SET-OFFS AND CORPORATE INSOLVENCIES
A COMMENTARY ON THE PAPER PRESENTED BY DR DERHAM

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There are two matters on which I would like to say something. On one matter not a great deal and on the other a little bit more.

ONE ASPECT OF MUTUALITY

One point that Dr Derham made as to mutuality deserves particular notice. He says - and clearly correctly - that there is no mutuality between a bank's (personal) claim against a customer and a claim of that customer as trustee against the bank. The trust fund is not to be brought into set-off when the trustee personally is in trouble.

He then turns to the case of the customer's personal claim against the bank and the claim by the bank against the customer incurred in respect of the trust. He says that the position should be (and I think he means by that that it is) that there is mutuality in that case because the liability to the bank is that of the trustee alone (and not the less so that he is entitled to be indemnified from the trust), and in general the liability to the bank is not limited to the value of the assets in the trust.

That all made me wonder, and it is on any view a tricky area. I finish up agreeing with Dr Derham on this, and I say so because the proposition surprised me when I first saw it. I see it as follows.

The fact that the customer's liability where he is acting as trustee of a trust is generally not limited to the value of the assets in the trust is, I think, irrelevant. Even where the liability is limited in that way it remains a personal liability to the bank. To limit its size is not to affect its nature.

The fact that the limiting of the liability to the amount of the value of the assets at the relevant time means that the bank knows that the trustee's right of indemnity will be fully effective, rather than the bank being in the position of neither knowing nor caring whether that will be so, does not seem to bear on the matter of mutuality.

You are left with the fact that in the absence of any special arrangement the customer as trustee does have personal liability to the bank. And while that is so there would seem to be the necessary mutuality between that liability and his own private claim against the bank.

CONTINGENT DEBTS IN SET-OFF

The area where I want to say rather more, and in parts not so much disagree with Dr Derham as query what precisely is being said, relates to various matters to do with contingent debts. It is fair to say, I think, that Dr Derham rather hoists his flag to the mast of Graham v. Russell (1816) 5 M & S 498, which he cites at pp. 3-4 for the proposition that any claim which may be proved prima facie should be capable of being set off.

The difficulty might lie in the words "prima facie" and "should". Certainly any claim which is provable is entitled to be considered for the question of entry into set-off. But Dr Derham does I think go rather beyond that at p. 4, when in relation to Day & Dent Constructions Pty Ltd v. North Australian Properties Pty Ltd (1982) 150 CLR 85 he seems to suggest that the principle underlying the decision was provability, and not the less so that the court said that the principle it was applying was that the set-off section applies to transactions which naturally result in a debt (a narrower statement which Dr Derham suggests is vague and uncertain and obscures the real principle).

One does have to I think issue the warning that the Chief Justice of the High Court may think that the real principle was what Mason J. said it was, and that in so expressing it the court did limit to some extent the range of provable debts which qualify to be brought into set-off. It is little use as lawyers advising people that the Full High Court, affirming the earlier dictum of Sir Owen Dixon, has served to obscure the principle. Dr Derham may not like the judgment very much but as a practical matter there it is and that is the principle which the court has adopted.

So in relation to that matter there is now affirmed in Day & Dent the dictum of Dixon J. in Hiley and The Peoples Prudential Assurance (1938) 60 CLR 468 at 497, which sets out the test to be applied in relation to contingent claims of an insolvent company. The statement is made at p. 12 of Dr Derham's paper that that decision was inconsistent with English authority, Ince Hall Rolling Mills Company Limited v. The Douglas Forge Company (1882) 8 QBD 179, which Dixon J. failed to cite. I think that Dr Derham is not criticising Hiley's case for being different to Ince Hall, but is simply saying that it is inconsistent. It is I think a difference that he likes, though it does not, as I understand his comment on Day & Dent, go quite as far away from Ince Hall as he would like.

The dictum of Dixon J. is as follows:

> "In the first place, the general rule does not require that at the moment when the winding up commenced there shall be two enforceable debts, a debt provable in the liquidation and a debt enforceable by the liquidator against the creditor claiming to prove. It is enough that at the commencement of the winding up mutual dealings exist which involve rights and obligations whether absolute or contingent of such a nature that afterwards in the events that happen they mature or develop into pecuniary demands capable of set-off. If the end contemplated by the transaction is a claim sounding in money so that, in the phrase employed in the cases, it is commensurable with the cross-demand, no more is required than that at the commencement of the winding up liabilities shall have been contracted by the company and the other party respectively from which cross-claim moneys accrue during the course of the winding up." (50 CLR at pp. 496-497).

That seems to me not inconsistent with Ince Hall, and it is worth noticing why.

The authorities which Dixon J. cited were four. In Naoroji v. Chartered Bank of India (1868) LR 3 CP 441 a bankrupt trader owed money to a bank. At the commencement of the bankruptcy the bank had in its hands bills drawn by the trader on other traders, for collection and remission to the trader. Held, the debt arising on collection by the bank arose from a mutual credit that existed at the moment of the winding up and could be brought into set-off by the bank to satisfy claims by it for other sums due to it. Collection of the proceeds and the creation of the debt resulting therefrom were natural ends of the mutual dealings which existed at the moment of the bankruptcy.

It is interesting to note that Mr Watkin Williams, who as judge some eleven years later decided Ince Hall, was counsel in Naoroji. He clearly would have known about it, especially as he lost. Barristers rarely forget cases they lose.

