into a running account on which, by reason of the customary method of keeping such account, there will at any given moment be an outstanding debit or credit balance. Similarly, producers of such commodities as fruit and vegetables, who market them through selling agents in, for example, Covent Garden, normally, if not necessarily, deal with those selling agents on a running account in which credits in their favour will arise in respect of proceeds of sales received by the agents, with related debits for commissions and sale expenses incurred by the agents in disposing of the goods or making allowances for quality deficiencies. These are only examples which could be almost indefinitely as multiplied by taking into consideration such other relationships those of a landlord and his rent collectors, or transactions of collection of outstanding debts. The common and essential characteristic of all such dealings, which I regard as the type of mutual

p10

> dealings contemplated by the section, although many others less comprehensive and of shorter continuity would also be included, is that by the intention of the parties expressed or implied, they each extend to the other credit in respect of individual sums of money until such time as such sums are brought into account and in the account set off against other sums, in totality, in respect of which the other party has given credit: to be contrasted are dealings of a kind which may occur either in isolation or within the complex of a continuous run of dealings, which are themselves mutual, of such a kind that it is clear from their character that the parties intend that the monetary outcome of them shall be separately settled between the parties and not treated as a mere item on one side or the other of a running account."

In the agreed bundle of documents is a letter dated the 21st March 1975, from the defendant to Mr Gadsden referring to an enclosed cheque for K23,003.86n that was a payment for work done on the Pemba contract; no deduction, or reference, was made to any claim the defendant then had arising out of the plaintiff's abandonment of the Group L contract. Payments for work done on the Pemba

contract were made monthly but no deduction was effected for any loss under the Group L contract and the first intimation the plaintiff received that the defendant proposed to set-off the claim it had for the loss under the latter contract against the sum of K40,000 claimed by the plaintiff on the Pemba contract, was on the 2nd January 1976, when Mr Gadsden received a letter dated the 31st December 1975, some fifteen months after its abandonment. If it was the contention of the parties that mutual dealings existed between them, the right to set-off payments due under the Pemba contract would have been exercised far earlier than it was. I am satisfied on the evidence before the court that it was the intention of the parties that the monetary outcome should be separately settled and that the Pemba and Group L contracts were intended to be and were treated as separate and distinct contracts and not as mere items on one side or the other of a running account, and that the defendant cannot set-off its claim against that of the plaintiff under s. 34 of the Bankruptcy Act.

The defendant is faced with a further difficulty in pursuing its counterclaim in that the right to set-off cannot apply where money has been handed over for a specific purpose unless an end has been put to such specific purpose by agreement between the parties. The position is clearly stated by Lord Hanworth, M.R., in *Re: City Equitable Fire Insurance Company Limited* (2), at p. 319:

> "There is no doubt of the principle of set-of which was originally adopted in bankruptcy proceedings as far back as the 4th and 5th of Queen Anne and subsequent statutes in the reign of George II, and later, all of which are indicated in the judgment delivered by SIR NICHOLAS TINDALL and are set out at the end of the notes to *Rose v Hart* (3) in 2 Smith Leading cases (12th Edn.), p. 292. That principle has been distinctly widened and developed. It is suggested now that it has become so wide as to embrace almost all matters

p11

> which ultimately end in a sum of money being due on the one side and the other inter se persons who are creditors of a bankrupt or a company in liquidation. To hold that would be to go too far. It has been quite explicitly explained in *Eberle's Hotels and Restaurant Co. v Jonas* (4) (18 Q.B.D. 459 at p. 468) that the two items on either side must be commensurable, and that where you have a claim to specific goods in detinue, and a debt in money on the other side, you cannot have a set-off, although there are some wide observations made in that case on which the Globe has relied. Different considerations apply where money has been handed over for a specific purpose and not treated as a mere item in accounts kept between the bankrupt and his creditors. Illustrations of money handed over for a specific purpose are to be found in *Re Pollitt, Ex parte Minor* (5) and *Re Mid - Rent Fruit Factory* (6). The effect of handing over money for a specific purpose appears from the cases to be that it is taken out from the current accounts as between the parties, to be held, so to speak, in suspense between them until that specific purpose for which it had been handed over has been completed; but even then it appears that the nature and quality of the specific purpose still attaches to the balance of the fund, if any, which remains in the hands of the deposited, because it was originally placed in his hands for the particular purpose, and unless and until there has been some subsequent agreement between them to release that specific purpose the nature and quality of the specific purpose still attaches to the balance of the fund which may remain. Indeed, in all cases it must be the balance of the fund which is in dispute. If the specific purpose had been carried out, then there can remain

no question at issue between the parties. It is only in respect of the balance not employed in a specific purpose in respect of which the rights of the parties to it can be canvassed with a view as to whether a set-off applies or not. It appears plain from the cases which are cited that where there has been a specific purpose declared there is not until the specific purpose is put an end to by agreement between the parties any withdrawal of the specific quality or any right of set-off which arises from the general transactions between business men.

In *Re Pollitt* (5) Lord Esher says this; he deals with the facts ((1893) 1 Q.B. at p. 457), showing that a certain authority had been given for a specific purpose, and then on p. 458 he says this:

'There is this difficulty. If the money was given to the solicitor for a specific purpose, then as between him and the bankrupt there could not be a set-off; nor as between them could there be any mutual credit.'

