Set-off against statutory avoidance and insolvent trading claims in company liquidation

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The purpose of this article is to consider whether a set-off under s 553C of the Corporations Act 2001(Cth) may be relied on as a defence to the various statutory recovery claims available to a company's liquidator under the Act, with particular reference to unfair preferences, uncommercial transactions, void dispositions and insolvent trading. That question, though capable of simple expression, gives rise to considerable complexity. A line of authority has developed in Australia in favour of the view that set-off may be available against those claims under s 553C, including at intermediate appellate level as a consequence of comments in the New South Wales Court of Appeal in Buzzle Operations Pty Ltd v Apple Computer Australia Pty Ltd (2011) 81 NSWLR 47. It is contended in this article that that view is wrong as a matter of principle, and that a set-off should not be available for three reasons. First, a set-off would be contrary to the statutory purpose of the claims, being to benefit unsecured creditors. Secondly, and related to the first point, there is a lack of mutuality. It is commonly said that mutuality is determined by reference to equitable interests, but the expression of the principle in those terms does not always explain mutuality. It is suggested that in some cases the answer may be found in the concept of beneficial ownership, using that expression in the sense of ownership for one's own benefit, and a consequent right to deal with property as one's own, as opposed to the interest of a beneficiary of a trust in the strict sense. Thirdly, the statutory claims do not arise until after the time for determining the availability of set-offs in the liquidation, and are not properly characterised as contingent at that time. The contrary view, that the claims exist as contingent before the liquidation, is supported by the decision of the New South Wales Court of Appeal in Vale v TMH Haulage Pty Ltd (1993) 31 NSWLR 702 in relation to insolvent trading and also, arguably, by the recent analysis of the United Kingdom Supreme Court in Re Nortel GmbH [2014] AC 209 in relation to proofs of debt for statutory liabilities. But it is suggested that there are difficulties with those cases in Australia, particularly in light of the reasoning of the High Court in Foots v Southern Cross Mine Management Pty Ltd (2007) 234 CLR 52 in relation to proofs of debt for costs orders. Nevertheless, a distinction arguably may be drawn on this third issue between director liability for insolvent trading and the other statutory claims (including holding company liability for insolvent trading). There is an argument in the former situation that the statutory claims exist as contingent before the liquidation which would not be available in relation to the latter.

INTRODUCTION

Part 5.7B of the *Corporations Act 2001* (Cth) sets out various grounds for recovering property or compensation for the benefit of creditors in a company liquidation. They include (in Div 2) voidable transactions such as unfair preferences and uncommercial transactions.[1] If a transaction is voidable in the liquidation of a company on the basis of an unfair preference or an uncommercial transaction, the

* Barrister, Sydney. This article essentially concerns the subject considered in Derham R, *Derham on the Law of Set-off* (4th ed, Oxford University Press, Oxford, 2010) pp 537-547, but analysed in considerably greater detail, and it incorporates some thoughts in relation to fundamental principles not previously canvassed. Parts of the article originally published in the book have been reproduced with the permission of Oxford University Press.

[1] See *Corporations Act 2001* (Cth), ss 588FA (unfair preferences), 588FB (uncommercial transactions).

liquidator may apply to the court for various orders, including an order for payment of a sum of money to the company.[2] Part 5.7B also includes provisions relating to insolvent trading.[3] If a company incurred debts while it was insolvent and the company later goes into liquidation, the liquidator may recover from the directors and its holding company, as a debt due to the company, an amount equal to the loss or damage suffered by creditors in relation to those debts because of the company's insolvency.[4] Another ground for recovery is set out in s 468, which avoids dispositions of property of a company made after the commencement of its winding up by the court. These various grounds are referred to generically in this article as "statutory insolvency claims".

Set-off is available in company liquidation pursuant to s 553C, which is expressed to apply in circumstances where there have been mutual credits, mutual debts or other dealings between a company in insolvent liquidation and a person with a provable debt. Essentially, the section provides that an account is to be taken of what is due from the one party to the other in respect of the mutual dealings, the sum due from the one party is to be set off against the sum due from the other, and only the balance of the account is admissible to proof against the company, or is payable to the company, as the case may be. This is subject to the qualification in s 553C(2), that a person is not entitled to claim the benefit of a set-off if, at the time of giving credit to the company or at the time of receiving credit from the company, the person had notice of the fact that the company was insolvent.

In bankruptcy,[5] it is accepted in both England and Australia that a creditor sued by a trustee in bankruptcy for repayment of a preferential payment is not entitled to rely on a set-off against that liability.[6] A set-off requires mutuality, which refers to cross-claims between the same parties. A preference claim in bankruptcy is not derived from an obligation owed by the creditor to the bankrupt. Rather, it accrues to the trustee in his or her own right. The trustee's preference claim against the preferred creditor, and the creditor's cross-claim against the bankrupt, accordingly are not mutual. This is also accepted in England as the position in company liquidation.[7] Company liquidation differs from bankruptcy in that, unlike in the case of a trustee in a bankruptcy, the property of a company ordinarily[8] is not vested in the liquidator. However, the absence of a transfer of property to a liquidator does not affect the position in England.[9] The right to recover is not regarded as the property of the company, but rather it is said that it arises pursuant to a statutory power given to the liquidator for the benefit of the creditors among whom the liquidator has a duty to distribute the company's assets.[10] Therefore, a set-off against a cross-debt owing by the company is not permitted. This characterisation is not confined to preference claims, but applies generally in England to rights of action which only arise after the liquidation and which are recoverable only by the liquidator pursuant to statutory powers conferred on him or her.[11]

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[2] *Corporations Act 2001* (Cth), s 588FF.

[3] See *Corporations Act 2001* (Cth), Pt 5.7B, Divs 3, 4, ss 588G-588Q (director liability), Div 5, ss 588V-588X (holding company liability).

[4] See *Corporations Act 2001* (Cth), ss 588M(2) (director liability), 588W (holding company).

[5] *Bankruptcy Act 1966* (Cth), s 86 is in similar terms to *Corporations Act 2001* (Cth), s 553C.

[6] Derham R, *Derham on the Law of Set-off* (4th ed, OUP, 2010) pp 531-532 [13.07].

[7] Derham, n 6, pp 532-533 [13.08].

[8] In the absence of a vesting order under *Insolvency Act 1986* (UK), s 145; see also *Corporations Act 2001* (Cth), s 474(2).

[9] *Re A Debtor* [1927] 1 Ch 410 at 420.

[10] *Re Oasis Merchandising Services Ltd* [1998] Ch 170 at 181-183; *Lewis v Commissioner of Inland Revenue* [2001] 3 All ER 499 at [36]-[37].

[11] *Re Oasis Merchandising Services Ltd* [1998] Ch 170 at 181-182; *Lewis v Commissioner of Inland Revenue* [2001] 3 All ER 499 at [36]-[37]; see also *Oasis Merchandising* (at 182-183) in relation to a void disposition (referring to *Re Ayala Holdings Ltd [No 2]* [1996] 1 BCLC 467).

However, a different approach has been adopted in Australia in relation to company liquidation. There are a number of cases in Australia which support the availability of a set-off in the case of uncommercial transactions, insolvent trading claims and void dispositions. Further, if a set-off is available in the case of an uncommercial transaction, it should also be available in the case of an unfair preference since in all relevant respects the statutory provisions are the same. It is contended in this article that the views expressed in those cases are wrong as a matter of principle, and that a set-off should not be available against the statutory insolvency claims.

Payment "to the company"

Before considering the cases, the language of Div 2 of Pt 5.7B of the *Corporations Act* in relation to voidable transactions should be noted.

The remedy in the case of a voidable transaction under Div 2 of Pt 5.7B, including for an uncommercial transaction and an unfair preference, is provided for in s 588FF. This states that the court "on the application of a company's liquidator" may make one or more of the forms of order set out in the section. The application is made by the liquidator, not the company;[12] the voidable transaction provisions do not create any right of action in the company.[13] Nevertheless, in the case of an order for payment of a sum of money, the section refers to an order for payment "to the company".[14] Legislation in the form of Div 2 of Pt 5.7B, including s 588FF, was introduced in amendments to the *Corporations Law* in 1992.[15] It stands in contrast with the form of preference provision in company liquidation as it existed before those amendments, which simply incorporated the corresponding bankruptcy provision (with appropriate modifications for liquidation).[16] Essentially, this provided that a payment or transfer of property by a company that, if it had been made by a natural person would, in the event of his or her becoming bankrupt, be void as against the trustee in bankruptcy, was, in the event of the company being wound up, void as against the liquidator. There was no express reference to payment "to the company". Under that form of legislation, it was said that a payment which was void as a preference could not be set off under the insolvency set-off section, this being consistent with the position in bankruptcy.[17] However, the trend of more recent authorities suggests that the position may differ under the form of legislation after the 1992 amendments.

In considering the significance that should be attached to the expression "to the company" in s 588FF, it should be appreciated that, before the introduction of s 588FF, the appropriate order in a successful preference action was for payment to the company notwithstanding that the action was brought in the name of the liquidator.[18] Therefore, the inclusion of a stipulation for payment to the company in s 588FF simply reflected the prevailing view before the enactment of the section as to the appropriate order.

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[12] *Olsen v Nodcad Pty Ltd* (1999) 32 ACSR 118; 150 FLR 174 at [7]; *Carob Industries Pty Ltd v Simto Pty Ltd* (2000) 23 WAR 515 at [42]; *Re Harris Scarfe Ltd* (2006) 203 FLR 46 at [27]; cf *SJP Formwork (Aust) Pty Ltd v Deputy Commissioner of Taxation (Cth)* (2000) 34 ACSR 604.

[13] *Fortress Credit Corporation (Australia) II Pty Ltd v Fletcher* (2014) 87 NSWLR 728 at [127] (Barrett JA) (decision affirmed *Fortress Credit Corporation (Australia) II Pty Ltd v Fletcher* (2015) 89 ALJR 425; [2015] HCA 10).

[14] See *Corporations Act 2001* (Cth), s 588FF(1)(a), (c).

[15] *Corporate Law Reform Act 1992* (Cth).

[16] *Corporations Law*, s 565 (see *Corporations Act 1989* (Cth)).

[17] *Calzaturificio Zenith Pty Ltd v NSW Leather & Trading Co Pty Ltd* [1970] VR 605 at 618 (*Bankruptcy Act 1924* (Cth), s 82 being the applicable set-off section).

[18] *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360 at 372; *Bibra Lake Holdings Pty Ltd v Firmadoor Australia Pty Ltd* (1992) 7 WAR 1 at 6-7; *Re Fresjac Pty Ltd* (1995) 65 SASR 334 at 343; *Cook v Italiano Family Fruit Co Pty Ltd* (2010) 190 FCR 474 at [19]. Before the introduction of *Corporations Act 2001* (Cth), s 588FF, the liquidator was regarded as the proper plaintiff in the action (see *Bibra Lake* and *Re Fresjac* at 343).

The cases

The most comprehensive analysis of the availability of a set-off against a statutory insolvency claim is the judgment of Mansfield J in *Re Parker* (1997) 80 FCR 1. The case concerned an insolvent trading claim against a holding company under s 588W. That section is expressed in terms that, if the conditions for the imposition of liability are satisfied, the "company's liquidator may recover from [the holding company], as a debt due to the company".[19] Mansfield J held that the holding company's liability could be the subject of a set-off in the subsidiary's liquidation against a separate debt owing by the subsidiary to the holding company.[20] His Honour rejected the view that the circumstance that the insolvent trading claim was required to be brought by the subsidiary's liquidator in his own name meant that there was no mutuality.[21] Referring to the stipulation in the legislation that the amount of the claim was recoverable "as a debt due to the company", he said that the claim as a matter of substance was the claim of the subsidiary. The fact that the claim may be enforced by the liquidator was said to be merely "the procedural device for enforcing what is clearly a claim of the company".[22]

The question of set-off in relation to insolvent trading arose again in *Hall v Poolman* (2007) 65 ACSR 123; 215 FLR 243 at [405]-[434], on this occasion in the context of director liability. Section 588M(2), in relation to director liability, is in a similar form to s 588W in relation to holding company liability, providing that "the company's liquidator may recover from the director, as a debt due to the company". Palmer J did not refer to *Re Parker* but reached the same conclusion as Mansfield J in that case, that a set-off was available in the liquidation against the director's liability. His Honour regarded the insolvent trading claim as a claim of the company.[23] Gleeson J followed those decisions in the context of director liability in *Smith v Boné* [2015] FCA 319 at [415]-[427].

Before those cases, *Shirlaw v Lewis* (1993) 10 ACSR 288 considered the availability of set-off in the context of a void disposition made by a company after the commencement of a court-ordered winding up.[24] The case concerned a contract for the sale of a business. The purchaser went into possession prior to completion, but the contract provided that if the purchaser defaulted, the vendor was entitled to terminate the purchaser's licence to conduct the business and to resume possession, whereupon the vendor would purchase all of the purchaser's goods and saleable stock in trade used in the business. The purchaser repudiated the contract and as a result it incurred a liability in damages to the vendor. The vendor accepted the repudiation, thereby terminating the contract. An application for the winding up of the purchaser was filed and a liquidator subsequently was appointed. After the filing of the application (being the commencement of the winding up) the vendor re-took possession, at which time a purchase of the stock by the vendor pursuant to the sale agreement occurred. The vendor then on-sold the stock. The liquidator asserted that the sale of the stock to the vendor after the commencement of the winding up upon resumption of possession was a void disposition within s 468 of the *Corporations Law*,[25] and sought damages in conversion from the vendor in the amount of the value of the stock as a result of the on-sale. Hodgson J doubted that a retrospective avoidance of a disposition could retrospectively make a disposal of goods a wrongful act of conversion.[26] But in any event he considered that, whether the claim against the vendor was characterised as being a claim in

[19] *Corporations Act 2001* (Cth), s 588M(2), in relation to director liability for insolvent trading, is in a similar form.

[20] See also *BGC Contracting Pty Ltd v Kimberly Gold Pty Ltd* (2000) 35 ACSR 633 at [96] (Master Bredmeyer).

[21] *Re Parker* (1997) 80 FCR 1 at 11.

[22] *Re Parker* (1997) 80 FCR 1 at 11.

[23] See *Hall v Poolman* (2007) 65 ACSR 123; 215 FLR 243 at [422] ("Wines" claim under CA s 588M(2) for "insolvent trading").

[24] Under *Corporations Law*, s 468. See now *Corporations Act 2001* (Cth), s 468.

[25] Hodgson J accepted that the disposition occurred upon the resumption of possession (*Shirlaw v Lewis* (1993) 10 ACSR 288 at 295).

[26] *Shirlaw v Lewis* (1993) 10 ACSR 288 at 295. That doubt was well-founded. See *Perpetual Trustees Australia Ltd v Heperu Pty Ltd* (2009) 76 NSWLR 195 at [75]-[81] in relation to conversion of cheques; cf *Sydlow Pty Ltd v Melwren Pty Ltd* (1994) 13 ACSR 144 at 147.

conversion or (as it was also put) a claim based on unjust enrichment,[27] the vendor could set off its damages cross-claim arising from the repudiation.[28] The legislation in relation to void dispositions does not specifically provide for payment, or for a debt due, "to the company". It simply avoids the disposition, and it is then necessary to find an appropriate common law or equitable remedy available to the company consequent upon the avoidance.[29] But the possibility of a set-off against a monetary remedy was recognised. The decision in *Shirlaw v Lewis* subsequently was referred to with approval by White J in *JLF Bakeries Pty Ltd v Baker's Delight Holdings Ltd* (2007) 64 ACSR 633 at [37]-[41]; [2007] NSWSC 894.

In *Buzzle Operations Pty Ltd v Apple Computer Australia Pty Ltd* (2011) 81 NSWLR 47 the question of set-off in company liquidation came before the New South Wales Court of Appeal in relation to an uncommercial transaction. Avoidance of an uncommercial transaction is dealt with in the same part of the *Corporations Act* (Div 2 of Pt 5.7B) dealing with unfair preferences,[30] and essentially it is subject to the same provisions, including s 588FF. That is to say, it requires an application to the court by the company's liquidator, and in the case of a successful application the section provides for an order for payment "to the company". In that respect, the scheme of the legislation is similar to that applicable in *Re Parker* and *Hall v Poolman* in relation to insolvent trading. It was argued against a set-off in *Buzzle Operations* that the claim was the liquidator's claim, not that of the company,[31] and that it did not exist at the date of the liquidation. Essentially, this was a repetition of the argument that had been rejected in *Re Parker* in relation to insolvent trading.[32] The set-off point in fact was not necessary for the decision in *Buzzle Operations*,[33] but Young JA nevertheless said that he would follow *Re Parker*, and accepted that the line of reasoning used by Mansfield J in that case was also applicable in the case of avoidance of an uncommercial transaction.[34] That is to say, the claim was to be regarded as the company's as a matter of substance. If it had been necessary, Young JA said that he would have declared that a set-off was available in *Buzzle Operations* under s 553C. Whealy JA agreed with Young JA on this point.[35] Delphically, Hodgson JA said[36] that he "substantially" agreed with Young JA's reasons.[37] However, given his Honour's earlier view in relation to set-off in *Shirlaw v Lewis* in the context of void dispositions,[38] it is likely that the agreement extended to Young JA's discussion of set-off.

