SET-OFFS IN COMPANY INSOLVENCIES

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INTRODUCTION

This paper is concerned with set-offs in company liquidations. The most important right of set-off in such a case is the right conferred by s.86 of the Bankruptcy Act 1966, which allows a set-off in the event of mutual credits, mutual debts or other mutual dealings. This right of set-off is imported into the law of company liquidation by s.438 of the Companies Code.

THE RELEVANT DATE

The existence of a right of set-off in a company liquidation is determined as at the date of the liquidation of the company. In a voluntary liquidation this is the date of the resolution for a winding up. In a compulsory liquidation there is some controversy as to whether this means the date when the liquidation is deemed by the Companies Code to commence, ie. the date of the filing of the application for the winding up,[1] or the date when the administration of the winding up commences, ie. the date of the winding up order.[2] The better view, which has the support of Mason J. in Day & Dent Constructions Pty Ltd v. North Australian Properties Pty Ltd,[3] is that the later of the dates, the date of the winding up order, should be the relevant date. However, the ascertainment of rights of set-off by reference to the date of the liquidation is subject to s.86(2) of the Bankruptcy Act, which states that "A person is not entitled under this section to claim the benefit of a set-off if, at the time of giving credit to the person who has become a bankrupt or at the time of receiving credit from that person, he had notice of an available act of bankruptcy committed by that person." Acts of bankruptcy are not a part of the law of company liquidation. While it is accepted nonetheless that this qualification to the right of set-off is still relevant to company liquidations, the method of application has not been settled. One suggestion has been that an individual should be substituted for the company, and that the existence of a right of set-off should depend on whether an act of bankruptcy would have been committed if the act in question actually performed by the company in fact had been performed by an individual.[4]

This is unsatisfactory, because the imminent winding up of a company may be indicated by events which have no direct equivalent in the acts of bankruptcy. A second suggestion is that one should look to see whether by analogy anything had happened in relation to the company which was of the same quality as an act of bankruptcy would have been in respect of an individual.[5] The trouble with this is that the rights of the parties would then depend on what may be a difficult analogy. The better view, which is based upon the judgment of Jacobs J.A. in Law v. James,[6] is that the equivalent concept of notice of an act of bankruptcy in company law is notice of any act or omission of the company which could have founded a petition to wind up the company upon the ground that the company was unable to pay its debts. Consequently, transactions with a company after notice of the company's inability to pay its debts may not give rise to a set-off.[7]

PROCEDURAL OPERATION

It is sometimes assumed that the occurrence of a bankruptcy or the commencement of a winding up brings about an automatic cancellation of cross-demands,[8] though in fact this does not appear to be the case. The right of set-off in bankruptcy is procedural in its operation, and the parties remain indebted to each other until such time as an account is taken, either in the context of a proof lodged in the liquidation or when a set-off is raised as a defence to an action brought against the creditor by the liquidator.[9] This seems clear from the language of s.86 itself, which is expressed in the present rather than the past tense; an account "shall be taken" of what "is due" from each party to the other and the sum "due" from the one party "shall be set off" against any sum due from the other. This indicates that the ascertainment of what is due and the allowance of a set-off is to take place at the time of the taking of the account, rather than the earlier date of the winding up.[10] Given that this is the case, consider the following situation. During the course of a winding up, the liquidator assigns a debt owing to the company to a third party assignee. The debtor also happens to be a creditor of the company on another transaction. The assignee of the debt does not seek to enforce the debt until after the company is dissolved, while the debtor on the assigned debt did not lodge a proof in the liquidation asserting a set-off. After the dissolution the assignee sues the debtor on the assigned debt, and the debtor then seeks to set off the company's indebtedness to him (on the basis of the principle that an assignee takes subject to equities). One would have thought that the claim for a set-off should fail. Because the debtor failed to assert a set-off in the winding up, the cross-debts would not actually have been set against each other. Moreover, when a company is dissolved, any indebtedness that the company otherwise had is gone by operation of law[11] (unless the dissolution is declared by the court to have been void).[12] Since nothing would be due from the dissolved company to the debtor, there should no longer be an existing "equity" available to the debtor to which

the assignee could be made to take subject. However, there is in fact recent authority to the contrary. In 1984, in Farley v. Housing and Commercial Developments Limited,[13] it was held that the assignee in this situation should be subject to a set-off, while in an unreported Queensland case in 1985[14] a similar result occurred in the analogous case of an assignee enforcing a debt after the assignor had been discharged from bankruptcy.[15] While on one view it may be regarded as fair on a public policy basis that the assignee in these cases should take subject to a set-off, the allowance of a set-off nevertheless is not easy to reconcile with a first principles analysis, and it may be doubted whether these cases correctly state the law. A debtor of a company in liquidation who is possessed of a cross-claim should lodge a proof in the winding up asserting a right of set-off. This would have the effect of protecting the debtor in the event of a later action brought by an assignee from the company in the period after dissolution.[16]

THE FUNDAMENTAL PRINCIPLE

A fundamental notion is that the right of set-off in bankruptcy is merely a rule "as to debts and liabilities provable".[17] Section 86 stipulates that there should be a person claiming to prove a debt in the bankruptcy, so that the creditor's claim against the bankrupt or the company in liquidation obviously should be capable of proof. However, the converse proposition also applies, that any claim which may be proved prima facie should be capable of being set off. This principle was applied as early as 1816, in the case of Graham v. Russell,[18] and its existence was noted by Professor Christian in the second edition of his work on bankruptcy law in 1818.[19] Indeed, it was expressly incorporated into the set-off sections in the English Bankruptcy Acts of 1825 and 1849. While an express statement of the principle was omitted from the 1869 English legislation and from subsequent English Acts, as well as from the Australian legislation, the courts nevertheless have continued to emphasise it.[20]