Those words are clear. In *Re Mid - Kent Fruit Factory* (6), Vaughan Williams J., to whom everyone would pay tribute as being a master in his knowledge of the bankruptcy law, not only decides the case, but also adds a few words as to the law as it now stands, as they may be useful in future cases. He had before him a

p12

case in which certain money by several cheques had been handed over to the solicitors of a company for the payment of specific debts. The argument was that the specific purpose had been exhausted, 'that there was no longer any specific purpose to which the money was to be applied; and that from that time forward the money remained in the hands of the solicitors as a debt due to the company.' That was the argument, but VAUGHAN WILLIAMS J, holds that:

> 'the onus is on the solicitors to show the company's consent to the money remaining in their hands; and I fail to find that, the consent was given or that the solicitors ever communicated to the company that they had the balance in their hands.'

In other words, dealing clearly with the argument presented that with regard to this balance not included for the specific purpose the quality and nature of the specific purpose ceased, he definitely holds that it did not, because until there was an agreement or some arrangement between the parties that the original quality of the fund should be withdrawn it remained and attached to the balance of the fund just as it had originally attached to the whole of the fund."

The performance bond requires the Zambia State Insurance Corporation Limited to pay to the defendant the sum of K40,000 should the plaintiff fail to carry out its obligations under the Group L contract, subject to the conditions stated therein. It is clear from the evidence, however, that the performance bond was to secure the advance of the K40,000; as the performance bond had not been issued the initial advance of K20,000 was deductible from monthly payments made under the Pemba contract. If the performance bond had been issued prior to the initial payment no deductions

would have been made from moneys due to the plaintiff. The retention of the sum of K40,000 from the money due under the Pemba contract was for the specific purpose of its being security until the performance bond was executed by Zambia State Insurance Corporation Limited and there was never any agreement that the purpose for which it was held by the defendant was to come to an end. The quality and nature of the specific purpose for which the money was held continued and continues to be attached to it; there was never any consent to it being held for any other purpose and it cannot therefore be set-off against a claim the defendant might have against the plaintiff for damages arising from a breach of the Group L contract.

Learned counsel for the plaintiff has submitted that the counterclaim has not been proved, that the statement of loss is too generalised and that the losses sustained might have been sustained in any event even if the plaintiff had performed its obligations under the contract. The fact that the loss sustained by the defendant in completing the Group L contract would have been incurred even if the plaintiff had not abandoned the contract cannot assist the plaintiff; if the plaintiff would have sustained a loss in completing the contract there is no evidence to show that it would have been indemnified for such loss whether by the defendant or the

employer. If the contract could only have been completed at a lose, such loss would have had to have been met by the plaintiff as the defendant took over the completion of the contract, any loss suffered that would have been sustained in any event is one for which the plaintiff must be liable.

Mr S. Vladimir said that the extent of the work undertaken in carrying out the Group L contract was increased by about 10 per cent as a result of variations and extras ordered by the employer. There had been an increase in the cost of materials but this was passed on to the employer. There was no increase in the amount paid in wages.

The court is satisfied from the evidence given by Mr. Cruickshank that the defendant suffered a loss of K266,367 after it took over the Group L contract from the plaintiff until the date of the witness's statement, namely the 20th July, 1978. As the loss incurred by the defendant was increased by the variations and extras by approximately 10 per cent, the loss that would have been incurred on the contract as originally executed would have been approximately K239,700. However there was no evidence to establish that the work done by the defendant in completing the contract was performed in such a way that the loss incurred was kept to a minimum and that the loss represents the correct measure of damages for which the plaintiff is responsible.

The scheme of arrangement between the plaintiff and its creditors as sanctioned by the court is bidding on all the plaintiff' s ordinary creditors. Various clauses of the scheme read:

"2. The rights of all Ordinary Creditors of the Company against any surety or sureties for the debts due to them and against all persons other than the Company and all rights of any Creditor or Creditors in respect of any security or securities which they or any of them hold for their said debts or claims are hereby expressly reserved.

6. A Distribution Account shall be opened in the name of the Company at such bank in Lusaka as the Committee of Management shall decide and there will be paid into such account all

proceeds of such completion and maintenance as aforesaid and all proceeds of sale of any surplus assets of the Company and such other monies as may be available from the profits or other income of the Company as the Committee of Management shall from time to time determine.

7. The Company will pay from the Distribution Accounts firstly those persons or groups of persons set out in Rule 192 of the Companies Winding Up Rules their costs and expenses in the manner and order prescribed in that rule and secondly, all Creditors who have preferential claims and whose debts are admitted, in the order and manner prescribed by the Preferential Claims in Bankruptcy Act and the Zambia National Provident Fund Act both as amended and thirdly, to ordinary Creditors as admitted.

19. On the commencement of this Scheme any Ordinary Creditor holding or possessing any plant materials or property belonging to the Company shall return the same to the Company and any

p14

Ordinary Creditor on whose behalf the Sheriff or his Bailiffs are holding any plant materials or property shall instruct the Sheriff or his Bailiffs to release the plant materials or property to the Company."

Although the scheme does not expressly stay proceedings by creditors against the plaintiff, by its adoption the creditors have accepted its provisions in substitution of their former rights against the plaintiff, and the defendant's recourse is in participating in the scheme and receiving dividends for the amount due to it as provided therein, and not by way of pursuing court proceeding for a judgment for the amount claimed. Should it transpire that the defendant is not prevented from pursuing its loss by way of set-off and counterclaim the court would have held that it had not sufficiently proved its loss and the counterclaim would have been dismissed.

Judgment is entered in favour of the plaintiff for the sum of K40,000 together with interest thereon at the rate of 6 per cent per annum from the date of the issue of the writ of summons, namely the 11th March 1976, and the counterclaim is dismissed.

Judgment for the plaintiff