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[27] See *Shirlaw v Lewis* (1993) 10 ACSR 288 at 295-296.

[28] Compare *Re Buchanan Enterprises Pty Ltd* (1982) 7 ACLR 407 in relation to equitable set-off. *Thomas v Hatzipetros* (1997) 24 ACSR 286 concerned a different question, whether a disposition of property after the commencement of a winding up should be validated under the equivalent of *Corporations Act 2001* (Cth), s 468 on the ground that the company was no worse off by the disposition because the bank as the disponee in any event would have claimed a set-off.

[29] *Shirlaw v Lewis* (1993) 10 ACSR 288 at 295, referring to *Re J Leslie Engineers Co Ltd* [1976] 1 WLR 292.

[30] See in particular, *Corporations Act 2001* (Cth), ss 588FB, 588FE(3), 588FF,

[31] The voidable transaction provisions do not create any right of action in the company: *Fortress Credit Corporation (Australia) II Pty Ltd v Fletcher* (2014) 87 NSWLR 728 at [127] (Barrett JA) (decision affirmed *Fortress Credit Corporation (Australia) II Pty Ltd v Fletcher* (2015) 89 ALJR 425; [2015] HCA 10).

[32] *Re Parker* (1997) 80 FCR 1 at 9 (see the second argument), 11 (see above).

[33] This was emphasised: *Buzzle Operations Pty Ltd v Apple Computer Australia Pty Ltd* (2011) 81 NSWLR 47 at [278].

[34] *Buzzle Operations Pty Ltd v Apple Computer Australia Pty Ltd* (2011) 81 NSWLR 47 at [271]-[278]. The grounds of appeal in *Buzzle* concerned insolvent trading and uncommercial transactions (at [55]). No defence of set-off was raised in relation to the insolvent trading claim (see at [49], and the first instance judgment *Buzzle Operations Pty Ltd v Apple Computer Australia Pty Ltd* (2010) 77 ACSR 410; 238 FLR 384 at [20], [337]). Hence, the discussion of Young JA (at [271]-[279]) would appear to have concerned uncommercial transactions.

[35] *Buzzle Operations Pty Ltd v Apple Computer Australia Pty Ltd* (2011) 81 NSWLR 47 at [285]-[287].

[36] *Buzzle Operations Pty Ltd v Apple Computer Australia Pty Ltd* (2011) 81 NSWLR 47 at [2]

[37] Query whether his Honour only intended to exclude from his expressed agreement with Young JA's reasons the matters that he expressly discussed in the following paragraphs in his judgment.

[38] *Shirlaw v Lewis* (1993) 10 ACSR 288 at 295-296 (see above).

If a set-off is available in the case of an uncommercial transaction, prima facie it should also be available in the case of an unfair preference since essentially the same statutory scheme applies in both cases, in particular s 588FF. This was accepted in the Queensland District Court,[39] following *Buzzle Operations*. On this view, the position would differ from that in bankruptcy, and in company liquidation in England, where it is accepted that set-off is not available in the case of a preference.[40] Before *Buzzle Operations*, Einstein J, in *Cashflow Finance Pty Ltd v Westpac Banking Corporation* [1999] NSWSC 671 at [574], considered that the rationale which precludes set-off against an obligation to repay a preference must apply also to a transaction which is a voidable uncommercial transaction. This assumed that there is no set-off in the case of an unfair preference. But if the view favoured in *Buzzle Operations* is correct, that a set-off is available in the case of a voidable uncommercial transaction, the converse of the proposition accepted by Einstein J would also seem to apply, that a set-off is similarly available in the case of an unfair preference.[41] It is difficult on the face of the legislation to see why they should be treated differently.

Notwithstanding the views expressed in *Re Parker* and *Hall v Poolman* in relation to insolvent trading, in *Buzzle Operations* (obiter) in relation to uncommercial transactions (and, it would seem, unfair preferences), and in *Shirlaw v Lewis* in the context of a void disposition, it is suggested that set-off is not available against an obligation arising out of a statutory insolvency claim. In the case of a preferential payment, one reason for denying a set-off after the avoidance of the payment *as against the debt which was the subject of the payment* is that that debt is not provable until the preference has been repaid in full.[42] If there is no provable debt, there is no set-off.[43] More generally, including in relation to other debts in the case of an unfair preference, a set-off should be denied for three reasons. First, a set-off would be contrary to the purpose of the statutory insolvency claim, secondly, there is a lack of mutuality, and, thirdly, the obligation arises after the cut-off time for determining rights of set-off in the liquidation.[44] Each of these grounds is considered below.

Preliminary point: Notice of insolvency precluding set-off under s 553C(2)

Before considering those grounds, brief mention should be made of another reason sometimes given for denying a set-off, based on the qualification to the availability of a set-off in s 553C(2).

In essence, s 553C(2) provides that a person is not entitled to claim the benefit of a set-off if, at the time of giving credit to the company or at the time of receiving credit from the company, the person had notice of the fact that the company was insolvent.[45] This differs from the level of notice required under s 588FG(2) in order to establish a defence to a preference or an uncommercial transaction claim. The notice required under s 588FG(2) is based instead upon reasonable grounds to suspect insolvency. This difference means that a preferred creditor could be denied a defence to a preference claim under s 588FG(2), because he or she had reasonable grounds to suspect insolvency at the relevant time, but not be precluded from asserting a set-off (were a set-off otherwise thought to be

[39] *Morton v Rexel Electrical Supplies Pty Ltd* [2015] QDC 49. In *Duncan v Vinidex Tubemakers Pty Ltd* [1999] SASC 157, the SA Full Court accepted, in an application to amend a defence in a preference action to plead a set-off, that it was reasonably arguable, on the basis of *Re Parker*, that the defence was available, though Williams J commented (at [23]) that the defendant was faced with a "difficult task" in seeking to apply *Re Parker* in that context. Contrast, eg *Jetaway Logistics Pty Ltd v Deputy Commissioner of Taxation* (2008) 68 ACSR 226; 229 FLR 363 (decision reversed (2009) 26 VR 567) which concerned a different question, as to whether an agreement between a company and a creditor for a set-off of cross-claims could be avoided as a preference in the company's subsequent liquidation, as opposed to the situation under discussion, as to whether a set-off is available against an obligation to repay a payment avoided as a preference: see Derham, n 6, pp 534-535 [13.10].

[40] See above.

[41] Other than against the debt the subject of the preferential payment. See below.

[42] See *Corporations Act 2001* (Cth), s 588FI; Derham, n 6, p 537 [13.14]. This was the practice before the intervention of statute. See *NA Kratzmann Pty Ltd v Tucker [No 2]* (1968) 123 CLR 295 (esp at 297)

[43] See Derham, n 6, pp 367-368 [7.24].

[44] In England, see *Re A Debtor* [1927] 1 Ch 410; Derham, n 6, pp 532-533 [13.08], and generally, pp 296-297 [6.63].

[45] See Derham, n 6, pp 304-305 [6.87]-[6.89].

available) by virtue of the qualification because his or her knowledge was not sufficient to constitute notice of the fact that the company was insolvent.[46]

In a recent decision in the Queensland District Court,[47] it was accepted (following *Buzzle Operations*) that set-off may be available against a preference claim under s 553C, but that the defendant may be deprived of a set-off by virtue of the operation of subs (2).[48] This accords with *Smith v Boné* [2015] FCA 319 at [415]-[427] in the context of insolvent trading.[49] If, however, the obligation to repay a preferential payment is not susceptible to a set-off, the question of the operation of subs (2) would not arise.

There is a further point, which is relevant to the application of the qualification to the preference claim itself. This arises from the matters discussed (below) in greater detail in relation to the third ground. Section 553C(2) refers to notice of insolvency at the time of giving or receiving "credit". The concept of "credit" also appears in subs (1), in the expression "mutual credits, mutual debts or other mutual dealings", and it should have a corresponding meaning in both places. In the context of subs (1), it is said that, in order to support a set-off in an insolvency, the "credits" must at least exist as contingent at the relevant date for determining the availability of set-offs.[50] A contingent liability requires an existing obligation out of which, on the happening of a future event, an obligation to pay a sum of money would arise.[51]

Therefore, the requirement that a credit the subject of a set-off should at least exist as contingent at the relevant date imports the notion that there should be an existing obligation before the occurrence of the winding up. The correspondence between "credits" in the expression "mutual credits", and "credit" in subs (2), suggests that this should also apply in the case of the latter. That is to say, before one can say that credit has been given or received, there must be an obligation. But in relation to a claim to recover a preferential payment, it is suggested in the discussion below of the third ground that there is no obligation imposed upon the preferred creditor before the occurrence of a winding up. This reasoning suggests that subs (2), and the question of notice under it, can have no application to a preference claim (as opposed to a cross-claim on the other side of the account). There is no receiving of credit from the company before the winding up for the purpose of the qualification.

FIRST GROUND: CONTRARY TO THE STATUTORY PURPOSE

A common feature of the statutory insolvency claims is that they are given for the benefit of the general body of creditors. This has been emphasised in the case of preferences,[52] insolvent trading

[46] As to what constitutes notice, see Derham, n 6, p 305 [6.89].

[47] *Morton v Rexel Electrical Supplies Pty Ltd* [2015] QDC 49 at [80]-[83] (Searle DCJ).

[48] The set-off against the preference claim related to other debts owing by the company which were not the subject of preferential payments, and the question of notice of insolvency related to those debts. Compare the discussion below as to whether the qualification to the set-off section can apply to the preference claim itself.

[49] See also *Re Docker* (1938) 10 ABC 198 at 238-239 (preference). Contrast cases such as *Russell Wilkins & Sons Ltd v Outridge Printing Co Ltd* [1906] St R Qd 172 at 190; *Re Hardman* (1932) 4 ABC 207 at 212-213; *Re Smith* (1933) 6 ABC 49 at 57, which concerned a different question, as to whether a set-off was available in relation to a debt arising from a transaction that gave rise to a preference and the debt owing by the debtor to the creditor the subject of the preference. It was held in each case that there was no set-off. In *Re Pitts & Lehman Ltd* (1940) 40 SR (NSW) 614 at 621-622, it is unclear from the report what precisely was the subject of the asserted set-off.

[50] *Gye v McIntyre* (1991) 171 CLR 609 at 623-624 (referring to *Hiley v Peoples Prudential Assurance Co Ltd* (1938) 60 CLR 468 at 497 (Dixon J)).

[51] *Community Development Pty Ltd v Engwirda Construction Co* (1969) 120 CLR 455 at 459 (Kitto J). See the discussion below of contingent debts in relation to the third ground.

[52] *Sheahan v Carrier Air Conditioning Pty Ltd* (1997) 189 CLR 407 at 428 (referring, inter alia, to *Willmott v London Celluloid Co* (1886) 34 Ch D 147 at 149-150); *Re Fresjac Pty Ltd* (1995) 65 SASR 334 at 347 ("for the purposes of distribution in the liquidation"); *Re MC Bacon Ltd* [1991] Ch 127 at 137; *Fortress Credit Corporation (Australia) II Pty Ltd v Fletcher* (2014) 87 NSWLR 728 at [127]-[129] (decision affirmed *Fortress Credit Corporation (Australia) II Pty Ltd v Fletcher* (2015) 89 ALJR 425; [2015] HCA 10). See also *Cook v Italiano Family Fruit Co Pty Ltd* (2010) 190 FCR 474 at [48], referring to [1035] of the Explanatory Memorandum to the *Corporate Law Reform Act 1992* (Cth) (purpose of the voidable transaction provisions was to ensure that "unsecured creditors are not prejudiced").

claims[53] and void dispositions.[54] Indeed, it is reflected in the heading to Pt 5.7B of the *Corporations Act* (which includes the unfair preference, uncommercial transaction and insolvent trading provisions): "Recovering Property or Compensation for the Benefit of Creditors of Insolvent Company".

In the case of unfair preferences, courts in Australia, like those in England,[55] have accepted that a charge granted by a company over its present and future assets does not attach to a right to recover a preferential payment[56] in a liquidation or the proceeds of recovery.[57] Similarly, neither a right to set aside a preferential payment nor the proceeds of recovery could be assigned by the company prior to its liquidation as future property.[58] Those propositions are not affected by the inclusion in s 588FF of a provision for payment "to the company".[59] In the first place, as noted above, that provision simply reflects the previously accepted view as to the appropriate order in a successful preference action. But apart from that, the purpose of the preference provisions is to benefit the general body of creditors, and it would be contrary to that purpose if the benefit of a recovery consequent upon setting aside a preferential payment went to a secured creditor or to a pre-liquidation assignee. As Dawson, Gaudron and Gummow JJ observed in *Sheahan v Carrier Air Conditioning Pty Ltd* (1997) 189 CLR 407 at 428, in relation to a fixed and floating charge given by a company (TOC) over its present and future assets, in circumstances where a liquidator appointed to TOC had obtained judgment in proceedings to recover preference payments:

> However, such a charge would not extend to payments of money recovered by the liquidator of TOC under the statute law proscribing preferences. The right to have such preferential dealings set aside, statutory in nature, is given for the benefit of the general body of creditors. *Hence*, the security would not attach to the proceeds of the judgments the [liquidator] recovered at first instance in the present litigation [emphasis added].

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[53] The Explanatory Memorandum circulated with the *Corporate Law Reform Bill 1992* (Cth), which introduced ss 588V and 588W in relation to holding company liability for insolvent trading, stated (at [1128]) that the liquidator "may take proceedings against the holding company to recover, for the benefit of unsecured creditors, loss or damage suffered by unsecured creditors as a result of the holding company's contravention of 588V"; in relation to director liability, see [1096] ("When the liquidator takes such action, any amounts paid are paid as compensation to the company for the benefit of any unsecured creditors").

[54] *Re Fresjac Pty Ltd* (1995) 65 SASR 334 at 341-345; *Re Loteka Pty Ltd* [1990] 1 Qd R 322 at 324; *Rose v AIB Group (UK) plc* [2003] 1 WLR 2791 at [14]. In *Re Fresjac* (at 341-342, 343, 344-345), Doyle CJ said that the purpose of the statutory provisions relating to preferences and void dispositions was to enable recovery of property with a view to rateable distribution among the general creditors but subject to the rights of secured creditors. The qualification relating to secured creditors concerned the situation where the subject of the disposition was specific and identifiable property subject to a charge prior to the disposition, which property is then recovered, as opposed to a payment of money (*Re Fresjac* at 340-345): see Derham, n 6, p 533 [13.08]n.

[55] See Derham, n 6, pp 532-533 [13.08].

[56] As distinct from a situation in which the subject of the preference was a transfer of specific property which is ordered to be transferred back: see Derham, n 6, p 533 [13.08]n. For a criticism of the distinction, see *Cook v Italiano Family Fruit Co Pty Ltd* (2010) 190 FCR 474 at [52]-[62].

[57] *NA Kratzmann Pty Ltd v Tucker [No 2]* (1968) 123 CLR 295 at 299-301; *Re Fresjac Pty Ltd* (1995) 65 SASR 334 at 346-347; *Sheahan v Carrier Air Conditioning Pty Ltd* (1997) 189 CLR 407 at 428; *Hamilton v National Australia Bank Ltd* (1996) 66 FCR 12 at 37; *G & M Aldridge Pty Ltd v Walsh* [1999] 3 VR 601 at [35]; *Tolcher v National Australia Bank Ltd* (2003) 44 ACSR 727; 174 FLR 251. See also *Cook v Italiano Family Fruit Co Pty Ltd* (2010) 190 FCR 474 at [13] (proceeds recovered) (note the subsequent discussion in *Cook* wherein it is queried whether *Kratzmann* is correct as a matter of principle or policy).

[58] *Cook v Italiano Family Fruit Co Pty Ltd* (2010) 190 FCR 474 at [12]. See also *UTSA Pty Ltd v Ultra Tune Australia Pty Ltd* [1997] 1 VR 667 at 698 in relation to the period after the commencement of a liquidation, which would apply a fortiori before liquidation.