CONTINGENT DEBTS OF THE COMPANY

Given this principle, the hand-wringing that went on in this country until the decision of the High Court in the Day & Dent Constructions case,[21] and that to a considerable extent is still going on in England, as to whether a contingent claim may be employed in a set-off, is surprising. The classic example is the case of a surety who pays the creditor after the principal debtor's winding up, so that at the date of the winding up the surety only had a contingent claim to an indemnity from the principal debtor. A contingent debt is provable in a winding up,[22] and so this provable debt should be capable of being employed in a set-off in the principal debtor's liquidation. While the surety's right of set-off was upheld by the High Court in Day & Dent Constructions, the decision in favour of a set-off was not based upon the provability of the demand, but rather upon

a principle adopted by the court that the set-off section applied to transactions which would naturally, or in the ordinary course of business, end in a debt (as distinct from must of necessity end in a debt). It is submitted that statements such as these are inherently vague and uncertain, and only serve to conceal the real principle applicable to questions of set-off. Mason J. said in Day & Dent Constructions that the provability of the demand only provided indirect assistance to the application for a set-off, though his Honour would seem to have understated the weight traditionally attached by the courts to this principle.

Occasionally there have been statements suggesting that a set-off will not be available in respect of a contingent claim unless the contingency had occurred before the taking of the account.[23] However, it is not a prerequisite to the proof of a claim which is contingent at the date of the liquidation that it should have vested before the proof is lodged. The procedure is that the liquidator should estimate the value of contingent debt as at the date of the winding up (provided of course that it is capable of being fairly estimated).[24] If the liability vests before the proof is lodged, that fact may be considered as evidence of the true value of the claim as at the date of the winding up for the purpose of proof.[25] If, however, the contingency has not occurred, the claim nevertheless may be proved, based upon an estimate of its value pursuant to s.82 of the Bankruptcy Act. Given the connection between provable debts and debts which may be employed in a set-off, it is submitted that as a general rule (but subject to the specific exception that I shall mention shortly) it should not be necessary in order to employ a debt that was contingent at the date of the liquidation in a set-off that the contingency should actually have occurred before the taking of the account. It should be possible to take an account based upon a valuation made for the purpose of proof. The valuation should be regarded as the sum due for the purpose of the set-off section. There is some support for this approach in Ex parte Law. In re Kennedy,[26] a case decided by the English Bankruptcy Court in 1846. Certain legislation (6 Geo. 4, C. 16, s.54) had required the commissioners in bankruptcy to ascertain the value of an annuity payable by a bankrupt, and the annuity creditor was permitted to prove in respect of that value. In this case an order was made to the effect that the annuity creditor should also employ the valuation in a set-off. There is, nevertheless, an exception to this general rule in the specific situation considered in Day & Dent Constructions, of a surety who has not paid the sum for which he is liable under the guarantee by the time the account is to be taken between himself and the principal debtor in the principal debtor's liquidation, so that his right to an indemnity is still dependent upon a contingency.[27] The English Court of Appeal in Re Fenton. Ex parte Fenton Textile Association, Limited[28] held that the rule against double proof operates to deprive the surety of any right to prove his contingent claim in the debtor's winding up, and that consequently he may not set it off against a liability that he has to the debtor.[29] The unpaid creditor is entitled to prove

the debt in the debtor's liquidation, and if in addition the surety were allowed to prove his contingent right to an indemnity, the principal debtor's estate would be subjected to a double proof in respect of the same debt. The creditor is the party who is out of pocket, and so his right of proof should be preserved. Therefore, in order to prevent the possibility of a double proof, the surety should be denied the opportunity of proving his contingent claim,[30] and if he cannot prove it was held that he should not be entitled to a set-off.[31]

MUTUALITY

For a set-off under the bankruptcy legislation there must be mutuality. Mutuality refers to two characteristics, that the demand must be between the same parties and that they must be held in the same capacity (or right or interest).[32] It is concerned with the status of the parties, and their relationship with each other. The requirement of same parties means that, for example, as a general rule[33] a demand possessed by a number of creditors jointly may not be set off against a claim against one only of those creditors.[34] The same capacity or right means that there must be identity between the person beneficially interested in the claim and the person against whom the cross-claim exists.[35] In determining mutuality under the bankruptcy legislation, one looks to the equitable interests of the parties rather than their bare legal rights.[36]

Sometimes, when advice is given in relation to a bank's right of set-off in the event of a liquidation of a customer, the opinion is expressed that neither the customer's claim against the bank nor the customer's liability to the bank should have been incurred in the capacity of trustee. This is certainly correct in relation to the customer's claim. If the customer is a trustee of the claim there would not be mutuality between that claim and a liability of the customer. However, in relation the the customer's liability, it should not make any difference that the liability may have been incurred on behalf of a trust. The liability of a person acting as trustee is his own personal liability. As far as a person dealing with the trustee is concerned, the trustee alone is obliged to satisfy it. There is no such concept as a trust of a liability. While the trustee may have a right of indemnity from the trust fund, the trustee's liability generally is not limited to funds available for an indemnity so that the fact that the liability is incurred on behalf of a trust by itself should not be sufficient to destroy mutuality.[37]

THE COMPANY'S CLAIM

I mentioned earlier that the question whether a creditor's claim against a company in liquidation may be employed in a set-off essentially is to be determined by reference to whether the claim is provable in the liquidation. However, what about claims possessed by the company in liquidation against the creditor?