Next was Astley v. Gurney (1869) LR 4 CP 714. Prior to his bankruptcy the trader had lodged with the great bank Overend, Gurney and Co bills of lading for cotton and coffee, to secure the bank in relation to the acceptance of one group of bills of exchange. Prior to his bankruptcy the trader had authorised the bank to sell the cotton and the coffee and apply the proceeds in meeting those bills. The cotton was sold before the bankruptcy, the coffee afterwards. The proceeds more than met the bills. The bank was left holding the surplus. The bank claimed to be entitled to bring that surplus into account in set-off against other claims due to it by the trader. Held, in the Court of Exchequer Chamber, the arrangements subsisting at the commencement of the bankruptcy, and in particular the fact that the direction to sell had already been given, constituted a

mutual credit such that when the surplus and hence the debt arose it was within the set-off provision. The court said:

> "... where there is a debt on one side, and a delivery of property, with directions to turn it into money, on the other, in such case the credit given by the delivery of the property must in its nature terminate in a debt, the balance will be taken on the two debts, and the statute is in every respect complied with." (4 CP at p.722, citing the judgment of Gibbs C.J. in Rose v. Hart 8 Taunt, 499).

Next was Palmer v. Day & Sons (1895) 2 QB 618. At the time of his bankruptcy paintings belonging to a householder were in the hands of auctioneers with instructions to sell them and keep the money towards commission on earlier sales that they had handled. After the bankruptcy the auctioneers sold the paintings and claimed to set off the proceeds against their commission. Held, they were entitled to do so:

> "There was a debt on one side and a delivery of property with directions to turn it into money on the other." (at p.623).

That is one group of cases where in various ways the debt arose out of the arrangements existing at the time. Mutuality existed. It was in each case a dealing with the company which led to that debt.

Ince Hall, it seems to me, was different. A company agreed on the 19th of November to sell a creditor 60 tons of various sizes of iron at £5.15.0 a ton. (It is an odd case. The report makes it quite clear that on the 19th of November the company was in bad trouble, that the creditor knew the company was in bad trouble, that the company owed him money, and the creditor agreed to buy the iron with the deliberate intent of not paying for it but claiming to set off the resulting debt and so get 240 pence in the pound, which no one else was going to get. Nobody seemed to mind and nothing seems to be made of the fact. They mention it but let it go).

Watkin Williams J. said quite rightly:

> "This contract ... did not amount to a bargain and sale of specific goods, and created no debt between the parties.
>
> It amounts to no more than an executory contract to supply, sell, and deliver on one side, and to accept on the other, certain quantities of unascertained goods at a future day."

Accordingly at that point there was no right to sue for the debt. No one had delivered the goods. There was no contingent right to sue for the debt. The greatest right that existed was a right to sue for damages if the purchaser should thereafter refuse to accept and pay for the iron.

That was all on 19th November. On the 4th December an order was made for winding up the company, the petition having been presented on the 23rd or 24th November (the report seems inconsistent). On 25th November and 8th December the company delivered 37 tons of the 60. Following that the liquidator said "Now I'll send you the rest, but of course you had better send me the money." The creditor said no, that what he was intending to do was to pay by way of set-off. The transaction went no further. The liquidator refused to deliver the balance, and claimed in respect of the 37 tons that had already gone across. Held, that had the debt arisen prior to the commencement of the liquidation, the debts would have been mutual. But no debt arose until delivery of the iron. That delivery was by a company already in winding up, and the delivery of the iron by the company at that time gave rise to a debt due to it in a new capacity and interest because once the winding up order was made the business of the company was carried on for interests quite different from those for which had been carried on earlier. It was now being carried on by a liquidator on behalf of creditors.

Thus the claim to the debts was one arising in the liquidation. There was not the necessary mutuality. True it was that as a matter of history the delivery of iron grew out of what happened before the winding up. But the debt sued on did not grow out of events which had happened before the liquidation. It is not something as to which there was any kind of right until the later stage when the iron was delivered by the company in winding up. That delivery being a necessary part of the cause of action, there was not mutuality between the creditor on the one hand and the company as at the moment of the winding up on the other.

That seems to me to be unarguably right and consistent with Hiley. The company never did have a contingent right to sue for the price (of goods it had not delivered). The most it earlier had was a contingent loss of profits claim if the transaction should go off. The size of that claim would have depended on the price at which that iron could be sold in the market. Nothing suggests that that price would have been lower than the price at which that creditor was to buy it. On that basis there would have been no damages. That seems to me to be the proper reason for the matter not having been discussed in Hiley. It is simply a case not within the principle being discussed.

I add that the case was likewise not discussed by French J. in the recent case In re Clune (1988) 14 ACLR 261, in the Federal Court. I may say that I agree with Dr Derham that Clune is not a very satisfactory case. If it shows one thing, it is the wisdom judges show in usually not reporting judgments given on applications made by counsel on one side with no appearance for the other party. Maitland used to say that argued law was tough law. A judge who has only heard one side has not had the benefit of the close analysis which dispute is apt to bring forth. I think, as Dr Derham does, that Clune could have been decided on simpler grounds than it was. In any event what French J. did in

the present respect was to say "Well look, there is Hiley's case, and there is Day & Dent applying it". That seems to me enough. When he has the Full Court of the High Court affirming Dixon J., it is not for a single judge of an inferior court to wonder whether it is all inconsistent with an English case decided a century ago. French J. can be perfectly well forgiven for thinking that the Full Court of the High Court was sufficient authority for what he was doing, though I agree that his judgment does not add anything to the understanding of the doctrines that we would have had without it.

For the rest, and indeed in those areas too, I should express my personal gratitude to Dr Derham for having been forced to think on these matters. It is an important area and one in which it has not been in the past easy to find the material, let alone have it charted. We are grateful to Dr Derham for having both collected and charted it, both in this paper and in the larger publication which will be available for purchase in the bookshop immediately on the adjournment.