[59] *Hamilton v National Australia Bank Ltd* (1996) 66 FCR 12 at 37 (where this was assumed); *Tolcher v National Australia Bank Ltd* (2003) 44 ACSR 727; 174 FLR 251; *Cook v Italiano Family Fruit Co Pty Ltd* (2010) 190 FCR 474 at [46]-[51]; cf *Riaps Pty Ltd v Tim Ferrier Pty Ltd* [2001] QSC 10 at [16] (not followed in *Tolcher*); Bennetts K, "Voidable Transactions: Consequences of Removing Avoidance Powers from the Liquidator and Vesting Them in the Court" (1994) 2 Insolv LJ 136 at 139-140, where Bennett referred to some comments by Knox J in *Re Produce Marketing Consortium Ltd (No 2)* [1989] BCLC 520 in the context of a claim for wrongful trading under *Insolvency Act 1986* (UK), s 214, as supporting the contrary view, however those comments no longer reflect the position in England. In *Re Oasis Merchandising Services Ltd* [1998] Ch 170 at 181 the Court of Appeal accepted that a right of action by a liquidator for fraudulent (s 213) or wrongful trading, and the fruits of such an action, are not property of the company and are not caught by a debenture. See also *Re MC Bacon Ltd* [1991] Ch 127 at 138; *Lewis v Commissioner of Inland Revenue* [2001] 3 All ER 499 (preference).

That observation was made in the context of the position prior to the enactment of s 588FF, but the reasoning is equally applicable to a recovery under s 588FF, notwithstanding the stipulation in s 588FF for payment "to the company".[60]

The observation in *Sheahan* was made in the context of a preference, but it is equally pertinent to other statutory insolvency claims given for the benefit of the general body of creditors. In *Re Fresjac Pty Ltd* (1995) 65 SASR 334 at 345, Doyle CJ[61] said that the right to recover property the subject of a void disposition is not property of the company to which a pre-existing charge granted by the company would attach, and nor are the proceeds of the exercise of the right caught by the charge.[62] Similarly it has been accepted in relation to insolvent trading that a company prior to its liquidation could not charge any subsequently accruing insolvent trading claim so as to give a secured creditor of the company a prior ranking entitlement to any future recovery,[63] and nor could the company before liquidation assign for its own benefit a potential insolvent trading claim as future property.[64] In relation to a charge, that proposition is reflected in s 588Y(1), which provides that an amount paid to a company on account of insolvent trading is not available to pay secured debts of the company unless all the company's unsecured debts have been paid in full.[65] This suggests that a charge may attach after unsecured creditors have been paid in full. But since the amount recoverable in an insolvent trading claim is the amount of the loss or damage suffered by unsecured creditors because of the company's insolvency,[66] there should not ordinarily be any excess payable to a secured creditor out of insolvent trading recoveries after unsecured creditors have been paid.

Set-off, though not a security in the strict sense of the word, nevertheless performs a similar function,[67] and similar reasoning to that set out in *Sheahan* should apply in that context. A set-off would operate to the benefit of the particular creditor claiming the set-off. In one sense it would also benefit the general body of creditors in that, to the extent of the set-off, the particular creditor with that right would not be proving in competition with the other creditors. But that benefit may be only marginal. The general body of creditors would be worse off as a consequence of a set-off than would be the case if there was no set-off and the recovery was available for distribution among all unsecured creditors. In that sense, a set-off would not be for the benefit of the general body of creditors and therefore would be contrary to the purpose for which the statutory insolvency claims are given.

Insolvency set-off differs fundamentally from the charge the subject of the comment in *Sheahan* in that it is statutory in origin, and its scope therefore is determined by the terms of the statute. But

[60] In *Re Fresjac Pty Ltd* (1995) 65 SASR 334 at 343, Doyle CJ, speaking in relation to the position prior to the introduction of s 588FF into the *Corporations Law* in 1992, noted that the appropriate order in the case of a preference was for the payment of any sum recovered to be made to the company, and commented that this "suggests that the fact that money is received by the company is not sufficient of itself to enable a charge to attach to the money, because it is clear that in the case of the recovery of a preferential payment such recovery is for the benefit of the general creditors and not for the benefit of a secured creditor"; this reasoning is equally pertinent to the stipulation for payment to the company in s 588FF.

[61] Matheson J agreeing.

[62] On the other hand, Doyle CJ (*Fresjac* at 340, 344-345) accepted that, when the property disposed of is specific property the subject of a charge, as opposed to money, that property, if recovered, would again become subject to the charge: see Derham, n 6, p 533 [13.08]n, but note the criticism of the distinction in *Cook v Italiano Family Fruit Co Pty Ltd* (2010) 190 FCR 474 at [52]-[62].

[63] *Tolcher v National Australia Bank Ltd* (2003) 44 ACSR 727; 174 FLR 251 (in relation to the insolvent trading claim against the shadow director under s 588M(2)); *Cook v Italiano Family Fruit Co Pty Ltd* (2010) 190 FCR 474 at [12]-[13] (note the subsequent discussion wherein it is queried whether *NA Kratzmann Pty Ltd v Tucker [No 2]* (1968) 123 CLR 295 is correct as a matter of principle or policy).

[64] *Cook v Italiano Family Fruit Co Pty Ltd* (2010) 190 FCR 474 at [12]. In *UTSA Pty Ltd v Ultra Tune Australia Pty Ltd* [1997] 1 VR 667 at 698 Hansen J at first instance accepted that a claim by a liquidator under *Corporations Law*, s 588FF (in relation to an uncommercial transaction) is not assignable by the company.

[65] *Corporations Act 2001* (Cth), s 588Y is discussed in *Re Mustang Marine Australia Services Pty Ltd* [2010] NSWSC 1429 at [125]-[128].

[66] See *Corporations Act 2001* (Cth), ss 588M(2), 588W(1). A secured debt becomes an unsecured debt for the purpose of s 588Y to the extent that the creditor proves for the debt as an unsecured debt (s 588D).

[67] See Derham, n 6, pp 269-271 [6.20]-[6.21].

that requires a consideration of the legislation as a whole, which in this case should include the relevant statutory insolvency claim provisions.[68] The requirement to read an Act as a whole can have the consequence that the apparent scope of a section may be limited by other sections in the Act.[69] The terms of the set-off section therefore should not be read in isolation. The circumstance that a set-off in this situation would operate contrary to the interests of those for whose benefit the statutory insolvency claims are given, and hence contrary to the statutory purpose of the relevant provisions, suggests that the set-off section does not extend to those claims.

Similar reasoning in another context

Similar reasoning has been used to deny a set-off under the insolvency legislation in another context. A shareholder in a company who holds partly paid shares, and who is the subject of a call by a liquidator of the company for the unpaid amount of the shares, cannot set off a separate debt owing to him or her by the company.[70] This denial of a set-off has been explained on a number of grounds,[71] but one explanation given is that the legislation for winding up companies contemplates that the call is to come into the assets of the company to be applied with the company's other assets in payment of its debts pari passu, and it would be contrary to that notion to permit a set-off to the shareholder.[72] That explanation has implicit support in the joint judgment in the High Court[73] in *Commissioner of Taxation (Cth) v Linter Textiles Australia Ltd (In liq)* (2005) 220 CLR 592 at [40]-[42].[74] Their Honours rejected an explanation of the decisions denying a set-off in this situation in terms of a trust, but nevertheless referred to their "good sense",[75] commenting:[76]

> To permit one creditor to pay himself while retaining his own calls would in effect give him a preference and exonerate him from his obligation as a shareholder to contribute towards the debts of the other creditors.[77]

The sentiment underlying that observation is equally pertinent to a claim for a set-off against a statutory insolvency claim. The set-off would operate to the benefit of the creditor claiming the set-off, and would exonerate that creditor from his or her obligation to contribute funds towards payment of the debts of the general body of creditors.

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[68] As to the general principle of construction, see *K & S Lake City Freighters Pty Ltd v Gordon & Gotch Ltd* (1985) 157 CLR 309 at 315 (Mason J). Though a dissenting judgment, Mason J's comments have been accepted as correctly stating the law in subsequent cases, see: *Busby v Australian Telecommunications Commission* (1988) 20 FCR 463 at 468; *Solution 6 Holdings Ltd v Industrial Relations Commission (NSW)* (2004) 60 NSWLR 558 at [90]. The context must be considered in the first instance, and not merely at some later stage when ambiguity might be thought to arise: *CIC Insurance Ltd v Bankstown Football Club Ltd* (1997) 187 CLR 384 at 408. See also *Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355 at [69] ("The primary object of statutory construction is to construe the relevant provision so that it is consistent with the language and purpose of all the provisions of the statute").

[69] Pearce DC and Geddes RS, *Statutory Interpretation in Australia* (8th ed, LexisNexis Butterworths, 2014) p 148 [4.3].

[70] See Derham, n 6, pp 408-418 [8.64]-[8.79].

[71] See Derham, n 6, pp 410-411 [8.65]-[8.66].

[72] See Derham, n 6, p 411 [8.66].

[73] Gleeson CJ, Gummow, Hayne, Callinan and Heydon JJ.

[74] The point was not referred to in the separate judgments of McHugh and Kirby JJ.

[75] *Commissioner of Taxation (Cth) v Linter Textiles Australia Ltd (In liq)* (2005) 220 CLR 592 at [42].

[76] *Commissioner of Taxation (Cth) v Linter Textiles Australia Ltd (In liq)* (2005) 220 CLR 592 at [41].

[77] That comment was made in the context of a discussion of the Statutes of Set-off, which were applied in company liquidation before the incorporation of the bankruptcy set-off section into company liquidation by the *Supreme Court of Judicature Act 1875* (UK): see Derham, n 6, p 262 [6.05]. But the comment should also be relevant to the position under the insolvency set-off section.

SECOND GROUND: MUTUALITY, DETERMINED ON THE BASIS OF BENEFICIAL OWNERSHIP

Meaning of mutuality

Section 553C requires "mutual" claims. Essentially, this means that the demands must be between the same parties and they must be held in the same capacity, or right, or interest.[78]

The principle in relation to mutuality is commonly expressed in terms of equitable or beneficial interests, or equitable rights. Speaking of insolvency set-off, the High Court said in *Gye v McIntyre* (1991) 171 CLR 609, that "it is the equitable or beneficial interests of the parties which must be considered".[79] Dixon J earlier had commented in similar terms in *Hiley v Peoples Prudential Assurance Co Ltd* (1938) 60 CLR 468.[80] In most cases the expression of the principle in those terms suffices. But that may not always be the case. There are situations in which something more may be required than a consideration of equitable interests.

Executor of an unadministered estate

Consider the case of an executor of a deceased's estate still in the course of administration.[81] Prior to completion of the administration the legatees do not have any legal or equitable interest in any particular asset comprised in the estate, and the executor, though in a fiduciary position in relation to the assets that come into his or her hands, is not a trustee in the strict sense of the word.[82] The testator's property comes to the executor "in full ownership, without distinction between legal and equitable interests. The whole property was his".[83] All that the legatees have at that time is a chose in action to have the estate property administered,[84] and it is in that sense that it may be said that the legatees have a transmissible interest in the entire estate.[85] A similar position applies in the case of an intestacy[86] and a common form of discretionary trust.[87] The circumstance that the legatees do not have an equitable interest in any particular asset while the estate is being administered does not mean that there is a hiatus or gap in the equitable interest in the estate pending completion of the

[78] Derham, n 6, pp 471-3 [11.01]-[11.02].

[79] *Gye v McIntyre* (1991) 171 CLR 609 at 623; cf at 619, where the High Court referred to "beneficial ownership" (see below).

[80] *Hiley v Peoples Prudential Assurance Co Ltd* (1938) 60 CLR 468 at 497: "the equitable or beneficial interest of the parties in the mutual debts, credits or dealings must be considered and not merely the dry legal right"; see also Rich J at 488 ("mutual credits, debts and dealings are determined according to equitable rights"): see further *Popular Homes Ltd v Circuit Developments Ltd* [1979] 2 NZLR 642 at 656 ("requirement of mutuality of beneficial rights, as opposed to legal rights"), 657 ("mutuality of beneficial interests"), 658 ("where both parties are beneficially interested in their respective claims").

[81] See Derham, n 6, pp 603-605 [13.125]-[13.126].

[82] *Commissioner of Stamp Duties (Qld) v Livingston* [1965] AC 694 at 707-708; *Ayerst v C & K (Construction) Ltd* [1976] AC 167 at 177-178; *Marshall v Kerr* [1995] 1 AC 148 at 165; *Barns v Barns* (2003) 214 CLR 169 at [50].

[83] *Commissioner of Stamp Duties (Qld) v Livingston* [1965] AC 694 at 707; the executor has vested in him "the whole right of property" (at 712).

[84] *Commissioner of Stamp Duties (Qld) v Livingston* [1965] AC 694 at 717; *Marshall v Kerr* [1995] 1 AC 148 at 166.

[85] *Barns v Barns* (2003) 214 CLR 169 at [50] (referring to *Official Receiver in Bankruptcy v Schultz* (1990) 170 CLR 306 at 313-314). In *Re Maye* [2008] 1 WLR 3151, the chose-in-action was held to constitute "property" for the purpose of the *Proceeds of Crime (Northern Ireland) Order 1996*, albeit that it did not give rise to a proprietary interest in any particular asset of the estate (see esp at [16]-[18]).

[86] *Re Leigh's Will Trusts* [1970] 1 Ch 277 at 281-282.

[87] See Derham, n 6, p 604n. See also *Sir Moses Montefiore Jewish Home v Howell & Co [No 7] Pty Ltd* [1984] 2 NSWLR 406 at 411; *ASIC v Carey [No 6]* (2006) 153 FCR 509 at [29], [36]; *Lygon Nominees Pty Ltd v Commissioner of State Revenue* (2007) 23 VR 474 at [69]-[78]. Contrast the collective entitlement of discretionary objects in the case of an exhaustive discretionary trust with a closed class of beneficiaries: see *Schmidt v Rosewood Trust Ltd* [2003] 2 AC 709 at [40]; *ASIC v Carey [No 6]* (2006) 153 FCR 509 at [29] (sole beneficiary of an exhaustive trust); *Elliott v Department of Education, Employment & Workplace Relations* (2008) 249 ALR 182 at [35]-[38 (decision affirmed *Department of Families, Housing, Community Services & Indigenous Affairs v Elliot* (2009) 174 FCR 387).

administration.[88] Equitable interests are not carved out of a legal estate, but are impressed (or engrafted) upon it.[89] If there is no equitable interest impressed upon the legal estate, the holder of that estate has the full ownership of the property.[90] This describes the position of an executor of an unadministered estate.[91]

If an executor, prior to completion of the administration, has the full ownership of the assets in the estate without distinction between legal and equitable interests, and the legatees do not have any equitable interest in any particular asset in the hands of the executor, a determination of mutuality by reference to equitable interests might suggest that there is mutuality in relation to a debt owing to the deceased,[92] which has come to the executor in full ownership, and a debt owing by the executor in his or her personal capacity to the debtor on the first-mentioned debt, so as to support a set-off in relation to those debts. But clearly there would be no merit in that result. An executor should not be permitted to use a debt owing to the estate in a set-off against a personal debt. There is ancient authority for that proposition.[93] It was justified on the ground that the debts were due in different rights. But what is it about the nature of the right in which the debt is due to the executor that has the consequence that there is no mutuality, if that conclusion is not explicable by reference to equitable interests?

Beneficial ownership: Meaning

Instead of equitable or beneficial interests, mutuality is sometimes expressed in terms of "beneficial ownership".[94] In *Secretary of State for Trade & Industry v Frid* [2004] 2 AC 506 at [26], Lord Hoffmann (in a speech with which the other members[95] of the House of Lords agreed) said in relation to mutuality in insolvency set-off that "The law is concerned with beneficial ownership and not mere legal title".[96] In Australia, the High Court in *Gye v McIntyre* discussed mutuality in terms of equitable or beneficial interests (see above),[97] but also referred to beneficial ownership.[98] What is meant by "beneficial ownership"?

Beneficial ownership is a concept commonly found in revenue legislation. Ownership is said to consist of various rights over property, for example rights of exclusive enjoyment, of destruction,

[88] See *Chief Commissioner of Stamp Duties (NSW) v Buckle* (1998) 192 CLR 226 at [37] in relation to the analogous case of a trustee of a discretionary trust.

[89] See *DKLR Holding Co (No 2) Pty Ltd v Commissioner of Stamp Duties (NSW)* (1982) 149 CLR 431 at 474 (Brennan J); *Re Transphere Pty Ltd* (1986) 5 NSWLR 309 at 311; see also *Commissioner of State Revenue v Serana Pty Ltd* (2008) 36 WAR 251 at [135]-[139]; *Austino Wentworthville Pty Ltd v Metroland Australia Ltd* [2013] NSWCA 59 at [87].

[90] "[A]n absolute owner in fee simple does not hold two estates, a legal estate and an equitable estate. He holds only the legal estate, with all the rights and incidents that attach to that estate": *DKLR Holding Co (No 2) Pty Ltd v Commissioner of Stamp Duties* [1980] 1 NSWLR 510 at 519 (Hope JA) (decision varied on other grounds (1982) 149 CLR 431), referred to in *Commissioner of Taxation (Cth) v Linter Textiles Australia Ltd (In liq)* (2005) 220 CLR 592 at [30]). See also *DKLR Holding Co (No 2) Pty Ltd v Commissioner of Stamp Duties (NSW)* (1982) 149 CLR 431 at 442-443, 449-451, 463-464, 473-474; *Peldan v Anderson* (2006) 227 CLR 471 at [37].