How does one determine if the insolvent company's claim against the creditor may be the subject of a set-off? The relevant principle is that, as a general rule, the right to set-off should depend on the nature and character of the claim itself, and not upon the side of the account on which it is to be placed. Thus, if B's indebtedness to A could have resulted in a set-off in B's own liquidation, then equally B should be able to employ that indebtedness in a set-off when A instead is in liquidation. Authority for this proposition is derived from the decision in 1816 of the twelve judges of the Exchequer Chamber in the case of Graham v. Russell.[38] The case involved legislation which allowed an insured under a policy of insurance to prove a claim on the policy in the bankruptcy of the underwriter, even though the loss may not have occurred until after the bankruptcy.[39] However, in this case it was the insured, rather than the underwriter, who was bankrupt, and the underwriter wanted to set off a liability that accrued on the policy after the insured's bankruptcy against a separate indebtedness of the insured for premiums. The underwriter's right to do so was upheld, on the basis that if the underwriter instead had been the bankrupt party the claim on the policy could have been proved, and consequently could have been set off, in his bankruptcy.[40]

TRUST FUNDS

Trust funds often present problems in relation to set-offs. If a bankrupt holds funds on trust for a person who is indebted to the bankrupt on another transaction, the beneficiary's right to recover the trust fund may not be the subject of a set-off in respect of a cross-demand, since the trust fund will not pass to the bankrupt's trustee in bankruptcy as property of the bankrupt.[41] This being the case, the beneficiary may seek its return without lodging a proof, in which case the set-off section will not apply, since there will not be "a person claiming to prove a debt in the bankruptcy" (as is required by s.86). Normally, of course, the fact that the beneficiary may recover the trust fund in toto will mean that he will not need a set-off. Consider though the converse situation, in which the beneficiary is the bankrupt party (or the party in liquidation), and the trustee wants to set off an indebtedness of the beneficiary in liquidation to him against his obligation to account for the trust fund. One would have thought that a set-off should not be available to the trustee since, on the basis of the approach adopted by the court in Graham v. Russell,[42] the right to a set-off should depend upon the nature and character of the claims rather than the side of the account on which they appear. While there is indeed authority in support of this principle,[43] in fact it has not always been applied by the courts.[44] One particular instance when it has not always been applied is when property is deposited with a person with directions to turn it into money (as, for example, when goods are deposited with an auctioneer for the purpose of sale by the auctioneer, or when a bill is given to an agent to collect and remit the proceeds). Often the status of the depository of the property will be that of a fiduciary, and

any money subsequently received by the depository in respect of the property will be impressed with a trust in favour of the depositor.[45] Nevertheless, if the depositor becomes bankrupt, the depository may set off the proceeds against a separate indebtedness of the depositor to him, and the courts in reaching this conclusion for some reason have not given any consideration at all to the possibility of the proceeds being impressed with a trust.[46]

SPECIAL PURPOSE PAYMENTS OR RETENTIONS

A company prior to its liquidation may have paid a sum of money to another person (or that person may have retained a sum of money) for a special purpose which has failed or which has not been carried into effect. In such a case the liquidator of the company may recover the special purpose payment undiminished by a set-off.[47] On the analysis earlier proposed in relation to Graham v. Russell, this is understandable when the special purpose payment is impressed with a trust. However, there is authority suggesting that the denial of a set-off is based upon something other than a trust, so that a set-off may be denied even though the relationship between the parties is only one of debt. This appears from the decision of the English Court of Appeal in In Re City Equitable Fire Insurance Company Limited.[48] A reinsurer under a treaty of reinsurance had agreed to accept a share of all fire insurance policies accepted or renewed by the insurer, and in order to secure the due performance of the reinsurer's obligations under the treaty, the insurer was entitled to retain a percentage of the premiums credited to the reinsurer. The reinsurer went into liquidation, and after all its obligations to the insurer under the treaty had been satisfied the insurer still retained a substantial fund. It was held that the retention money constituted money left in the hands of the insurer for a special purpose, and that the balance remaining after that purpose was satisfied had to be returned to the liquidator without a right to set off separate debts owing to the insurer by the reinsurer. Counsel for the insurer argued that the deposit was not a trust fund, and that therefore the insurer should be able to employ it in a set-off. There was no apparent obligation on the insurer to keep the deposit separate from its own funds, and the insurer was required to pay interest to the reinsurer on the deposit, a factor which is considered to be a powerful indication of a debt rather than a trust relationship.[49] However, the existence or otherwise of a trust apparently was not considered to be important. Thus Maugham J. commented at first instance: "It does not seem to me to matter much whether it is or is not regarded as a trust fund. It is, to my mind, moneys 'deposited for a specific purpose' ...".[50] On appeal the Court of Appeal failed to mention the presence or absence of a trust; it was sufficient to deny a set-off that the moneys were retained for a specific purpose. The decision in this case is not easy to explain.[51] If it were correct, it could be argued that when a customer deposits money in a special purpose account with its bank (eg. for the bank to pay to the

credit of a third party), the account could not be employed by the bank in a set-off in the customer's liquidation if the purpose has failed or has not been carried into effect, even though the relationship between the bank and the customer is purely one of debt and the obligation to pay the third party is purely contractual.[52]

It has been said that a set-off is denied in these special purpose cases because the money was received for a particular purpose and it would be a breach of contract to use it for any other purpose.[53] The trouble with this view is that failure to pay any debt on the due date constitutes a breach of contract.[54] Yet a person who has breached his contract by refusing to pay a debt on the due date may still employ the debt in a set-off in the creditor's subsequent liquidation, even if the very purpose of doing so is to engineer a situation in which there may be a set-off.[55] It is difficult to see why a breach of contract in any other form should be treated differently. Moreover, the House of Lords has now confirmed, in National Westminster Bank Ltd v. Halesowen Presswork & Assemblies Ltd,[56] that the parties to mutual dealings may not contract out of the operation of the set-off section. It would be unusual if the parties nevertheless may separate out a particular debt by stipulating that the proceeds of the debt may only be used for a particular purpose. Curiously though, both Lord Kilbrandon and Lord Simon of Glaisdale in the House of Lords in Halesowen referred to and discussed the City Equitable Fire case without adverse comment, though their respective explanations for these special-purpose payment cases each seem to countenance a form of trust fund. Lord Kilbrandon said that the funds in these cases were "impressed with quasi-trust purposes",[57] a concept that has also been used to explain the status of property held under a fiduciary obligation that is similar to a trust but is not a trust in the technical sense of the word.[58] The use of this expression was criticised by Lord Simon as giving "uncertain guidance in the law". He preferred to say that a set-off is denied "if the money is paid in such circumstances that it would be a misappropriation to use it for any other purpose than that for which it is paid".[59] It is not clear what his Lordship meant by misappropriation. However, it does seem to imply that the parties should have intended that there be a separate fund which is not to be misappropriated, and such a fund may be characterised as a trust fund. To the extent that the City Equitable Fire case in fact seems to depart from this and to deny a set off when there is no separate fund the subject of a trust, in my view it should be regarded as wrongly decided.

CONTINGENT CLAIMS OF THE COMPANY

Reference has already been made to the situation in which a creditor of a company in liquidation has a claim against the company in liquidation which claim is merely contingent at the date of liquidation. Day & Dent Constructions is authority for the proposition that the creditor may employ the claim in a set-

off. However consider the opposite situation, in which the company in liquidation is possessed of a contingent claim against a creditor arising out of a dealing entered into before the liquidation. When the claim vests the liquidator sues the creditor. Can the creditor set off in that action the separate debt owing to him by the company? This situation conceivably could arise if a person has an obligation to deliver foreign currency to a company which went into liquidation prior to the due delivery date, and if, in addition, the obligation to deliver foreign currency is regarded as an obligation to deliver a commodity rather than a monetary obligation.[60] If the nature of the obligation is to deliver a commodity, and the person with the obligation refuses to perform the contract after the occurrence of the company's liquidation, the company in liquidation would not have acquired a claim for damages for breach of contract until after its liquidation when the obligation to deliver accrues. On the analysis earlier proposed, the person should be entitled to a set-off against his liability for damages to the company in liquidation. If the person with the obligation to deliver was the party in liquidation, the company could have employed its contingent claim in a set-off, on the authority of Day & Dent Constructions. Equally, then, applying Graham v. Russell, a set-off should be available when the company instead is in liquidation. In England, though, there is authority to the contrary. In the context of a bankruptcy, a set-off was denied in Waite's case[61] in respect of a right of indemnity acquired by a bankrupt surety after his bankruptcy arising out of a prior guarantee given to a creditor of the principal debtor, while, in the specific case of a company liquidation, a claim for a set-off failed in The Ince Hall Rolling Mills Company, Limited v. The Douglas Forge Company.[62] A company before the commencement of its liquidation had entered into a contract to supply the defendant with certain quantities of unascertained goods at a future date. However, no debt was actually created until the delivery of the goods after the commencement of the liquidation. Despite the fact that the debt arose out of a dealing entered into before the liquidation, Watkin Williams J. held that the debt arising after the liquidation pursuant to that prior dealing could not be the subject of a set-off. His Lordship said that lack of mutuality prevented a set-off, on the basis that, if a company after the commencement of its liquidation enters into or completes a transaction, it does so in a new interest and a new capacity, and solely for the purpose of winding up its affairs in the interest of creditors and shareholders. This should be distinguished from the situation considered earlier in which a company in liquidation incurs a liability after the liquidation as a result of a prior contract, because in this case the liability is still the liability of the company so that mutuality is not a problem. The better view though is that, when a company acquires a claim after its liquidation as a result of a prior contract, mutuality should be determined by reference to the identity of the person who was a party to the original transaction, and of course the company in the Ince Hall case originally entered into the contract (before the liquidation) for

its own benefit. This contract should be regarded as the source of mutual credit or mutual dealings originally subsisting between the parties. On this view any difficulty with mutuality is more perceived than real. Indeed in Australia there is authority for the view that there may be a set-off in this situation, but it is unfortunate that in neither of the cases in question was there any mention of Ince Hall. The first Australian authority is Hiley v. The Peoples Prudential Assurance Company Limited,[63] in which Dixon J. said that an indebtedness accruing on either side of the account after a liquidation as a result of a prior dealing may ground a set-off.[64] This was applied in the second of the cases, Re Clune,[65] a decision in 1988 of French J. in the Federal Court. In this case it was held that sums received by an agent for a company after the commencement of the company's liquidation could be employed in a set-off, since they related to a prior agency arrangement. The principle applied, in my view, is correct, though the case is unsatisfactory because there was no mention of Ince Hall, when that case seems to constitute direct authority to the contrary. With respect, Re Clune is unsatisfactory in another sense. Often, but not always, moneys received by an agent on behalf of his principal will be impressed with a trust in favour of the principal.[66] If the moneys were the subject of a trust, they should not have been susceptible to a set-off. However, this particular question was not explored in the judgment.