[91] *Commissioner of Stamp Duties (Qld) v Livingston* [1965] AC 694 at 712-713. *Livingston* "exploded" the "assumption that the law of property requires the location at all times and in all circumstances of distinct legal and beneficial ownership" (*Commissioner of Taxation (Cth) v Linter Textiles Australia Ltd (In liq)* (2005) 220 CLR 592 at [30]).

[92] The property vesting in an executor includes debts owing to the deceased: see, eg *Probate and Administration Act 1898* (NSW), s 44 together with the definition of "personal estate" in s 3.

[93] *Bishop v Church* (1748) 3 Atk 691; 26 ER 1197 (executrix and residuary legatee); see also *Phillips v Howell* [1901] 2 Ch 773.

[94] On a general level, I acknowledge my debt to earlier articles on beneficial ownership, see Stone and Lesnie, "Some Thoughts on Beneficial Interests and Beneficial Ownership in Revenue Law" (1996) 19 UNSWLJ 181; Speed R, "Beneficial Ownership" (1997) 26 AT Rev 34.

[95] Lord Nicholls of Birkenhead, Lord Hope of Craighead, Lord Phillips of Worth Matravers and Lord Brown of Eaton-Under-Heywood,

[96] See also *Hayate Investment Co Ltd v ManagementPlus (Singapore) Pte Ltd* [2012] SGHC 259 at [35] (citing *Frid*); *Commissioner of Inland Revenue v Wright* [2013] NZHC 476 at [37] ("they are both beneficial owners of the debt or other claim and are liable personally"). In *Forster v Wilson* (1843) 12 M & W 191 at 204; 152 ER 1165 at 1171, Parke B explained the denial of a set-off in relation to a debt on the ground that the debt, though legally due from the debtor to the bankrupt, "would not have been recovered for his own benefit", which essentially reflects the meaning of beneficial ownership (see below).

[97] *Gye v McIntyre* (1991) 171 CLR 609 at 623.

alteration and alienation, and of maintaining and recovering possession from other persons.[99] The term "beneficial" is usually employed in trust law as a cognate of "beneficiary",[100] and it has been said that the phrase "beneficial ownership" ordinarily is used to describe a situation in which there is a trust in the strict sense.[101] But beneficial ownership has another, more general, meaning. To obtain an interest "beneficially" means to obtain the relevant benefit oneself and not for the benefit of others.[102] "Beneficial ownership" thus can mean ownership for one's own benefit,[103] and it refers to a person who enjoys the benefits of owning.[104] In this sense, it places emphasis on the concept of benefit rather than on the jurisdictional division between legal and equitable interests.[105] Beneficial ownership requires a legal or an equitable proprietary interest,[106] but the point has been made that it is not necessarily the same as "equitable ownership" or holding a beneficial (or an equitable) interest[107] (though there is authority which suggests the contrary[108]).

In *Wood Preservation Ltd v Prior* [1969] 1 WLR 1077, the Court of Appeal held that a vendor under a conditional contract to sell shares in a subsidiary[109] had ceased to be the beneficial owner on

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[98] *Gye v McIntyre* (1991) 171 CLR 609 at 619 ("'substantial justice' requires that the operation of set-off in bankruptcy be confined within limits which protect the creditors of the bankrupt from being disadvantaged by a set-off being allowed in circumstances where debts, credits or other dealings have not been genuinely mutual as a matter of substance, such as where beneficial ownership is not the same").

[99] *Halsbury's Laws of England* (5th ed, 2013) Vol 80, p 838 [812]; Speed, n 94 at 36. See also *Kent v SS "Maria Luisa" [No 2]* (2003) 130 FCR 12 at [61]-[66] (and the authorities there referred to).

[100] *Commissioner of Taxation (Cth) v Linter Textiles Australia Ltd (In liq)* (2005) 220 CLR 592 at [52].

[101] *Commissioner of Taxation v Linter Textiles Australia Ltd* (2003) 129 FCR 42 at [34] (Hill, Goldberg and Conti JJ).

[102] *Landrow Properties Pty Ltd v Commissioner of State Revenue* [2008] VSC 590 at [42] (appeal dismissed *Commissioner of State Revenue v Landrow Properties Pty Ltd* [2010] VSCA 197).

[103] In *J Sainsbury plc v O'Connor* [1991] 1 WLR 963 at 978, Nourse LJ (with whom Ralph Gibson LJ agreed) said that "beneficial ownership" means "ownership for your own benefit as opposed to ownership as trustee for another".

[104] *Jowitt's Dictionary of English Law* (3rd ed, Thomson Reuters, London, 2010) Vol 1, p 242 defines "beneficial owner" as "an individual who enjoys the benefits of owning, in equity, a security or property, regardless of whose name the title is in".

[105] *Linter Textiles Australia Ltd v Commissioner of Taxation* (2002) 20 ACLC 1,708; [2002] FCA 1089 at [55] (Hely J), referring to Stone and Lesnie, n 94 at 182-183.

[106] *Lygon Nominees Pty Ltd v Commissioner of State Revenue* (2007) 23 VR 474 at [69]-[78], referring (at [69]) to the judgment at first instance *Lygon Nominees Pty Ltd v Commissioner of State Revenue* [2005] VSC 247 at [56]-[58] (in relation to a discretionary trust).

[107] *Masri v Consolidated Contractors International Co SAL* [2011] EWHC 1024 (Comm) at [277] (Christopher Clarke J: "The meaning of 'beneficial interest' is debatable. It is an expression akin to but not the same as 'beneficial ownership', which has been said to be similar but not identical to 'equitable ownership'"); *Brooklands Selangor Holdings Ltd v Inland Revenue Commissioners* [1970] 1 WLR 429 at 450 (Pennycuick J: "considerable difficulties arise in this connection if one seeks to equate the expression 'beneficial owner' with the expression 'equitable owner' in the technical sense in which that term is used in equity law … I do not think, however, that equitable ownership is to be thus equated for this purpose with beneficial ownership although, no doubt, in many instances they may come to the same thing"); see also *J Sainsbury plc v O'Connor* [1991] 1 WLR 963 at 975. In Victoria, Mandie J observed in *Trust Co of Australia Ltd v Commissioner of State Revenue* (2007) 19 VR 111 at [59] that "Some commentators … have pointed out that 'beneficial ownership' is not necessarily the same as holding a 'beneficial interest' or having an entitlement to an 'equitable interest'", referring to Stone and Lesnie, n 94 esp at 182-183; Speed, n 94.

[108] See the authorities discussed in *J Sainsbury plc v O'Connor* [1991] 1 WLR 963 at 970-973 (Lloyd LJ), 978-979 (Nourse LJ) (as to which see *Commissioner of Taxation (Cth) v Linter Textiles Australia Ltd (In liq)* (2005) 220 CLR 592 at [30]n). See also *Citicorp Trustee Co Ltd v Barclays Bank plc* [2013] EWHC 2608 (Ch) at [98] (referring to Nourse LJ in *Sainsbury v O'Connor*); *Commissioner of Taxation v Linter Textiles Australia Ltd* (2003) 129 FCR 42 at [58], where the Full Federal Court emphasised that the case concerned the meaning of "beneficially owned" in *Income Tax Assessment Act 1936* (Cth), s 80A(1) in light of the section's history and the mischief to which it was directed (see esp at [55]-[57], [59]-[60]). The decision on this point was affirmed on appeal by the High Court in *Commissioner of Taxation (Cth) v Linter Textiles Australia Ltd (In liq)* (2005) 220 CLR 592 at [50]-[59]; cf the Full Federal Court's discussion (*Linter Textiles* 129 FCR 42 at [30]-[37]) of beneficial ownership other than in the context of a trust in the strict sense.

[109] The sale was subject to a condition that within one month a letter would be produced from a German company giving an assurance that it would continue certain rights in favour of the subsidiary to market a product.

execution of the contract,[110] notwithstanding that the purchaser may not have become beneficial owner while the condition remained operative.[111] The question whether the vendor was beneficial owner did not turn on whether the purchaser could have obtained specific performance, but rather on the nature and extent of the rights retained by the vendor.[112] Harman LJ referred to "beneficial ownership" in terms of a "right at least to some extent to deal with the property as your own",[113] and Lord Donovan, while commenting that it would be rash to attempt an exhaustive definition of "beneficial ownership", spoke of it in terms of an ability to appropriate to oneself any of the benefits of ownership.[114] In concluding that the vendor had ceased to be beneficial owner, Lord Donovan said that, while the vendor was still the legal owner after entering into the contract, it was "bereft of the rights of selling or disposing or enjoying the fruits of these shares".[115]

Subsequently, Lord Diplock[116] in *Ayerst v C & K (Construction) Ltd* [1976] AC 167 at 177-178, rejected the view that the concept of beneficial ownership is confined to a trust in the strict sense. He considered that a person is not the beneficial owner of property if that person "could not enjoy the fruits of it himself or dispose of it for his own benefit".[117] Similar views have been expressed in Australia.[118] In *Linter Textiles*, Kirby J[119] said:

> [a] person cannot be said to be the beneficial owner of property unless that person has the right to deal with the property as that person's own. In the case of shares, such dealing ordinarily includes the unimpeded possibility of disposal or sale of the shares and enjoyment of the fruits of such disposal or sale.[120]

[110] Compare *J Sainsbury plc v O'Connor* [1991] 1 WLR 963, in which it was held that the grant by the registered holder of shares of an option to purchase the shares did not deprive the shareholder of the beneficial ownership.

[111] *Wood Preservation Ltd v Prior* [1969] 1 WLR 1077 at 1096 (Lord Donovan), 1097 (Harman LJ), 1097 (Widgery LJ). It is inaccurate to describe an unpaid vendor under an uncompleted contract of sale as a trustee: see *Kern Corporation Ltd v Walter Reid Trading Pty Ltd* (1987) 163 CLR 164 at 191-192; *Stern v McArthur* (1988) 165 CLR 489 at 522; *Southern Pacific Mortgages Ltd v Scott* [2015] AC 385.

[112] See the discussion of *Wood Preservation Ltd v Prior* [1969] 1 WLR 1077 in *J Sainsbury plc v O'Connor* [1991] 1 WLR 963 at 972-975 and *Masri v Consolidated Contractors International Co SAL* [2011] EWHC 1024 (Comm) at [277].

[113] *Wood Preservation Ltd v Prior* [1969] 1 WLR 1077 at 1097. See also *Baytrust Holdings Ltd v Inland Revenue Commisioners* [1971] 1 WLR 1333 at 1354 (Plowman J): "It is common ground that if, at that date, Thos Firth was not free to deal with those shares as it wished, it was not the beneficial owner of them.".

[114] *Wood Preservation Ltd v Prior* [1969] 1 WLR 1077 at 1096.

[115] *Wood Preservation Ltd v Prior* [1969] 1 WLR 1077 at 1096. See also *Inland Revenue Commissioners v Ufitec Group Ltd* [1977] 3 All ER 924 esp at 939-940.

[116] Viscount Dilhorne, Lord Kilbrandon and Lord Edmund-Davies agreeing.

[117] *Ayerst v C & K (Construction) Ltd* [1976] AC 167 at 178. In Australia, Lord Diplock's discussion of "beneficial ownership" in *Ayerst* was adopted by Mandie J in *Trust Co of Australia Ltd v Commissioner of State Revenue* (2007) 19 VR 111 at [58]-[59]. While the decision in *Ayerst* (that the winding up of a company divested it of the beneficial ownership of its assets) was not followed by the High Court in *Commissioner of Taxation (Cth) v Linter Textiles Australia Ltd (In liq)* (2005) 220 CLR 592, Mandie J considered that that circumstance did not detract from the correctness of what Lord Diplock said about beneficial ownership.

[118] See discussions of "beneficial ownership" by Stone and Lesnie, n 94 esp at 182-183; Speed, n 94.

[119] Kirby J differed from the other members of the court in relation to the question whether the appointment of a liquidator to a company had the consequence that shares held by the company ceased to be "beneficially owned" by the company (cf *Commissioner of Taxation (Cth) v Linter Textiles Australia Ltd (In liq)* (2005) 220 CLR 592 at [50]-[59] (Gleeson CJ, Gummow, Hayne, Callinan and Heydon JJ), [124]-[130] (McHugh J) with [224]-[238] (Kirby J)). However, the difference centred on whether the change in control of the affairs of a company consequent upon liquidation affected a change in beneficial ownership of its assets, as opposed to the fundamental meaning of beneficial ownership.

[120] *Commissioner of Taxation (Cth) v Linter Textiles Australia Ltd (In liq)* (2005) 220 CLR 592 at [225] (referring to *Wood Preservation Ltd v Prior* [1969] 1 WLR 1077 at 1096-7).

To a like effect, Redlich JA[121] commented in the Victorian Court of Appeal in *Lygon Nominees Pty Ltd v Commissioner of State Revenue (Vic)* (2007) 23 VR 474 at [32] that: "Rights of beneficial ownership generally import a notion of ownership for a person's benefit and the exclusion of a holding for the benefit of others."

In substance,[122] set-off involves the use of an asset (a claim) to pay a liability. It is therefore appropriate that beneficial ownership, in the sense of ownership for one's own benefit and an entitlement to deal with property as one's own, should inform the concept of mutuality for the purpose of determining the availability of a set-off. This is not simply a question of considering the equitable or beneficial interests of the parties, though mutuality is commonly expressed in those terms.[123]

The concept of beneficial ownership, in this sense, explains why there is a lack of mutuality prior to completion of the administration of a deceased's estate in relation to a debt owing to the estate and a personal debt of the executor. An executor of an unadministered estate has the full ownership of the assets comprised in the estate, including any debt owing to the estate,[124] without distinction between legal and equitable interests, and is not a trustee (in the strict sense). But that ownership is not ownership for the executor's own benefit, that is to say, it is not beneficial ownership.[125] Hence, the debt owing to the estate should not be available for set-off against the executor's personal debt. Similar reasoning may apply in relation to an administrator in an intestacy and a trustee of a discretionary trust.[126]

Beneficial ownership and statutory insolvency claims

Consider the position in relation to statutory insolvency claims.

As noted earlier, Mansfield J in *Re Parker* attached significance to the stipulation in the insolvent trading provisions that the liquidator may recover "as a debt due to the company", and his Honour's reasoning in that case was adopted in *Buzzle Operations* as also supporting the availability of a set-off in the case of avoidance of an uncommercial transaction. In that context, s 588FF (which also applies to unfair preferences) is similar to the insolvent trading provisions in that it provides for an order for payment "to the company".

In relation to preferences, English courts have said that preference recoveries are held on trust for unsecured creditors,[127] and in Australia that was also accepted by the New South Wales Court of Appeal (Ipp JA; Santow and McColl JJA agreeing) in *White Constructions (ACT) Pty Ltd v White* [2005] NSWCA 173 at [316], Ipp JA citing as authority *NA Kratzmann Pty Ltd v Tucker [No 2]* (1968) 123 CLR 295 at 300-301 and *Re Yagerphone Ltd* [1935] Ch 392. In *Yagerphone*, Bennett J held that money recovered by the liquidators of a company as a fraudulent preference did not fall within the ambit of a crystallised floating charge given by the company as a security before the winding up, his Lordship commenting that the money was received by the liquidators impressed with a trust for the creditors among whom they had to distribute the assets of the company, and the decision in that case was approved by the High Court in *Kratzmann*. If preference recoveries are held on trust, the trust might be said to extend to the claim itself, in which case there would be a lack of mutuality for the

[121] Ashley JA and Bell AJA agreeing.

[122] But not necessarily in form: see Derham, n 6, pp 797-799 [16.98]-[16.102].

[123] See above.

[124] See, eg *Probate and Administration Act 1898* (NSW), s 44, together with the definition of "personal estate" in s 3; *Law Reform (Miscellaneous Provisions) Act 1944* (NSW), s 2(1). See also Martyn JR and Caddick N, *Williams, Mortimer and Sunnucks – Executors, Administrators and Probate* (20th ed, Sweet & Maxwell, London, 2013) pp 590, 670ff.

[125] *Ayerst v C & K (Construction) Ltd* [1976] AC 167 at 178; cf Heydon JD and Leeming MJ, *Jacobs' Law of Trusts in Australia* (7th ed, LexisNexis, 2006) 34 [240] (fn 164), though "beneficial owner" there appears to be used in a different sense, as referring to the proprietary interest of a person with full ownership without distinction between legal and equitable interests.

[126] See above.