I earlier expressed the opinion that, when a company in liquidation is contingently liable to a person, that person as a general rule should be able to have regard to the company's contingent liability in a set-off even though the contingency has not occurred when the account is to be taken. A set-off in such a case may be based upon a valuation made by the liquidator pursuant to s.82 of the Bankruptcy Act. Of course, s.82 only applies to a contingent liability of a bankrupt or a company in liquidation; it does not enable a liquidator to put a present value upon a contingent claim possessed by a company in liquidation.[67] This being the case, a claim of a company in liquidation which is still contingent at the date for taking an account could not be the subject of a set-off even though a contingent liability of the company arguable could be set off.

SET-OFF AGREEMENTS

Prior to a company liquidation, parties dealing with each other may have entered into an agreement for the satisfaction of their cross-demands by bringing them into an account, so that henceforth there should only be one debt for the balance. In the context of a winding up, the effectiveness of the agreement is subject to two limitations. These limitations become important whenever the cross-demands are such that the mutual credit provision in the bankruptcy legislation in any event would not confer a right of set-off in the winding up, either because of lack of mutuality or because the qualification relating to notice of an act of bankruptcy has been infringed or because the nature

of one of the cross-demands is such that it is not susceptible to a set-off.

The first limitation is that a set-off pursuant to the agreement must not constitute a voidable preference within the terms of s.122 of the Bankruptcy Act (which is imported into the law of company liquidation by s.451 of the Companies Code).[68] In this regard it should be noted that, while s.122 provides a defence to a creditor against a claim for a preference if the creditor is a purchaser or payee in good faith and for valuable consideration and in the ordinary course of business, s.122(4) stipulates that a creditor is deemed not to be a purchaser or payee in good faith if the payment or transfer of property in question occurred under circumstances so as to lead to the inference that the creditor knew or had reason to suspect that the debtor was unable to pay his debts as they became due, and that the effect of the payment or transfer would be to give a preference priority or advantage over other creditors. It seems clear then that the question whether a set-off effected pursuant to an agreement will be struck down as a preference will be determined by reference to the creditor's knowledge of the state of the debtor's solvency as at the time of the set-off, and not at the time that the set-off agreement was entered into.[69] The scope of the preference provision represents a possible deficiency, as far as Australia is concerned, in netting by novation of foreign exchange contracts. In netting by novation, obligations of each of two counterparties to deliver the same currency on the same value date are brought into an account as soon as they are "matched" by the parties so that, on the value date, only the balance of that currency is deliverable. If one bank, Bank A, enters into a foreign exchange contract with another bank, Bank B, at a time when Bank A is aware that Bank B is unable to pay its debts as they fall due, the qualification to the set-off section may mean that an obligation arising out of that contract to pay a sum may not form the basis of a set-off in a subsequent liquidation of Bank B. As I mentioned earlier, the qualification to the set-off section is applied in a company liquidation on the basis of notice of a company's inability to pay its debts. Moreover, because of this notice of insolvency, the effect of s.122(4) may be that a netting-off of obligations pursuant to the agreement would constitute a preference. This should be compared to the position in England, where a payment will not be avoided as a preference unless there is an element of intention to prefer.[70] The parties in entering into the master netting agreement (or in entering into a foreign exchange transaction) would not have been influenced by a desire to confer a preference. In Australia, on the other hand, we look only to the effect of the transaction. Intention to prefer is irrelevant. Because of this distinction, opinions expressed by English banking lawyers, that netting by novation in relation to foreign exchange contracts entered into after notice of insolvency will not be voidable as a preference, should be regarded with caution in Australia.

The second limitation arises from the House of Lords decision in British Eagle International Airlines Limited v. Compagnie Nationale Air France,[71] and this is that the agreement may not be relied upon after the commencement of a winding up to bring into account demands that had not actually been set against each other before that date. To do so would be contrary to the statutory injunction in s.403 of the Companies Code, that the property of a company should be applied in its winding up in satisfaction of its liabilities pari passu. While s.403 is in a Division of the Code dealing with voluntary liquidations (and British Eagle itself concerned a voluntary liquidation), it is nonetheless accepted that it also applies to compulsory liquidations.[72] A compulsory winding up is deemed by the Code to have commenced at the date of the filing of the application for the winding up.[73] However, for the purpose of s.403, and the application of the British Eagle principle, it is submitted that the relevant date would be the date when the administration of the winding up commences, ie. the date of the winding up order, rather than the date of the filing of the application. Section 403 provides that "the property of a company shall, on its winding up, be applied in satisfaction of its liabilities equally". It would only be on the date of the winding up order that it could be said that the company's assets "shall" be applied in satisfaction of its liabilities. This is not to say, though, that a set-off effected pursuant to an agreement in the interval between the filing of the application and the winding up order could not be impugned if it would not otherwise be voidable as a preference. Section 368 of the Code avoids dispositions of a company's property after the commencements of its winding up (ie. the date of the filing of the application) unless the court otherwise orders. A set-off effected between the filing of the application and the winding up order could come within the ambit of s.368.[74] Indeed in Barclays Bank Limited v. TOSG Trust Fund Limited,[75] Nourse J., at first instance, held that a bank's act in debiting a customer's account so as to reduce a credit balance constituted a disposition of the company's property after the commencement of its winding up, though this aspect of the case was not considered on appeal by the Court of Appeal. Of course, even if the disposition is avoided, there may still be a set-off of the cross-demands in the liquidation if the requirements of s.86 of the Bankruptcy Act are satisfied.

FOOTNOTES

1. Companies Code s.365.

2. The authorities are referred to by Mason J. in Day & Dent Constructions Pty Ltd v. North Australian Properties Pty Ltd (1982) 40 ALR 399, 408-409.

3. 1982 40 ALR 399.

4. Russell Wilkins & Sons Ltd v. The Outridge Printing Company Limited [1906] St R Qd 172.

5. Re Eros Films Ltd [1963] 1 Ch 565, 575.

6. [1972] 2 NSWLR 573.

7. This approach was also adopted by Wood J. in his unreported judgment in the Supreme Court of New South Wales in Tooth & Co Ltd v. Rosier (1985).

8. Certain remarks of Neill J. in Farley v. Housing and Commercial Developments Ltd (1984) 26 Build LR 66, [1984] BCLC 442 may be interpreted as supporting this view.

9. See generally Derham, Set-off, Clarendon Press, Oxford, (1987), 73-75. For example, Brett J. commented in The New Quebrada Company, Limited v. Carr (1869) LR 4 CP 651, 653-4 that the set-off section's "only effect is to transfer the claim to the assignees, subject, when they seek to enforce it, to a right of the plaintiffs to deduct their debt. It does not, I think, extinguish the mutual debts". In Clarke v. Fell (1833) 4 B & Ad 404 a bankrupt prior to his bankruptcy had performed work on a carriage delivered to him by a person who was a creditor on another transaction. After the bankruptcy the creditor sued the assignees in bankruptcy for the recovery of the carriage. While the action failed, it seems clear from the judgments that it would have succeeded if the creditor had first lodged a proof in the bankruptcy asserting a set-off against his indebtedness for the cost of the work performed. The set-off would have constituted payment of the creditor's indebtedness for the cost of the work, so that the lien which in fact was successfully asserted by the assignees in bankruptcy in this action would have come to an end.

10. See Mason J. in Day & Dent Constructions (1982) 40 ALR 399, 415.

11. In re George. Ex parte Robson [1905] 1 KB 462, 464.

12. See the Companies Code, s.458, and also In re C.W. Dixon, Limited [1947] 1 Ch 251.

13. (1984) 26 Build LR 66, [1984] BCLC 442.

14. Martin v. Lewis (1985), Queensland Supreme Court.

15. When a bankrupt is discharged from bankruptcy, the discharge operates to release him from all debts provable in the bankruptcy. See the Bankruptcy Act 1966, s.153(1). While s.153(3) stipulates that the discharge does not affect the right of a secured creditor, secured creditor is defined in s.5 as a person holding a mortgage, charge or lien on the

property of the debtor. A person entitled to a set-off pursuant to the set-off section in the bankruptcy legislation does not come within this definition.

16. If the proof is rejected the debtor may appeal to the court. See reg. 126 of the Companies Regulations.

17. See Lord Selborne in Mersey Steel & Iron Co (Ltd) v. Naylor, Benzon & Co (1884) 9 App Cas 434, 437-8.

18. (1816) 5 M & S 498.

19. Christian, Bankrupt Law (2nd edn, 1818), Vol 1, 509.

20. For example Brett M.R. commented in Re Asphaltic Wood Pavement Co. Lee & Chapman's Case (1885) 30 Ch D 216, 222 that, "As between them this claim to damages can be proved in the winding-up. The moment I come to that conclusion, I must hold that the Bankruptcy Act, 1869, s.39, applies, and that the claim of the Commissioners is to be treated by way of set-off". Similarly, Cotton L.J. commented in that case (at 224) that, "that is properly a liability the damages for which are capable of being proved, and, if capable of being proved, are capable under the mutual credit clause of being set off". See also Palmer v. Day & Sons [1895] 2 QB 618, 621; In re Taylor. Ex parte Norvell [1910] 1 KB 562, 580; Paddy v. Clutton [1920] 2 Ch 554, 567; Ellis & Company's Trustee v. Dixon-Johnson [1924] 1 Ch 342, 357; In re City Life Assurance Company, Ltd. Grandfield's Case [1926] 1 Ch 191, 210-11, 212; In re Fenton [1931] 1 Ch 85, 113; Hiley v. The Peoples Prudential Assurance Company Limited (1938) 60 CLR 468, 490.

21. (1982) 40 ALR 399.

22. See the Bankruptcy Act 1966, s.82.

23. See Dixon J. in Hiley v. The Peoples Prudential Assurance Company Limited (1938) 60 CLR 468, 496-7, and Gibbs C.J. and Murphy J, in Day & Dent Constructions (1982) 40 ALR 399, 406, 416. See also Re Charge Card Services Limited [1986] 3 All ER 289, 316, 319.

24. See the Bankruptcy Act 1966, s.82.

25. In re Dynamics Corporation of America [1976] 1 WLR 757, 767-8; Re Hurren [1982] 3 All ER 982, 987.

26. (1846) De Gex 378. See also In re Daintrey. Ex parte Mant [1900] 1 QB 546, 557.

27. The fact that the creditor has obtained a judgment against a surety per se does not vest the surety's right against the principal debtor. Nor does it vest merely because a proof

lodged by the creditor in the surety's bankruptcy has been accepted by the trustee, if payment under the proof has not been made. See In re Fenton [1931] 1 Ch 85, and also Re Bruce David Realty Pty Ltd [1969] VR 240.