[127] *Re Yagerphone Ltd* [1935] Ch 392 at 396; *Re MC Bacon Ltd* [1991] Ch 127 at 137; *Lewis v Commissioner of Inland Revenue* [2001] 3 All ER 499 at [16], [18], [37] ("statutory trust").

purpose of a set-off in relation to a preference claim and a cross-claim by the preferred creditor against the company.[128] However, the view accepted in *White Constructions* has not been shared by other courts in Australia.[129]

In Queensland, McPherson JA (with whose reasons Pincus JA agreed) in *Re Starkey* [1994] 1 Qd R 142 at 153, rejected the proposition that a liquidator holds the proceeds of a preference recovery in trust for the unsecured creditors if, as his Honour said: "what is meant by that is a 'trust' in the full sense of the word, under which the unsecured creditors are equitable owners of the assets in winding up." McPherson JA acknowledged (at 153) that the High Court in *Kratzmann* had accepted the correctness of the decision in *Yagerphone*, but he said that it was "by no means clear" that the High Court adopted everything said by Bennett J in support of his decision.[130] McPherson JA referred to the issue in terms of the liquidator as a trustee, but the proposition that unsecured creditors are not equitable owners of the assets in a winding up should carry with it the rejection of any suggestion that the company holds preference recoveries on trust, and it should also constitute a rejection of a trust in relation to the preference claim itself.[131]

McPherson JA's reasoning in *Starkey* subsequently was approved by Doyle CJ (Matheson J agreeing) in the South Australian Full Court in *Fresjac*, his Honour expressing the principle generally in terms that "the proceeds of the recovery of a preferential payment are not held on trust for unsecured creditors".[132] *Starkey* and *Fresjac* concerned the corporations legislation before the 1992 amendments, but the comments in those cases would appear to be equally applicable to the current legislation.[133] It is suggested that McPherson JA's view is correct. On a general level, the view in Australia is that the making of a winding-up order does not create any kind of trust in relation to the company's assets,[134] and there is nothing in the *Corporations Act* which would suggest that moneys recovered as an unfair preference are to be held by the liquidator on terms different to those on which the liquidator holds the general assets of the company.[135]

If the view favoured in *Starkey* and *Fresjac* is followed in Australia, the stipulations in s 588FF and in the insolvent trading provisions for payment, or for a debt due "to the company", together with the rejection of a trust, would not require the conclusion that a preference (or other statutory insolvency) claim, and a cross-claim available to the defendant against the company, are mutual for the purpose of a set-off. Prima facie, there is the difficulty that the voidable transaction provisions have been said not to create any right of action in the company,[136] and a similar comment may be made in relation to an insolvent trading claim under s 588M(2) or s 588W(1).

[128] This assumes that there is a subsisting trust at the time for determining rights of set-off in the liquidation, that is to say, that there are subsisting rights at that time which could be the subject of a trust. See, eg Rich J's reference to vested rights in *Hiley v Peoples Prudential Assurance Co Ltd* (1938) 60 CLR 468 at 487 ("Rights must be vested in the creditor and in the company"). This is related to the third reason, discussed below, for denying a set-off against the statutory insolvency claims, that the claims do not arise until after the time for determining the availability of set-offs in the winding up.

[129] In addition to the cases referred to below, see *Cook v Italiano Family Fruit Co Pty Ltd* (2010) 190 FCR 474 at [33]-[42], [46]-[51] and the authorities there referred to.

[130] See also the discussion of *Starkey* in *Elfic Ltd v Macks* [2003] 2 Qd R 125 at [89]-[93] (McMurdo P), [196]-[200] (Davies JA).

[131] In relation to the company as a trustee, this is apart from the difficulty that the voidable transaction provisions in the *Corporations Act 2001* (Cth) do not create any right of action in the company: *Fortress Credit Corporation (Australia) II Pty Ltd v Fletcher* (2014) 87 NSWLR 728 at [127]-[128] (Barrett JA) (decision affirmed *Fortress Credit Corporation (Australia) II Pty Ltd v Fletcher* (2015) 89 ALJR 425; [2015] HCA 10) (see below).

[132] *Re Fresjac Pty Ltd* (1995) 65 SASR 334 at 348.

[133] See *Elfic Ltd v Macks* [2003] 2 Qd R 125 at [201]-[202].

[134] See *Commissioner of Taxation (Cth) v Linter Textiles Australia Ltd (In liq)* (2005) 220 CLR 592 esp at [127] (McHugh J).

[135] *Elfic Ltd v Macks* [2003] 2 Qd R 125 at [93] (McMurdo P), referring to the former *Corporations Law*, s 565. See also *Re Starkey* [1994] 1 Qd R 142 at 155.

[136] *Fortress Credit Corporation (Australia) II Pty Ltd v Fletcher* (2014) 87 NSWLR 728 at [127]-[128] (Barrett JA) (decision affirmed *Fortress Credit Corporation (Australia) II Pty Ltd v Fletcher* (2015) 89 ALJR 425; [2015] HCA 10) .

Mansfield J purported to deal with that point in *Re Parker* by reference to the stipulation in s 588W(1) that the amount of an insolvent trading claim is recoverable "as a debt due to the company".[137] He said that *as a matter of substance* it is the claim of the company, and that the fact that the claim may be enforced by the liquidator "is but the procedural device for enforcing what is clearly a claim of the company". But even if one otherwise accepts the validity of that approach, so as to regard it as the company's claim as a matter of substance, that should not suffice for mutuality. The company, while not a trustee, would not properly be characterised as the beneficial owner of the statutory insolvency claim. Prior to liquidation, the company could not charge or assign the claim as future property (see above in relation to statutory purpose). Nor could it give an effective release in relation to any such claim in a future liquidation. The claim is given for the benefit of others (the company's creditors),[138] and the company could not deal with it as its own. The company therefore is not a beneficial owner (in the sense in which that expression is used here).

If a company is not the beneficial owner of a statutory insolvency claim in a winding up, there should not be mutuality in relation to that claim and a separate debt owing by the company to the defendant, for the purpose of a set-off between those parties in the liquidation.

Some possible contrary arguments

There are two circumstances which may suggest that the company is the beneficial owner, though neither is compelling.

The first is that, after the commencement of a winding up, the company's liquidator has power under s 477(2)(c) of the *Corporations Act* to assign the proceeds of a claim under s 588FF consequent on avoidance of a transaction (for example an unfair preference),[139] a liquidator being the agent of the company.[140] However, this ability to deal with the proceeds of the claim should not suffice to establish beneficial ownership. The subject of any set-off would be the statutory claim, and the power to assign, while extending to the proceeds, does not extend to the claim itself.[141] This is because s 588FF provides that an application to set aside a transaction under the section must be made by the company's liquidator[142] (though there is some authority suggesting that an insolvent trading claim may be assigned[143] even though that claim similarly is brought by the liquidator in his or her own name[144]). But apart from that, the liquidator's power to assign the proceeds is not unfettered. It is subject to the control of the court, and any creditor or contributory, or ASIC, may apply to the court with respect to any exercise or proposed exercise of the power.[145]

The second circumstance is that the company is benefited by statutory insolvency claims in that the proceeds are to be used to pay its creditors, or costs and expenses of the winding up.[146] But the fact that the ownership of the claim is for the company's benefit in that sense should not suffice to establish beneficial ownership. This view is supported by a line of authority in relation to trusts. If A

[137] *Re Parker* (1997) 80 FCR 1 at 11.

[138] Contrast *Lygon Nominees Pty Ltd v Commissioner of State Revenu* (2007) 23 VR 474 at [32] ("Rights of beneficial ownership generally import a notion of ownership for a person's benefit and the exclusion of a holding for the benefit of others").

[139] See Derham, n 6, p 537 [13.15].

[140] *Commissioner of Taxation (Cth) v Linter Textiles Australia Ltd (In liq)* (2005) 220 CLR 592 at [33] (referring to *Thomas Franklin & Sons Ltd v Cameron* (1935) 36 SR (NSW) 286 at 296).

[141] An assignment of a debt, and an assignment of the proceeds of a debt, attract different considerations in relation to set-off: see Derham, n 6, pp 847-848 [17.66]-[17.67].

[142] *UTSA Pty Ltd v Ultra Tune Australia Pty Ltd* [1997] 1 VR 667 at 698; *Re Cant* (2011) 85 ACSR 31; [2011] FCA 898 at [14]-[16]. See also *Cook v Italiano Family Fruit Co Pty Ltd* (2010) 190 FCR 474 at [12].

[143] *Re Movitor Pty Ltd* (1996) 64 FCR 380 at 392; cf *Cook v Italiano Family Fruit Co Pty Ltd* (2010) 190 FCR 474 at [12] (an action for insolvent trading is a right which cannot be assigned because it can only be brought by the liquidator.

[144] *Re Parker* (1997) 80 FCR 1 at 11; *Cook v Italiano Family Fruit Co Pty Ltd* (2010) 190 FCR 474 at [12]. See *Corporations Act 2001* (Cth), ss 588M(2), 588W(1).

[145] *Corporations Act 2001* (Cth), s 477(6).

[146] Compare *Hall v Poolman* (2009) 75 NSWLR 99 at [186].

is indebted to B, and A pays B on terms that the money is to be used by B to pay B's own debt to a particular third party creditor, C, the money paid to B may be impressed with a trust[147] in B's hands to pay C.[148] B's use of the money for that purpose would be for its benefit in that it would result in payment of its debt to C, but that does not mean that B receives the money as beneficial owner. B is not free to deal with the money as it pleases. The position in relation to statutory insolvency claims is different in that the better view is that the proceeds of the claim are not held on trust, in the full sense of that word, for unsecured creditors.[149] But that point of distinction should not be critical. The important point is that the liquidator is obliged to apply the proceeds of the claim in accordance with the statutory regime in the *Corporations Act*, and the company itself is not, *and never was*,[150] free to deal with them (including as future property, before the liquidation) in any other way.

Distinguish Linter Textiles

The issue under discussion differs from that considered by the High Court in *Linter Textiles*.[151] It was held in *Linter Textiles* that a company does not cease to be the beneficial owner of its assets when it goes into liquidation, the asset in that case being a company's shareholding in its subsidiary. The critical point was that the change in control in the affairs of a company which occurs upon liquidation has no impact on its beneficial ownership of its assets.[152] As McHugh J expressed it: "On liquidation, the *ownership* of the shares [in the subsidiary] is not 'for the benefit of others'; rather, the *administration* of the assets is for the benefit of the creditors" (original emphasis).[153] But in the case of a statutory insolvency claim, the right itself (the "ownership") is given for the benefit of others (the general body of creditors).[154] It is not simply a question of the administration of assets which the company itself otherwise owned beneficially.

THIRD GROUND: OBLIGATION ARISES AFTER THE TIME FOR DETERMINING THE AVAILABILITY OF SET-OFFS

A third reason for denying a set-off is that the obligation in relation to a statutory insolvency claim arises after the time for determining rights of set-off in the company's liquidation.

Insolvent trading cases: Re Parker and Hall v Poolman

In *Re Parker* (1997) 80 FCR 1 at 10, Mansfield J conceded that an insolvent trading claim may not arise from a prior dealing between the holding company and the subsidiary. He went on to postulate that it nevertheless "may be the case" that the relationship of the holding company to its subsidiary, including periodic reviews of its financial position and decisions taken to continue to support it, reports to the holding company, and the like, could well constitute "dealings" for the purpose of a determination that the liability arose out of dealings between the two companies.[155] He declined, however, to decide the case on that basis, commenting that it would be surprising if the question whether an insolvent trading liability under ss 588V and 588W could be set off were to vary

[147] A *Quistclose* trust, so named after *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] AC 567.

[148] *Carreras Rothmans Ltd v Freeman Mathews Treasure Ltd* [1985] Ch 207. In *Re Australian Elizabethan Theatre Trust* (1991) 30 FCR 491 at 501 Gummow J said of *Carreras Rothmans*: "This decision supports the proposition that a debtor of company A can discharge the debt by paying the amount to A on terms that A hold it on trust for payment to creditors of A nominated by that debtor. This trust is enforceable by the debtor despite the supervening winding up of A. It was held that A never acquired any beneficial interest in the moneys paid to it by the debtor." See also *Re Goldcorp Exchange Ltd* [1995] 1 AC 74 at 100.

[149] *Re Starkey* [1994] 1 Qd R 142; *Re Fresjac Pty Ltd* (1995) 65 SASR 334 at 348. See above.

[150] Compare *Commissioner of Taxation (Cth) v Linter Textiles Australia Ltd (In liq)* (2005) 220 CLR 592 below.

[151] *Commissioner of Taxation (Cth) v Linter Textiles Australia Ltd (In liq)* (2005) 220 CLR 592.

[152] *Commissioner of Taxation (Cth) v Linter Textiles Australia Ltd (In liq)* (2005) 220 CLR 592 at [54]-[55], [58]; see also McHugh J at [125].

[153] *Commissioner of Taxation (Cth) v Linter Textiles Australia Ltd (In liq)* (2005) 220 CLR 592 at [125]. A similar distinction was drawn in a different context in *Davies v Australian Securities Commission* (1995) 59 FCR 221 at 235-237.

[154] *Sheahan v Carrier Air Conditioning Pty Ltd* (1997) 189 CLR 407 at 428. See above in relation to statutory purpose.

[155] *Re Parker* (1997) 80 FCR 1 at 10-11.

depending on the extent of the interaction between the holding company and the subsidiary. There is much to be said for that view. Apart from that, a dealing sufficient to support a set-off should be such as to involve both companies,[156] whereas matters such as periodic reviews of the subsidiary's financial position and decisions taken to continue to support the subsidiary may involve the holding company alone.

Re Parker should be contrasted with *Hall v Poolman* (above), in which a set-off was justified on the basis of prior dealings. The case concerned director liability for insolvent trading. Palmer J considered that a director acting in the course of his or her duties as such is "dealing" with the company, that the company likewise is "dealing" with the director even though it is passive in the relationship, and that the "dealing" between the director and the company is "mutual".[157] A problem with this approach is that liability for insolvent trading would often be a consequence of lack of diligence and inaction. It may be difficult in such cases to identify a "dealing" (involving both the director and the company) from which it could be said that the liability arose.[158]

The set-off in *Re Parker* was justified instead on the basis of mutual debts or credits. Mansfield J noted that the events which gave rise to the insolvent trading claim occurred before the commencement of the subsidiary's liquidation. He said that the claim was the "natural outcome" of those events, and on that basis the set-off section was held to apply.[159] However, there are difficulties with this reasoning. Those difficulties would apply whether it is sought to base a set-off on mutual debts or credits or (as in *Hall v Poolman*) on claims arising from prior mutual dealings.

Circumstances must have occurred before the relevant date

Speaking of the position in company liquidation, Dixon J in *Hiley*[160] expressed the principle in relation to the determination of set-offs in terms of claims or dealings subsisting "at" the commencement of the winding up, and it has been expressed in similar terms on other occasions and in other contexts.[161] Prima facie, this could extend to claims which arose or dealings which occurred *on* that date. But that point was not in issue in *Hiley*, and there is an apparent difficulty with it in relation to company liquidation under the *Corporations Act*. Under s 553(1), provable debts are determined by reference to the "relevant date". Section 553(1) makes provable "all debts payable by, and all claims against, the company … the circumstances giving rise to which occurred before the relevant date".[162] The reference point for determining provable debts therefore must be the position *before* the relevant date.[163] In a set-off, the claim against the company must be provable in the liquidation (this being a necessary, but not a sufficient, condition for the inclusion of a claim against the company in a set-off).[164] The circumstances giving rise to the claim against the company therefore must have occurred before (and not on) the relevant date. But what about the claim on the other side of the account, being the company's claim against the creditor?

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[156] See *Gye v McIntyre* (1991) 171 CLR 609 at 623 ("'dealings' which involved the bankrupt and the other party"), 626 ("The critical matters for the purposes of s 86 are that there had been dealings in which the creditor and the bankrupt were both involved").

[157] *Hall v Poolman* (2007) 65 ACSR 123; 215 FLR 243 at [423]-[425].

[158] Consistent with Mansfield J's discussion in *Re Parker* (1997) 80 FCR 1 at 10-11 in the context of holding company liability.

[159] *Re Parker* (1997) 80 FCR 1 at 11-12.

[160] *Hiley v Peoples Prudential Assurance Co Ltd* (1938) 60 CLR 468 at 497, 499; see also Rich J at 487 ("at the time when the winding up commences").

[161] See, eg *Gye v McIntyre* (1991) 171 CLR 609 at 619-620, 623-624, 629 (personal insolvency).

[162] But see *Corporations Act 2001* (Cth), ss 553(1A), 553(1B) in relation to the situation in which a company was under a deed of company arrangement immediately before a resolution or a court order that the company be wound up: see Derham, n 6, pp 290-292 [6.56]-[6.57].

[163] See also *Foots v Southern Cross Mine Management Pty Ltd* (2007) 234 CLR 52 at [10] in relation to bankruptcy ("provable debts … must arise before (not after) bankruptcy").

[164] *Corporations Act 2001* (Cth), s 553C(1) refers to "mutual credits, mutual debts or other mutual dealings between an insolvent company that is being wound up and a person who wants to have a debt or claim admitted against the company": see Derham, n 6, pp 367-370 [7.24]-[7.26].

The concept of the "relevant date" does not appear in s 553C dealing with set-off. Nevertheless, in *Re Parker*,[165] Mansfield J held that set-off entitlements should also be determined by reference to the relevant date, on the basis that the date for assessing whether set-offs should occur should be the same as the date fixed for determining what debts are provable.[166] This accords with the approach that generally has been adopted in the past in bankruptcy, that the date which defined the accounts to be balanced was the same as that which determined what claims could be proved in the bankruptcy.[167] Accepting the correctness of that proposition,[168] the principle set out in s 553 for provable debts, that the circumstances giving rise to the claim should have occurred *before* the relevant date, should apply to both sides of the account in a set-off, that is to say, the company's claim against the creditor as well as the creditor's provable claim against the company. It is true that, unlike the creditor's claim against the company, the company's claim against the creditor need not be in the nature of a provable debt.[169] That was determined by the High Court in *Gye v McIntyre*.[170] But the issue here is different, as to the time by reference to which the availability of a debt or claim for a set-off is to be determined, as opposed to the nature of the claim.

This proposition, that the availability of a set-off must be determined by reference to the circumstances occurring before the relevant date, gives rise to an apparent difficulty in the case of a set-off against a statutory insolvency claim. In the case of a winding up not preceded by an administration or a deed of company arrangement, the "relevant date" is the day of the winding up order or the resolution for a winding up.[171] A statutory insolvency claim requires the occurrence of a winding up,[172] which (if not preceded by an administration or a deed of company arrangement) must of necessity occur *on* the relevant date, not *before* it. Because one of the circumstances required for the claim, being the occurrence of the winding up itself, cannot occur before the relevant date for the winding up, it could not be said that there was an existing claim at the time for determining the availability of a set-off. Alternatively, the winding up may have been preceded by an administration or a deed of company arrangement. In such cases, the "relevant date" is the day on which the administration began.[173] Since the winding up would occur after (and not before) that day, once again it would not be a case of an existing claim at the time by reference to which set-off entitlements are to be determined.

Contingent liabilities

Accepting that a statutory insolvency claim is not an existing claim at the time for determining the availability of a set-off (being the time *before* the "relevant date"), the question arises whether a set-off nevertheless may be justified on the basis that it constitutes a contingent liability to the company and

[165] *Re Parker* (1997) 80 FCR 1 esp at 12-16.

[166] *Re Parker* (1997) 80 FCR 1 at 15. See also *JLF Bakeries Pty Ltd v Baker's Delight Holdings Ltd* (2007) 64 ACSR 633 at [17]; [2007] NSWSC 894.

[167] Derham, n 6, pp 284-285 [6.45].

[168] But see the discussion of *Re Parker* (1997) 80 FCR 1 in Derham, n 6, pp 289-296 [6.55]-[6.62].

[169] See Derham, n 6, pp 370-372 [7.27]-[7.29].

[170] *Gye v McIntyre* (1991) 171 CLR 609 at 628-629.

[171] *Corporations Act 2001* (Cth), ss 9 (definition of "relevant date"), 513A, 513B.

[172] See *Corporations Act 2001* (Cth), ss 588FA(1), 588FE, 588FF. For insolvent trading, see ss 588M(1)(d), 588W(1)(d). In relation to void dispositions, see s 468(1). This differs from the situation discussed in *Sons of Gwalia Ltd v Margaretic* (2007) 231 CLR 160 at [168]-[176]. In that case it was the fact of the appointment of the administrators to the company which reduced the value of the shares in the company to zero, thereby triggering the claim for damages against the company. Nevertheless, had the relevant facts been known, a claim would have been available regardless of the appointment. Hence, it could be said that the circumstances giving rise to the claim had occurred before the appointment. The situation differs in the case of a statutory insolvency claim. In the absence of a liquidation, there can be no claim.

[173] *Corporations Act 2001* (Cth), s 513C.

therefore is available for a set-off on that ground.[174] This includes the situation where it is sought to justify a set-off on the ground that the obligation arose from a prior dealing or credit between the parties.

In *Gye v McIntyre*, the High Court accepted that, for a claim to be available for a set-off, whether on the basis that it constitutes a credit or a debt or a claim arising from a dealing, it must at least exist as contingent at the time for determining set-offs:

> The requirement that the credits, the debts or the claims arising from other dealings be commensurable does not mean they must be vested, liquidated or enforceable at the decisive date … *Provided they exist as contingent at that date* and are of a kind which will ultimately mature into pecuniary demands susceptible of set-off, the requirement of the section may be satisfied in relation to them [emphasis added].[175]

That observation accorded with earlier comments by Dixon J in *Hiley*, wherein the concept of mutual dealings was expressed in terms of "rights and obligations whether absolute or contingent":

> In the first place, the general rule does not require that at the moment when the winding up commences 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.[176]

In *Re Parker*,[177] Mansfield J justified the set-off in that case by reference to the passage in *Gye v McIntyre* set out above, which referred to a claim existing as contingent at the decisive date, and also by reference to comments attributed to Rich J in *Hiley*,[178] which contemplated a set-off in relation to a subsequently arising claim which was "the natural outcome of the earlier transactions".[179] Mansfield J said that, although the insolvent trading claim in *Re Parker* was only perfected as a consequence of the liquidation, the events which gave rise to the claim occurred before the date of the appointment of the administrators (this being the date for determining set-off entitlements in that case).[180] But it is important to note that Rich J went on in *Hiley* to refer to vested *rights* at the commencement of the winding up which grow in the natural course of events into a claim capable of set-off. His Honour said:

> But this statement does not mean that at the time when the winding up commences there must exist claims which then and there can be made the subject of account and set-off … Rights must be vested in the creditor and in the company which, without any new transaction, grow in the natural course of events into money claims capable of forming items in an account or capable of settlement by set-off.[181]

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[174] Derham, n 6, pp 399-401 [8.35]-[8.46].

[175] *Gye v McIntyre* (1991) 171 CLR 609 at 623-624. The High Court referred (at 630) to a "set-off of claims which are contingent or unliquidated at the time of a sequestration order" (at 630). See also *Ansett Australia Ltd v Travel Software Solutions Pty Ltd* (2007) 65 ACSR 47; 214 FLR 203 at [65]-[80] (set-off denied on the basis of mutual dealings because there was no contingent obligation at the relevant date).

[176] *Hiley v Peoples Prudential Assurance Co Ltd* (1938) 60 CLR 468 at 496-497. See also *Day & Dent Constructions Pty Ltd v North Australian Properties Pty Ltd* (1982) 150 CLR 85 at 90-91, 103; *MS Fashions Ltd v Bank of Credit & Commerce International SA* [1993] Ch 425 at 446; *JLF Bakeries Pty Ltd v Baker's Delight Holdings Ltd* (2007) 64 ACSR 633 at [18]-[19]; [2007] NSWSC 894.

[177] *Re Parker* (1997) 80 FCR 1 at 11-12.

[178] *Hiley v Peoples Prudential Assurance Co Ltd* (1938) 60 CLR 468 at 487.

[179] In *Re Parker* (1997) 80 FCR 1 at 12, Mansfield J referred to these as the "words of Rich J"), in fact, they were part of a passage in the judgment of Bigham J in *Re Daintrey* [1900] 1 QB 546 at 568 quoted by Rich J, that "the appellants are not seeking to alter the rights of the parties by reference to subsequent transactions, but are seeking to ascertain them by reference to the natural outcome of previous transactions".

[180] *Re Parker* (1997) 80 FCR 1 at 15.

[181] *Hiley v Peoples Prudential Assurance Co Ltd* (1938) 60 CLR 468 at 487 (referred to in *Day & Dent Constructions Pty Ltd v North Australian Properties Pty Ltd* (1982) 150 CLR 85 at 90, 102).

As noted above, the reference to the position at the commencement of the winding up must be modified to take into account the position under the *Corporations Act*, that the circumstances supporting a set-off must have occurred *before*, not on, the relevant date. This should include in relation to vested rights.

The requirement expressed in the cases in relation to a subsequently arising claim, that it should exist as contingent at the relevant time (see *Gye v McIntyre*) or that it be based on vested rights (see Rich J in *Hiley*), was not explored in *Re Parker*, and it is those concepts to which attention must be directed.

Contingent debts and the requirement of a prior existing obligation

For a liability to be characterised as contingent at a particular time, the generally accepted view in Australia[182] is that there must at that time be an existing obligation out of which, on the happening of a future event, an obligation to pay a sum of money would arise.[183] It is not sufficient that moneys may become payable in the future upon the occurrence of some event.[184] An obligation is a correlative of a right, and so the principle applicable to contingent liabilities also accords with Rich J's comment in *Hiley* (above) in relation to the necessity for vested rights.

Therefore, if a person liable for a statutory insolvency claim is to be permitted a set-off against the liability, it should be necessary to identify an existing obligation on the person *before* the relevant date, which (we have seen) is before the winding up. The presence or otherwise of any such obligation should be decided by reference to the language of the corporations legislation, rather than by resort to consequences which may appear to produce injustice.[185] However, problems arise in trying to identify an obligation under the *Corporations Act* in relation to the statutory insolvency claims before a winding up. Consider the position in relation to unfair preferences and uncommercial transactions. The essence of the scheme of the legislation in relation to them is set out in ss 588FE and 588FF. Section 588FE(1)(a) is expressed in terms that, "[i]f a company is being wound up … a transaction of the company may be voidable" if certain events have occurred in certain circumstances. If a court is satisfied that a transaction is voidable under s 588FE, it may then make one or more of the orders set out in s 588FF. On its face, that language is not apt to create an obligation before the winding up. The same comment may be made in relation to the legislation dealing with void dispositions and insolvent trading, in the latter case at least in relation to holding company liability. It is suggested below that the position may differ in relation to director liability for insolvent trading.

Shirlaw v Lewis criticised

In this context, consider once again *Shirlaw v Lewis* (1993) 10 ACSR 288, which concerned a void disposition. The facts were set out earlier but, briefly, a contract for the sale of a business provided that, if the purchaser defaulted, the vendor would repurchase the purchaser's goods and saleable stock. The purchaser repudiated the contract after which a summons was filed for its winding up, and a liquidator was appointed. After the filing of the application (being the commencement of the winding up), the vendor took possession of the stock and disposed of it. The liquidator asserted that the sale of

[182] Contrast the position in England following *Re Nortel GmbH* [2014] AC 209 (see below). In *McLellan v Australian Stock Exchange Ltd* (2005) 144 FCR 327 at [9], [16] Finkelstein J noted that the position in England may differ from that in Australia, referring to *Re Sutherland (decd)* [1963] AC 235 at 251, 253, 263 (*Sutherland* was followed in *Re Nortel*).

[183] See, eg *Community Development Pty Ltd v Engwirda Construction Co* (1969) 120 CLR 455 at 459 (Kitto J); *National Bank of Australasia Ltd v Mason* (1975) 133 CLR 191 at 200-201 (Barwick CJ); *Commissioner of Taxation (Cth) v Gosstray* [1986] VR 876 at 878-879; *Jones v Deputy Commissioner of Taxation* (1998) 157 ALR 349 at 354; *R v Dunwoody* (2004) 149 A Crim R 259; [2004] QCA 413 at [115]-[117]; *McLellan v Australian Stock Exchange Ltd* (2005) 144 FCR 327 at [9], [16]; *BE Australia WD Pty Ltd v Sutton* (2011) 82 NSWLR 336 at [90]-[95], [107]. See also *Sons of Gwalia Ltd v Margaretic* (2007) 231 CLR 160 at [174] (Hayne J, referring to Kitto J in *Engwirda* and Barwick CJ in *Mason*); *Foots v Southern Cross Mine Management Pty Ltd* (2007) 234 CLR 52 at [36] (referring to Kitto J in *Engwirda*). In the context of set-off, see *Ansett Australia Ltd v Travel Software Solutions Pty Ltd* (2007) 65 ACSR 47; 214 FLR 203 at [60]-[80]; *JLF Bakeries Pty Ltd v Baker's Delight Holdings Ltd* (2007) 64 ACSR 633 at [18]-[19]; [2007] NSWSC 894.

[184] *National Bank of Australasia Ltd v Mason* (1975) 133 CLR 191 at 200.

[185] *Kavich v Official Trustee in Bankruptcy* (1995) 58 FCR 82 at 86-87 (Hill J) in relation to the *Bankruptcy Act 1966* (Cth), s 82(1) (decision affirmed *Deputy Commissioner of Taxation v Kavich* (1996) 68 FCR 519).

the stock to the vendor after the commencement of the winding up pursuant to the contract constituted a void disposition, and sought damages in conversion from the vendor by reason of its conduct in disposing of the stock. Hodgson J accepted that, whether the claim against the vendor was characterised as a claim in conversion or a claim based on unjust enrichment, the vendor could set off its damages cross-claim arising from the repudiation against that claim. This was on the basis that "[w]hat ultimately happened was the crystallization of mutual obligations" arising out of the pre-liquidation dealings of the parties, and that "these mutual obligations as crystallized are matters which would be set off" under the insolvency set-off section.[186] In this case, there were prior obligations by reason of the contract, but that should not suffice for a contingent liability, and therefore for a set-off. For a contingent liability, the principle is expressed in terms that the liability must arise, or grow, out of a pre-existing obligation.[187] In the case of the vendor's liability consequent upon the avoidance,[188] the liability did not grow out of the pre-existing contractual obligations. Performance of the prior contractual obligations provided the occasion for an avoidance to occur in a winding up. But the liability arose out of the operation of the statute, not the contract.

Identifying a prior existing obligation in the case of a statutory liability

The difficulty in identifying a prior obligation in the case of the statutory insolvency claims is a reflection of the point that has been made in relation to the distinction between a liability arising as a result of a prior contract and a liability arising in other circumstances, for example under a statute. In the former case, the contract may provide the relevant pre-existing obligation which would support the characterisation of a liability that may arise out of it as contingent.[189] But the position is not so straightforward in other situations.[190] An illustration of a contingent statutory obligation is to be found in the income tax legislation.[191] The legislation imposes an obligation to pay income tax on 30 June of the year in respect of which the income was derived, but payment is contingent upon the Commissioner making and serving a notice of an assessment.[192] Nevertheless, as Lord Neuberger emphasised in *Re Nortel GmbH* [2014] AC 209 at [77], the mere fact that a person may become under a liability pursuant to a provision in a statute which was in force before a winding up cannot mean that, where the liability arises after the winding up, it arose by reason of an obligation incurred before that event. Something more is needed.

Statutory liabilities where liability depends upon a discretion

In the case of statutory liabilities, a particular problem arises in Australia[193] in relation to the identification of a prior existing obligation in the situation where liability depends on the exercise of a discretion. It has been said that, where a discretion is required to be exercised in a way which impacts on or is relevant to the debt, there is no obligation to pay until the discretion is exercised.[194] The discretion referred to is a discretion at large, as opposed to, for example, the case of an equitable claim

[186] *Shirlaw v Lewis* (1993) 10 ACSR 288 at 296.

[187] *Community Development Pty Ltd v Engwirda Construction Co* (1969) 120 CLR 455 at 459 ("there must be an existing obligation and … out of that obligation a liability on the part of the company to pay a sum of money will arise in a future event"); *National Bank of Australasia Ltd v Mason* (1975) 133 CLR 191 at 201 ("insistence on the presence of an existing obligation out of which the ultimate liability will grow") referring to *Re William Hockley Ltd* [1962] 1 WLR 555 at 558 (see above).

[188] Assuming that there was such a liability in the absence of a set-off, which was not decided.

[189] But see the point made above in relation to *Shirlaw v Lewis*.

[190] *Re Nortel GmbH* [2014] AC 209 at [75]-[76]. For an example of a contingent statutory obligation, see *Secretary of State for Trade & Industry v Frid* [2004] 2 AC 506 (explained by Lord Sumption in *Re Nortel* at [134]).

[191] See *Income Tax Assessment Act 1997* (Cth), s 4.10 (and earlier, *Income Tax Assessment Act 1936* (Cth), s 17).

[192] *Prentice v Cummins* (2002) 124 FCR 67 at [104]-[107]; *Commissioner of Taxation v Dexcam Australia Pty Ltd* (2003) 129 FCR 582 at [28] (see at [8] in relation to the assessments). See also *Federal Commissioner of Taxation v H* (2010) 188 FCR 440 at [38]-[43].

[193] Contrast the position in England following *Re Nortel GmbH* [2014] AC 209 (see below).