28. [1931] 1 Ch 85.

29. See also In re W. Guthrie and Allied Companies (1901) 4 GLR 155. This same notion was employed in Abbott v. Hicks (1839) 5 Bing (NC) 578, in which the undertaking given by the bankrupt partners to the defendant solvent partner to pay the partnership debts was said in effect to constitute the defendant a surety for those debts. See also Re Bruce David Realty Pty Ltd [1969] VR 240.

30. It was held in In re Paine. Ex parte Read [1897] 1 QB 122, and again in In re Blackpool Motor Car Company, Limited [1901] 1 Ch 77, that a surety before payment to the creditor is a "creditor" of the bankrupt for the purposes of the preference provision. In Fenton both Lord Hanworth M.R. (at 106) and Romer L.J. (at 118-20) agreed that these two cases were correctly decided, though they said that the issue determined was separate from the question whether a surety should be entitled to prove in the bankruptcy. See also The Liverpool (No 2) [1960] 3 All ER 307, 314; Re Bruce David Realty Pty Ltd [1969] VR 240, 243.

31. Compare In re Bell (1878) 5 QSCR 128, 130.

32. See The Ince Hall Rolling Mills Company, Limited v. The Douglas Forge Company (1882) 8 QBD 179, 183 ("between the same parties and in the same interest"); Shand v. M.J. Atkinson Limited [1966] NZLR 551, 570 ("by and against a person in the same right"); Peel v. Fitzgerald [1982] Qd R 544, 547 ("between the same parties and in the same right").

33. See Derham, op cit 146-152.

34. Ex parte Twogood (1805) 11 Ves Jun 517; Baker v. Gent (1892) 9 TLR 159.

35. West Street Properties Pty Ltd v. Jamison [1974] 2 NSWLR 435, 441.

36. Hiley v. The Peoples Prudential Assurance Company Limited (1938) 60 CLR 468, 488 per Rich J., 497 per Dixon J.

37. See eg. Nelson v. Roberts (1893) 69 LT 352, and generally Derham, op cit 197.

38. (1816) 5 M & S 498. See also Young v. The Bank of Bengal (1836) 1 Moore 150, 166-7.

39. (1746) 19 Geo 2, C. 32, s.2. Before 1825 contingent debts as a general rule neither could be proved nor set off in a bankruptcy.

40. The judgment of the court in Graham v. Russell (1816) 5 M & S 498 was delivered by Lord Ellenborough, who commented (at 502) that, "But, as in taking an account between parties, the question, whether any particular item shall be introduced into it, must depend upon the nature and character of the item itself, and not upon the side of the account at which it is to be placed; and ... from the operation of the stat. 19 G. 2, c. 32, the demand upon this policy would have constituted an item of mutual account if the underwriter had become bankrupt; we think it must also do so in the present case, where the assured has become a bankrupt ...".

41. See the Bankruptcy Act 1966, s.116(2)(a).

42. (1816) 5 M & S 498.

43. See for example In re The United Ports and General Insurance Company; Ex parte The Etna Insurance Company (1877) 46 LJ Ch 403; Wright v. Watson (1883) Cab & El 171 (sum held by solicitor on trust for bankrupt client); Elgood v. Harris [1896] 2 QB 491 (subrogation moneys held by broker on trust for bankrupt underwriter). When the creditor of a bankrupt was indebted to the bankrupt's assignee in bankruptcy in the assignee's private capacity, and the creditor himself later became bankrupt the fact of the assignee's trusteeship precluded any right to set off the dividend payable to the creditor against the creditor's own indebtedness to him. See Ex parte White (1742) 1 Atk 90, though compare Ex parte Nockold (1734), unreported but noted in Cooke, The Bankrupt Laws (8th edn, 1823), Vol 1, p 509, which has not been followed. See Re Henley, Thurgood, & Co (1863) 11 WR 1021, 1022.

44. See for example Re Arthur Sanders Limited (1981) 17 Build LR 125, in which Nourse J. said that equity would have deemed a notional trust fund for retention money to have been set up by the Greater London Council in favour of a building contractor, though his Lordship still seems to have accepted that a set-off could proceed in the contractor's liquidation in relation to the proportion of the retentions to which the contractor was beneficially entitled. In The Monkwearmouth Flour Mill Company (Limited) v. Lightfoot (1897) 13 TLR 327 Bruce J. allowed a set-off despite the use of language suggestive of a trust. See also Re Clune (1988) 14 ACLR 261, discussed below.

45. See generally Finn, Fiduciary Obligations (1977), p 105.

46. See generally Derham, op cit 111-123. For example, it was confirmed in Re Cotton (deceased); Ex parte Cooke (1913) 108 LT 310 (following Crowther v. Elgood (1887) 34 Ch D 691) that, when an auctioneer sells goods for a customer, he acts in a fiduciary capacity, and the customer is entitled to receive the full proceeds of sale from the auctioneer's insolvent estate rather than being confined to a proof. The auctioneer in Palmer v. Day & Sons [1895] 2 QB 618 similarly had sold the goods deposited with him by the bankrupt for the purpose of sale, and yet he was allowed to set off the proceeds against his charges still owing by the bankrupt for the sale of other goods. Compare also Naoroji v. The Chartered Bank of India (1868) LR 3 CP 444 with In re Brown, Ex parte Plitt (1889) 6 Morr 81, in the context of a bill deposited with a bank to collect and remit the proceeds (as opposed to credit the proceeds to an account).