[194] *Health Insurance Commission v Trustee in Bankruptcy of Estate of Alekozoglou* [2003] FCA 848 at [50] (Marshall J). In addition to the cases referred to below, see *Lofthouse v Commissioner of Taxation* (2001) 164 FLR 106 at [37]-[41].

which may depend on relative culpability and the availability of equitable defences, and which is referred to as discretionary, but which nevertheless arises from objective circumstances.[195]

Lyford v Carey (1985) 3 ACLC 515 concerned a director's liability for insolvent trading under former companies legislation in relation to debts incurred by the company while insolvent. Insolvent trading was constituted an offence under s 374C of the *Companies Act 1961* (WA), and s 374D provided that, where a person had been convicted of an offence under s 374C, the court "may if it thinks proper to do so" declare the person to be personally responsible to pay to the company an amount equal to the debts in question. Two directors of a company entered into compositions after the company had gone into liquidation. Subsequently the directors were convicted under s 374C in respect of debts incurred by the company before its liquidation, and the liquidator sought a declaration against them under s 374D for payment of the amount of the debts. The directors argued that the liability which might have been imposed on them pursuant to s 374D constituted a contingent liability to which they were subject at the date of the compositions and, being a provable debt, they had been released from the liability by virtue of the compositions. That argument was rejected by Franklyn J. For there to have been a contingent liability at the date of the compositions, there had to have been an "existing obligation" at that date upon which the contingency could operate. However, the court had a discretion to refuse to make a declaration under s 374D, and his Honour said that there was no obligation whatsoever on the defendants until such time as the discretion was exercised and a declaration made. Hence, there was no contingent liability at the time of the compositions.

In South Australia, Prior J reached the same conclusion on similar facts in *Corporate Affairs Commission (SA) v Karounos* (1984) 9 ACLR 405. Those decisions were followed by Mansfield J in *Gaffney v Commissioner of Taxation* (1998) 81 FCR 574. The case concerned s 21B of the *Crimes Act 1914* (Cth), which provided that, if a person was convicted of an offence against a law of the Commonwealth, the court "may" order the offender to make reparation to the Commonwealth. The applicant committed a relevant offence[196] before he became bankrupt, but a proceeding against him in relation to the offence was not commenced, and a reparation order was not made, until after the bankruptcy. It was held that the reparation order did not give rise to a provable debt in the bankruptcy. Mansfield J said:

> The need for critical decisions to be made both to prosecute the applicant, and to convict him … and then to make a reparation order, in my view all remove the circumstances at the bankruptcy of the applicant from constituting at that time an obligation by the applicant to the respondent.[197]

Foots v Southern Cross Mine

Those cases are consistent with the more recent decision of the High Court in *Foots v Southern Cross Mine Management Pty Ltd* (2007) 234 CLR 52. The question in that case was whether a costs order was provable in a bankruptcy, in circumstances where an adverse judgment in proceedings had been given against the bankrupt before the bankruptcy, but the costs order itself was not made against him until after the bankruptcy. The relevant proof of debt provision was s 82(1) of the *Bankruptcy Act 1966* (Cth), which made provable "all debts and liabilities, present or future, certain or contingent, to which a bankrupt was subject at the date of the bankruptcy, or to which he or she may become subject before his or her discharge by reason of an obligation incurred before the date of the bankruptcy". A

[195] *Buzzle Operations Pty Ltd v Apple Computer Australia Pty Ltd* (2007) 64 ACSR 300; 214 FLR 48 esp at [18]-[21], [32], [38]-[39] (Hammerschlag J).

[196] By reason of being concerned in, or taking part in, the management of a company which failed to remit tax instalment deductions to the Commissioner.

[197] *Gaffney v Commissioner of Taxation* (1998) 81 FCR 574 at 581.

rule of court provided that costs of a proceeding were in the discretion of the court but were to follow the event unless the court considered that another order was more appropriate,[198] this being the relevant source of power to make a costs order.[199]

The rule was expressed to apply in relation to a specified matter, being a proceeding, which in that case had both commenced and proceeded to judgment before the bankruptcy. Nevertheless, it was held (Gleeson CJ, Gummow, Hayne and Crennan JJ; Kirby J dissenting) that the costs order was not provable.[200] No obligation arose until the costs order was made. The most that could be said was that, once legal proceedings have been commenced, there is always a possibility or a risk that an order for costs may be made, but it was said that "that risk is not a contingent liability within the sense of s 82(1)".[201] The order for costs itself was the source of the legal liability and there was no certainty that the court would decide to make an order. The making of a costs order turns on discretionary considerations that arise independently of the entry of judgment.[202]

Not confined to judicial discretions

Lyford, *Karounos*, *Gaffney* and *Foots v Southern Cross Mine* all concerned a judicial discretion in relation to the ultimate issue as to whether a liability should be imposed. But the principle should not be confined to that situation.[203] The question in issue is whether a statute may be said to impose an obligation at a particular time before the exercise of a discretion necessary for the liability, so as to support the characterisation of the liability as contingent at that time.

Those cases say that there is no present obligation where there is a judicial discretion in imposing liability, but it is difficult to see why the principle should differ where a non-judicial discretionary decision has to be made at an earlier time in relation to the occurrence of a event which is required for liability but which has not yet occurred. In *Gaffney*, Mansfield J referred to the need for "critical decisions" to be made to prosecute and convict the applicant, and then to make a reparation order, as "all" impacting on the question whether a prior obligation was owed. A decision to prosecute plainly is not a judicial decision. There is English authority which also supports the broader view of discretion in this context.[204]

Discretions and decisions in relation to a winding up

The statutory insolvency claims require a winding up. Where a company is insolvent, a winding up requires the making of a critical discretionary decision by a potential applicant for a court-ordered

[198] *Foots v Southern Cross Mine Management Pty Ltd* (2007) 234 CLR 52 at [25] (referring to *Uniform Civil Procedure Rules 1999* (Qld), r 689(1)).

[199] *Knight v FP Special Assets Ltd* (1992) 174 CLR 178 at 185 (Mason CJ and Deane J), 193 (Dawson J: "The power to award costs is now statutory").

[200] See in particular *Foots v Southern Cross Mine Management Pty Ltd* (2007) 234 CLR 52 at [35]-[37]; cf the position in England in relation to costs orders: see *Re Nortel GmbH* [2014] AC 209 at [88]-[91] (Lord Neuberger), [136] (Lord Sumption) (see below).

[201] *Foots v Southern Cross Mine Management Pty Ltd* (2007) 234 CLR 52 at [36]; see also at [49].

[202] *Foots v Southern Cross Mine Management Pty Ltd* (2007) 234 CLR 52 at [37].

[203] Notwithstanding Mansfield J's reference to a "judicial determination" in *Gaffney v Commissioner of Taxation* (1998) 81 FCR 574 at 581. In *Health Insurance Commission v Trustee in Bankruptcy of Estate of Alekozoglou* [2003] FCA 848 at [50] Marshall J expressed the principle broadly: "Where discretion is required to be exercised, in a way which impacts on or is relevant to a debt, there is no obligation to pay until the discretion is exercised."

[204] See *R (Steele) v Birmingham City Council* [2006] 1 WLR 2380 (determination by the Secretary of State); *Re Liberty International plc* [2010] EWHC 1060 (Ch) at [14] (exercise of discretion by Pension Regulator). See also Lloyd LJ's reference in the Court of Appeal in *Re Nortel GmbH* [2012] 1 All ER 1455 at [74] to "the many discretions" involved in the use of the financial support direction regime in that case. Those authorities would no longer stand in England following the rejection by the English Supreme Court in *Re Nortel GmbH* [2014] AC 209 of the proposition that, in non-contractual cases, a contingent debt may not be based on discretionary factors: see at [136] (Lord Sumption), [96] (Lord Neuberger agreeing with Lord Sumption), [91] (Lord Neuberger) in relation to *R (Steele)* (see below). But to the extent that the rejected proposition may still represent the position in Australia, the earlier English authorities should remain relevant in relation to the nature of the discretion.

winding up,[205] by the court in any such application,[206] alternatively, by the directors (or by a chargee) as to whether to appoint an administrator[207] and, if an administrator is appointed, by creditors as to whether the company should execute a deed of company arrangement, or the administration should end, or the company should be wound up.[208] The possibilities of an administration and a deed of company arrangement are particularly significant, since they may provide an alternative to a winding up in the case of an insolvent company. Those discretionary decisions suggest that, in the case of a statutory insolvency claim, there is no existing obligation prior to a winding up on which to base the existence of a contingent liability at that time.

If a statutory insolvency claim did not exist as contingent before the winding up, the authorities referred to earlier, which require that a claim at least exist as contingent at the time for determining set-offs if it is to be included in a set-off, suggest that the statutory claim cannot be included in a set-off.

Four possible contrary points

In stating that conclusion, mention should be made of four points which may be said to support the view that the liability under a statutory insolvency claim may be characterised as contingent before the winding up, and therefore may be available for a set-off.

A pre-liquidation duty as the source of a prior obligation

The first point concerns the scheme of the insolvent trading provisions relating to director liability.

Director liability is dealt with in s 588M(2). One of the conditions for the imposition of liability on a director, set out in s 588M(1), is that the director has contravened s 588G(2) or (3) in relation to the incurring of a debt by the company. Section 588G is in Div 3 of Pt 5.7B, which is headed "Director's duty to prevent insolvent trading".[209] In summary, s 588G is expressed (in subs (1)) to apply in circumstances where a person is a director of a company when the company incurs a debt, the company is insolvent at that time or becomes insolvent by incurring the debt, and at the time there are reasonable grounds for suspecting that the company is insolvent. Attention is directed at circumstances occurring before a winding up, when the company is trading but is insolvent. Pursuant to subs (2), by failing to prevent the company incurring the debt, the person contravenes the section if the person is aware at the time that there are grounds for suspecting that the company is insolvent. This constitutes a civil penalty provision under s 1317E(1). Under s 588G(3), an offence is committed if the person's failure to prevent the company incurring the debt was dishonest.

Though the heading to Div 3 refers to a duty of a director, s 588G itself is not expressed in terms of laying down a duty. Rather, it attaches consequences to a failure to prevent the incurring of a debt. Nevertheless, the heading is part of the Act.[210] The heading makes it clear that there is a duty,[211] and a "duty" imports the notion of an obligation,[212] that is to say, an obligation to prevent insolvent trading in the circumstances set out in s 588G. For a contingent liability, it is said that the liability

[205] *Corporations Act 2001* (Cth), s 459P.

[206] *Corporations Act 2001* (Cth), s 467.

[207] *Corporations Act 2001* (Cth), ss 436A, 436C.

[208] *Corporations Act 2001* (Cth), s 439C; see also s 445E in relation to termination of a deed of company arrangement.

[209] The heading of a Division in the *Corporations Act 2001* (Cth) is part of the Act: see *Acts Interpretation Act 1901* (Cth), s 13; *Corporations Act 2001* (Cth), s 5C.

[210] *Acts Interpretation Act 1901* (Cth), s 13; *Corporations Act 2001* (Cth), s 5C.

[211] *Ford's Principles of Corporations Law* (LexisNexis, looseleaf, current to July 2012) at [20.080]. Ford suggests that one significance of a director being subject to a duty in relation to insolvent trading is that proceedings for breach of duty may be taken against a director under the "misfeasance" provision, *Corporations Act 2001* (Cth), s 598.

[212] The *Oxford English Dictionary* (online) defines "duty", inter alia, as: "Action, or an act, that is due in the way of moral or legal obligation; that which one ought or is bound to do; an obligation. (The chief current sense.)"

must arise,[213] or grow,[214] out of a pre-existing obligation. A claim under s 588M(2) requires the occurrence of a contravention under s 588G(2) or (3), and if s 588G lays down a duty, that duty arguably may provide the source of a prior obligation from which the s 588M(2) claim may be said to have arisen, or grown, for the purpose of characterising the claim as contingent before the winding up.

That reasoning, if correct, would appear to be confined to director liability for insolvent trading. Prima facie, it would not extend to holding company liability under Div 5.[215] This is because there is no reference to a duty in s 588V, which broadly corresponds with s 588G, or in the heading to Div 5, wherein s 588V is located. In addition, unlike s 588G(2), s 588V is not a civil penalty provision,[216] and unlike s 588(3) a contravention of s 588V does not constitute an offence (s 588V(2)). For holding company liability, the language of the legislation is not apt to impose an obligation before the occurrence of a winding up for the purpose of characterising the liability as contingent at that time.

Division 2 of Pt 5.7B, dealing with unfair preferences and uncommercial transactions, and s 468, relating to void dispositions, similarly are not expressed in terms of a duty on the affected party to prevent the matters the subject of the relevant statutory provisions occurring, and they also should not attract an argument similar to that which may apply in the case of director liability for insolvent trading.

In relation to unfair preferences, uncommercial transactions and void dispositions, the claim may be against a director (for example, as the recipient of a preferential payment) in circumstances where the director's conduct constituted a breach of duty to the company, either in equity or under the *Corporations Act* provisions dealing with directors' duties.[217] The question may arise whether that general pre-existing duty would suffice to support the characterisation of the director's liability under the statutory insolvency claim as contingent before the winding up, on similar reasoning to that outlined above in relation to director liability for insolvent trading. However, an argument to that effect would be problematic. In the situation under discussion, the director had various general duties to the company before the winding up. But a contravention of those duties is not constituted an element of the statutory insolvency claims. The general pre-existing duties, and the statutory liabilities, are distinct. It therefore might be said that the statutory liability does not arise, or grow, out of the general duties.

Recent English authority: Re Nortel

The second point is that the English Supreme Court in *Re Nortel GmbH* [2014] AC 209 ascribed a broad meaning to the term "obligation" in r 13.12(1)(b) of the *Insolvency Rules 1986* (UK) in relation to provable debts, in the situation where the debt in question arises under a statute after the date of the liquidation. Rule 13.12(1)(b) relevantly defines "debt" as follows:

> "Debt", in relation to the winding up of a company, means …
>
> (a) …
>
> (b) any debt or liability to which the company may become subject after [the date on which it goes into liquidation] by reason of any obligation incurred before that date …

Lord Neuberger[218] said that there is no real problem in relation to r 13.12(1)(b) where a debt or liability arises after an insolvency event (including a winding up) as a result of a prior contract. In

[213] *Community Development Pty Ltd v Engwirda Construction Co* (1969) 120 CLR 455 at 459 (Kitto J): "there must be an existing obligation and … out of that obligation a liability on the part of the company to pay a sum of money will arise in a future event".

[214] *National Bank of Australasia Ltd v Mason* (1975) 133 CLR 191 at 201 (Barwick CJ): "insistence on the presence of an existing obligation out of which the ultimate liability will grow" (referring to *Re William Hockley Ltd* [1962] 1 WLR 555 at 558).

[215] Compare *Re Parker* (1997) 80 FCR 1.

[216] Compare *Corporations Act 2001* (Cth), s 1317E.

[217] *Corporations Act 2001* (Cth), ss 180-184.

[218] Lords Mance, Clarke and Toulson agreeing; Lord Sumption in a separate judgment also expressed agreement with Lord Neuberger's reasons.

such a case, the contract can fairly be said to impose the incurred obligation. But the position is not so straightforward where the liability arises other than under a contract. He accepted that an arrangement other than a contractual one nevertheless can give rise to an "obligation" for the purpose of para (b),[219] and proceeded to consider that proposition in relation to statutory liabilities by reference to three suggested considerations:

> However, the mere fact that a company could become under a liability pursuant to a provision in a statute which was in force before the insolvency event, cannot mean that, where the liability arises after the insolvency event, it falls within rule 13.12(1)(b). It would be dangerous to try and suggest a universally applicable formula, given the many different statutory and other liabilities and obligations which could exist. However, I would suggest that, at least normally, in order for a company to have incurred a relevant "obligation" under rule 13.12(1)(b), it must have taken, or been subjected to, some step or combination of steps which (a) had some legal effect (such as putting it under some legal duty or into some legal relationship), and which (b) resulted in it being vulnerable to the specific liability in question, such that there would be a real prospect of that liability being incurred. If these two requirements are satisfied, it is also, I think, relevant to consider (c) whether it would be consistent with the regime under which the liability is imposed to conclude that the step or combination of steps gave rise to an obligation under rule 13.12(1)(b).[220]

The judgment suggests that this would also determine in a non-contractual context whether a contingent liability may be said to have arisen.[221]

The question in *Re Nortel* was whether a financial support direction proposed to be issued by the Pensions Regulator under the *Pensions Act 2004* (UK) to various companies in a group which had gone into administration, requiring the companies to provide financial support for an under-funded pension scheme, would give rise to a provable debt in the administrations. The Court of Appeal held that the liability resulting from the issue of a direction after the administration date would not be provable since there was no pre-existing obligation for the purpose of r 13.12(1)(b) (r 13.12 also applies where a company in England is in administration (r 13.12(5)). The use of the statutory regime for issuing financial support directions involved various discretions, and before the administration there was no more than a possibility that it would be invoked.[222]

However, the decision to that effect was reversed on appeal by the Supreme Court, Lord Neuberger considering that, in the circumstances, the matters that he had suggested in his judgment (above) for determining whether an obligation had been incurred were satisfied before the commencement of the administrations.[223] The circumstance that the operation of the regime involved various discretions did not preclude the view that an obligation had been incurred. On that point, the Supreme Court overruled earlier English decisions to the effect that a costs order made against a person after the commencement of an insolvency process, in proceedings commenced before that date, was not provable.[224] The contrary decision of the Australian High Court in *Foots v Southern Cross Mine*[225] (see above) was not mentioned, though it was referred to by the Court of Appeal.[226]

Lord Neuberger's approach arguably could extend to the case of a preferential payment by an insolvent company to a creditor in reduction or extinguishment of the debt. Applying (a) in his

[219] *Re Nortel GmbH* [2014] AC 209 at [74]-[76].

[220] *Re Nortel GmbH* [2014] AC 209 at [77].

[221] *Re Nortel GmbH* [2014] AC 209 at [78]-[81] (referring to *Re Sutherland (dec'd)* [1963] AC 235). Lord Neuberger said (at [81]): "It appears to me that the issue of (i) what is a contingent liability and (ii) what is an obligation by reason of which a contingent liability arises, are closely related."

[222] *Re Nortel GmbH* [2012] 1 All ER 1455; see esp at [73]-[76], and the discussion of the procedure for issuing financial support directions at [8]-[19].

[223] See *Re Nortel GmbH* [2014] AC 209 at [83]-[86].

[224] See *Re Nortel GmbH* [2014] AC 209 at [136] (Lord Sumption; with whose judgment Lord Neuberger (at [96]) expressed agreement), and Lord Neuberger (at [88]-[91]).

[225] *Foots v Southern Cross Mine Management Pty Ltd* (2007) 234 CLR 52.

[226] *Re Nortel GmbH* [2012] 1 All ER 1455 at [60].

suggested considerations, the payment had a legal effect, in that it reduced or extinguished the company's debt to the creditor. Further, applying (b), if the company was insolvent at the time, the payment would have resulted in the creditor being vulnerable to an order for repayment in a subsequent liquidation. However, difficulties may arise in relation to (c). This is because the answer may vary depending on the context in which the question is asked. On the one hand, it may be said to be inconsistent with the regime under which the liability is imposed (the unfair preference provisions) to conclude that the steps taken gave rise to an obligation, if to do so would let in a set-off to the detriment of the general body of creditors.[227] But a different conclusion could be arrived at if the question were to arise instead in the context of a proof of debt in the creditor's insolvency, where the creditor became bankrupt or went into liquidation before the company's own liquidation, and the issue is whether the preference claim is provable in the creditor's insolvency as a contingent liability.[228] In that situation, it might be said that recognition of a contingent obligation for the purpose of a proof of debt would not be inconsistent with the regime under which the liability is imposed. Whatever the view in relation to (c), depending on the circumstances, similar reasoning may also be open in the case of an uncommercial transaction or a void disposition.[229]

Nevertheless, the adoption of the *Re Nortel* approach in Australia would be problematic. That approach may apply regardless of whether the existence of a liability depends on the exercise of a discretion, and in particular it would permit a proof of debt in relation to a costs order made after bankruptcy or winding up. In Australia, this would be difficult to reconcile with the decision of the High Court in 2007 in *Foots* in relation to a discretionary costs order, and with the views adopted by other Australian courts in relation to the effect of discretions (see above).

Distinguish Lofthouse v Commissioner of Taxation

The third point relates to a Victorian decision referred to by Lord Sumption in *Re Nortel*.[230]

Lofthouse v Commissioner of Taxation (2001) 164 FLR 106 concerned s 588FGA of the *Corporations Act*, which applies in the situation where the court has made an order in the liquidation of a company pursuant to s 588FF setting aside a payment by the company to the Commissioner of Taxation as an unfair preference. Each director of the company is then liable under s 588FGA to indemnify the Commissioner in respect of any loss and damage resulting from the order. The directors in *Lofthouse* had entered into compositions after the company's liquidation but before an order was made against the Commissioner under s 588FF, and the question was whether the liability to indemnify the Commissioner under s 588FGA was provable in the compositions as a contingent liability. Warren J in the Victorian Supreme Court held that it was. Her Honour said that it arose from an obligation pursuant to an indemnity and "all the objective circumstances giving rise to the potential for the invocation of the chose in action" represented by the right of indemnity had occurred before the compositions.[231]

This was similar in terms to an earlier observation by Mansfield J in *Commissioner of Taxation v Siminiato Holdings Pty Ltd* (1997) 15 ACLC 477 at 482,[232] in the context of a discussion of the question whether an entity with an arguable claim for unliquidated damages could qualify as a contingent creditor, that the expression "existing obligation" in relation to contingent liabilities "may carry with it no more than the concept of a transaction, or set of facts, which are already in existence upon which some future adjudication or other event may give rise to an actual liability". It also recalls

[227] See the discussion of the First Ground above.

[228] See *Vale v TMH Haulage Pty Ltd* (1993) 31 NSWLR 702 (discussed below) in relation to insolvent trading.

[229] On the other hand, the general approach suggested by Lord Neuberger would be difficult to apply in the case of insolvent trading, since the relevant act having legal effect, being the incurring of debts, constitutes action by the company and the person to whom a debt is incurred, whereas liability is imposed on the directors or on a holding company.

[230] *Re Nortel GmbH* [2014] AC 209 at [135].

[231] *Lofthouse v Commissioner of Taxation* (2001) 164 FLR 106 at [45].

[232] Referred to with approval in *Eskdale South Cattle Co Pty Ltd v Deputy Commissioner of Taxation* [2013] FCA 1125 at [28].

Mansfield J's approach in *Re Parker* (see above)[233] in support of the set-off in that case. However, the reasoning in *Lofthouse* should not justify a general right of set-off against an obligation under a statutory insolvency claim. One of the objective circumstances required for the claim is the occurrence of a liquidation. This would occur *after* the time as at which the availability of a set-off is to be determined (that is, before the relevant date[234]) and would involve discretionary decisions (see above). In *Lofthouse*, on the other hand, the liquidation occurred *before* the compositions (being the relevant insolvency proceedings). The question of discretions in relation to a winding up therefore was not in issue.[235]

Lofthouse raises another issue in relation to discretions. The order against the Commissioner under s 588FF was not made until after the compositions, and s 588FF itself is expressed in discretionary terms, that the court on the application of a company's liquidator, if satisfied that a transaction of the company is voidable, "may" make one of the orders set out in the section. But this may not mean that the court has a discretion whether or not to make an order, although satisfied that the relevant transaction was voidable. There is first instance authority for the proposition that, in such a case, the discretion relates only to the form and terms of orders to be made in the particular case, as opposed to whether an order should be made at all[236] (though the question has been left open at intermediate appellate level[237]). Usually the appropriate order would be readily apparent.[238] This issue was not explored in *Lofthouse*.

Problem case: Vale v TMH Haulage

The fourth point relates to the difficult case of *Vale v TMH Haulage Pty Ltd* (1993) 31 NSWLR 702, a decision of the New South Wales Court of Appeal. The case concerned the liability of a director to a creditor of the company as a consequence of insolvent trading by the company, under s 556 of the *Companies (New South Wales) Code*.[239] The claim against the director did not arise until all the requirements of s 556(1) were satisfied, which included that the company had been, or was, in the course of being wound up. However, before the winding up in that case, the director's creditors had accepted a proposal for a composition under Pt X of the *Bankruptcy Act 1966* (Cth). It was submitted for the director that, even though the liquidation did not occur until after the composition, the claim was a provable debt under the composition and therefore a proceeding could not be brought against him upon the claim.

The Court of Appeal agreed, holding that the claim was provable as a contingent liability. The judgment of the Court of Appeal was delivered by Priestley JA,[240] who justified that view on two grounds. His Honour principally relied[241] on *Official Trustee in Bankruptcy v CS & GJ Handby Pty Ltd* (1989) 21 FCR 19, in which the Full Court of the Federal Court had held that the liability of a director under s 556 was a provable debt in the director's bankruptcy. *Handby* was a different case, however, because the company liquidation had occurred before the bankruptcy, not after, so that on the facts there was no issue in relation to a contingent liability. Apart from that case, Priestley JA reasoned

[233] *Re Parker* (1997) 80 FCR 1 at 11-12.

[234] See above.

[235] Hence, Warren J in *Lofthouse v Commissioner of Taxation* (2001) 164 FLR 106 at [35]-[41], distinguished the discretion cases: *Lyford v Carey* (1985) 3 ACLC 515; *Corporate Affairs Commission (SA) v Karounos* (1984) 9 ACLR 405; *Gaffney v Commissioner of Taxation* (1998) 81 FCR 574.

[236] *Cussen v Sultan* (2009) 74 ACSR 496 at [24]-[30]; *Re Frontier Architects Pty Ltd* (2010) 81 ACSR 158 at [28].

[237] *Sands & McDougall Wholesale Pty Ltd v Commissioner of Taxation (Cth)* [1999] 1 VR 489 at [68]-[71]; *Buzzle Operations Pty Ltd v Apple Computer Australia Pty Ltd* (2011) 81 NSWLR 47 at [258]-[261].

[238] As Einstein J observed in *Cashflow Finance Pty Ltd v Westpac Banking Corporation* [1999] NSWSC 671 at [567]-[568], the consequences of setting aside a transaction "include that any person who has received money under the transaction which is avoided must repay it"; see also at [570] ("Once it is shown that CODFA has received a payment which is indeed an insolvent transaction, I accept that there is no room for operation of any discretion in the court").

[239] See now *Corporations Act 2001* (Cth), s 588M(3) (creditor's power to recover from a director).

[240] Meagher and Sheller JJA agreeing.

[241] *Vale v TMH Haulage Pty Ltd* (1993) 31 NSWLR 702 at 709-710.

that, if immediately before a company incurred a debt there were reasonable grounds to suspect that it would not be able to pay all its debts as and when they became due, or it would not be able to pay all its debts if it incurred that debt, for the purpose of s 556, there must at that time be:

> at the very least a real possibility that, if the debt is incurred, the company will subsequently go into liquidation. That is frequently the fate of insolvent companies.[242]

That consideration led his Honour to think that it was "realistic" to regard the possibility of such a company going into liquidation[243] as a "relevant contingency", and to regard the liability under s 556 as contingent within the meaning of the *Bankruptcy Act* proof of debt provision[244] before the liquidation occurred.

Vale concerned a director's liability under the former *Companies Code* to a creditor of the company for debts incurred by the company while insolvent, but the reasoning (if correct) would also appear to be available in the case of potential statutory insolvency claims under the *Corporations Act* which depend on the occurrence of a winding up. The liability may be characterised as contingent before the winding up and therefore (apart from the other objections to a set-off relating to statutory purpose and mutuality) within the class of claims susceptible to a set-off in the liquidation.[245] The decision in *Vale* has been referred to without criticism by first instance judges in subsequent cases,[246] and it is consistent with the generous construction that has been accorded to the proof of debt provision.[247] Nevertheless, the reasoning is open to criticism.

There was no mention in *Vale* of the requirement of an existing obligation as the basis of a contingent liability, and no such obligation was identified. The conclusion that the claim was a contingent liability was founded instead on the perceived likelihood ("at the very least a real possibility") that a winding up would ensue.[248] However, the suggestion that the likelihood of an event occurring may determine whether there was a contingent liability is difficult to reconcile with the reasoning of the High Court in *Foots* (referred to above). The High Court[249] in that case held that a costs order made against the appellant after the appellant's bankruptcy but in respect of a judgment obtained against the appellant before the bankruptcy was not provable in the bankruptcy, since no obligation arose until the costs order was made. It was acknowledged that, once legal proceedings have been commenced, there is always a possibility or a risk that an order for costs may be made against a party. However. there was no certainty that that would occur, and the High Court rejected the view that the risk of that occurring gave rise to a contingent liability for the purpose of the bankruptcy proof of debt provision.[250] That was so notwithstanding that judgment had been given against the bankrupt before the bankruptcy, and the view earlier expressed in the Queensland Court of Appeal in

[242] *Vale v TMH Haulage Pty Ltd* (1993) 31 NSWLR 702 at 710.

[243] And as a consequence, being a company to which *Companies (New South Wales) Code*, s 556 applied; see ss 556(1)(c), 553(1).

[244] *Bankruptcy Act 1966* (Cth), s 82(1).

[245] See Derham, n 6, pp 379-394.

[246] *Gaffney v Commissioner of Taxation* (1998) 81 FCR 574 at 578-580; *Buzzle Operations Pty Ltd v Apple Computer Australia Pty Ltd* (2007) 64 ACSR 300; 214 FLR 48 at [24]-[25] (Hammerschlag J) (though in *Buzzle* the winding up occurred before the director's bankruptcy); *Taylor v Rudaks* (2007) 166 FCR 451 at [18]; *Re Jackgreen (International) Pty Ltd* [2010] NSWSC 817 at [57]-[58]. To the extent that *Vale* was cited as representing the position under the current legislation, it may have been correct to do so, though (it is submitted) not on the basis of the reasoning employed in *Vale* (see below).

[247] *Official Trustee in Bankruptcy v CS & GJ Handby Pty Ltd* (1989) 21 FCR 19 at 24 ("generously construed"). See also *Sons of Gwalia Ltd v Margaretic* (2007) 231 CLR 160 at [172]; *Taylor v Rudaks* (2007) 166 FCR 451 at 457.

[248] See also *Gaffney v Commissioner of Taxation* (1998) 81 FCR 574 at 578 (but cf at 581); *Re Nortel GmbH* [2014] AC 209 at [77] (Lord Neuberger's reference to "a real prospect of that liability being incurred").

[249] Gleeson CJ, Gummow, Hayne and Crennan JJ; Kirby J dissenting.

[250] *Foots v Southern Cross Mine Management Pty Ltd* (2007) 234 CLR 52 at [35]-[36]. The joint judgment emphasised that the appeal turned on the construction of *Bankruptcy Act 1966* (Cth), s 82 (see at [2]), but the reasoning would appear to be equally applicable to company liquidation. See *BE Australia WD Pty Ltd v Sutton* (2011) 82 NSWLR 336 at [113]-[114]; *Larkden Pty Ltd v Lloyd Energy Systems Pty Ltd* [2011] NSWSC 1567 at [64]; cf *Re Walker* (2007) 215 FLR 428 at [18]; 25 ACLC 1652.

that case,[251] that the trial judge's strongly adverse findings against the appellant made it "very likely" that a costs order would be made against him.[252] The likelihood of a costs order did not suffice to establish a contingent liability. This brings into question the correctness of *Vale*.[253]

It should nevertheless be noted that, if the creditor's claim against the director in *Vale* instead had been brought under the corresponding provision in the current legislation (s 588M(3)), the case may have been correctly decided. Section 588M(3) is similar to s 588M(2) in the *Corporations Act*, which provides for recovery by a liquidator from a director in the case of insolvent trading. Under both provisions, it is a condition of liability that there must have been a contravention of s 588G before the winding up in relation to the incurring of a debt by the company (see s 588M(1)(a)). The point was made earlier that the heading to s 588G is expressed in terms of a "duty" on directors to prevent insolvent trading. This duty may be said to import an obligation on directors before a winding up to prevent the company incurring debts while insolvent, and that obligation arguably may suffice to support the characterisation of the director's ultimate liability for insolvent trading as contingent before the occurrence of a winding up.

No such duty was imposed before winding up under the legislation in issue in *Vale*,[254] and so a similar argument would not have been available in that case. But because of the duty imposed on directors by s 588G, if similar circumstances to those in *Vale* were considered under the current legislation the result may be the same, that the liability is properly characterised as contingent before the winding up, notwithstanding the difficulty with the reasoning in the case. However, for the reasons set out earlier, a similar argument would not appear to be available in relation to other statutory insolvency claims not involving director liability for insolvent trading, including holding company liability for insolvent trading.

Conclusion in relation to the third ground

If a statutory insolvency claim is not properly characterised as contingent before the winding up, it would not arise until after the time for determining set-offs in the winding up, and therefore it should not be available for a set-off under s 553C. But if that view is not accepted, for the reasons set out earlier a set-off should still be objectionable as being contrary to the statutory purpose of the claim and for lack of mutuality.

[251] *Southern Cross Mine Management Pty Ltd v Ensham Resources Pty Ltd* [2006] QCA 531 at [13] (Jerrard JA).

[252] *Foots v Southern Cross Mine Management Pty Ltd* (2007) 234 CLR 52 at [17]. See also the reference to *Foots* in the Court of Appeal in *Re Nortel GmbH* [2012] 1 All ER 1124 at [60] ("a costs order was probably inevitable").

[253] See also the suggestion in *Australian Bankruptcy Law and Practice* (Thomson Reuters, subscription service) [82.1.100] that *Vale v TMH Haulage Pty Ltd* (1993) 31 NSWLR 702 may have to be reconsidered following the decision in *Foots*.

[254] *Companies (New South Wales) Code*, s 556.