47. In re Pollitt. Ex parte Minor [1893] 1 QB 655; In re Mid-Kent Fruit Factory [1896] 1 Ch 567.

48. [1930] 2 Ch 273. See also In re Pollitt. Ex parte Minor [1893] 1 QB 455, in which it was held that a solicitor could not employ funds deposited with him by a client specifically to meet future costs in a set-off in the client's bankruptcy. The question of a trust was not canvassed by the Court of Appeal. This was so despite earlier authority to the effect that the relation of trustee and cestui que trust ordinarily does not exist between a solicitor and a client although the solicitor may have received money from or for the client. See Sir Charles Hall V.C. in Watson v. Woodman (1875) LR 20 Eq 721, 731, following In re Hindmarsh (1860) 1 Dr & Sm 129 and distinguishing Burdick v. Garrick (1870) LR 5 Ch App 233. See also Friend v. Young [1897] 2 Ch 421, 432; Shand v. Atkinson Ltd [1966] NZLR 551, 566. Compare though Stumore v. Campbell & Co [1892] 1 QB 314. Compare now also legislation such as the Legal Profession Practice Act 1958 (Vic), s.40, which requires a solicitor who receives money for and on behalf of any person to pay that money into a trust account. In England the first such provision appears to have been set out in the Solicitors Accounts Rules 1935, made pursuant to the Solicitors' Act 1933, s.1.

49. See Pott v. Clegg (1847) 16 M & W 321, 327 per Parke B.; Foley v. Hill (1848) 2 HLC 28, 36; In re Broad. Ex parte Neck (1884) 13 QBD 740, 746.

50. [1930] 2 Ch 293, 303.

51. See the discussion in Derham, op cit 124-131.

52. Compare a case such as Barclays Bank Ltd v. Quistclose Investments Ltd [1970] AC 567, in which the customer himself received the money as trustee from a third party (and

therefore was obliged to keep it separate from his own funds) and the bank had notice of the circumstances giving rise to the trust so as to make the trust binding upon it.

53. Thus Astbury J. said in In re H.E. Thorne & Son, Limited [1914] 2 Ch 438, 450 that, "Now the principle ... is that where a creditor obtains money or has in hand a balance of money paid to him under a separate contract for a specific purpose he cannot and ought not to be allowed to claim a set-off ... if it involves a breach of the contract under which he obtained the money".

54. See Maugham J. at first instance in the City Equitable Fire case [1930] 2 Ch 293, 302.

55. See eg. Southwood v. Taylor (1818) 1 B & Ald 471; Willment Brothers Ltd v. North West Thames Regional Health Authority (1984) 26 Build LR 51 (payment on a cheque stopped).

56. [1972] AC 785.

57. Ibid 821.

58. See Foley v. Hill (1848) 2 HLC 28, 35-6, and generally Finn, op cit 89.

59. [1972] AC 785, 808.

60. See the discussion in Mann, The Legal Aspect of Money (4th edn, 1982), 184-193, where it is said that foreign money is money where it functions as such and is a commodity where it is an object of commercial intercourse. In Bando Trading Co Ltd v. Registrar of Titles [1975] VR 353 Starke J. held that foreign currency is a commodity. Compare Watson v. Lee (1979) 144 CLR 374 in which the High Court held that "currency" in s.51(xii) of the Constitution is not limited to Australian currency.

61. [1956] 1 WLR 1226 (which was distinguished in Re Charge Card Services Ltd [1986] 3 All ER 289 and criticised in Day & Dent Constructions, though in the context of a liability incurred by a company in liquidation as opposed to a claim acquired by the company).

62. (1882) 8 QBD 179, cited with evident approval by the English Court of Appeal in Rother Iron Works Ltd v. Canterbury Precision Engineers Ltd [1974] 1 QB 1, 6.

63. (1938) 60 CLR 468.

64. Ibid 497.

65. (1988) 14 ACLR 261.

66. "In equity the relation of agent would carry with it a duty to account, and, as a rule, a duty, if moneys are received in the course of the agency, to hold them specifically for the principal". Palette Shoes Pty Ltd v. Krohn (1937) 58 CLR 1, 30 per Dixon J.

67. In re Daintree. Ex parte Mant [1900] 1 QB 546, 557, 565.

68. In In re Washington Diamond Mining Company [1893] 3 Ch 95 there was an exchange of cheques between the parties, though it seemed to be accepted that an agreement for a set-off, without an actual exchange of cheques, similarly would have given rise to a preference on the basis that it would have constituted a payment for the purpose of the preference provision. See also In re Land Development Association. Kent's Case (1888) 39 Ch D 259.

69. The Law Reform Commission in its report on insolvency law has recommended that the court, in deciding whether a particular transaction should be voidable as a preference, may take into account all the circumstances surrounding the transactions, including the history and nature of the relationship between the parties and the purpose and object of the transaction. See s.AT3(6) of the draft legislation. However, the discussion of this proposal was in the context of running accounts (see Volume 1 of the Report paragraphs 654-655), and it is not clear that it would apply in the situation in which there was knowledge of insolvency at the time the transaction in question occurred but not when a prior agreement pursuant to which the transaction occurred was entered into.

70. See the Insolvency Act 1986, s.239.

71. [1975] 1 WLR 758.

72. Webb v. Whiffin (1872) LR 5 HL 711, 735.

73. Companies Code, s.365.

74. It has been said that "disposition of property" is a term of the widest significance, and accordingly should be given a wide meaning. See Re Dittmer Gold Mines Ltd (No 3) [1954] St R Qd 275, 282.

75. [1984] BCLC 1.