

Insolvent Companies – s 553C

Mutual Credit and Set-offs
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Discussion points

1. The provisions
2. The leading authorities
3. The purpose of s 553C
4. The requirement of mutuality
5. What are mutual credits, mutual debts and mutual dealings
6. Notice required under s 553C(2)
7. The current law in relation to set-offs in the context of preference payments
8. Whether the current law is wrong
9. Application to Construction Contracts



Section 553C(1)

- 1. [Where mutual claims and debts admissible]**
Subject to subsection (2), where there have been 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:
- (a) an account is to be taken of what is due from the one party to the other in respect of those mutual dealings; and
 - (b) the sum due from the one party is to be set off against any sum due from the other party; and
 - (c) only the balance of the account is admissible to proof against the company, or is payable to the company, as the case may be.





Section 553C(2)

- 2. [Where set-off not available]** A person is not entitled under this section to claim the benefit of a set-off if, at the time of giving credit to the company, or at the time of receiving credit from the company, the person had notice of the fact that the company was insolvent.



Leading authorities

The leading High Court decision is ***Gye v McIntyre*** (1991) 171 CLR 609.

The leading decision in the context of insolvent trading is ***Ex parte Parker*** (1997) 80 FCR 1



Leading authorities

Gye v McIntyre (1991) 171 CLR 609

- This was a decision involving set-off under section 86 of the *Bankruptcy Act 1966* (Cth), which is largely identical to s 553C.



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Leading authorities

Gye v McIntyre (1991) 171 CLR 609

- Facts:
 - Mr Gye was a member of a syndicate of 5 members which purchased a hotel and other property for \$1.25 million, in October 1980.



Leading authorities

- Facts (continued):
 - Ms McIntyre induced Mr Gye to enter the contract by fraudulent misrepresentations.



Leading authorities

- Facts (continued):
 - Ms McIntyre induced Mr Gye to enter the contract by fraudulent misrepresentations.
 - Ms McIntyre lent the purchasers \$200,000 to assist with the purchase price.



Leading authorities

- Facts (continued):
 - Ms McIntyre induced Mr Gye to enter the contract by fraudulent misrepresentations.
 - Ms McIntyre lent the purchasers \$200,000 to assist with the purchase price.
 - She obtained judgment against the purchasers for \$224,000 (being the loan, plus interest and costs).



Leading authorities

- Facts (continued):
 - Ms McIntyre induced Mr Gye to enter the contract by fraudulent misrepresentations.
 - Ms McIntyre lent the purchasers \$200,000 to assist with the purchase price.
 - She obtained judgment against the purchasers for \$224,000 (being the loan, plus interest and costs).
 - Execution of the judgment was stayed pending determination of a cross claim by the purchasers (including Mr Gye) for damages for the fraudulent misrepresentations.



Leading authorities

- Facts (continued):
 - In June 1988 Mr Gye obtained judgment against Ms McIntyre in the NSWSC for damages for deceit in the sum of \$214,600.89 plus costs.



Leading authorities

- Facts (continued):
 - In June 1988 Mr Gye obtained judgment against Ms McIntyre in the NSWSC for damages for deceit in the sum of \$214,600.89 plus costs.
 - Mr Gye applied to the Federal Court for a declaration that Ms McIntyre was not entitled to set-off the amount payable to her against the amount payable by her.



Leading authorities

- Finding at first instance:
 - Hill J made the declaration sought by Mr Gye.



Leading authorities

- Finding at first instance:
 - Hill J made the declaration sought by Mr Gye.
- On Appeal:
 - The Full Court of the Federal Court allowed Ms McIntyre's appeal.



Leading authorities

- High Court Appeal:
 - The High Court dismissed Mr Gye's appeal and upheld the decision of the Full Court of the Federal Court





Leading authorities

Ex parte Parker (1997) 80 FCR 1





Leading authorities

Ex parte Parker (1997) 80 FCR 1



Purpose of s 553C

1. “to do substantial justice between the parties”: ***Gye v McIntyre*** at 618 citing *Forster v Wilson* (1843) 12 M.&W.191
2. “Where there are genuine mutual debts, credits or other dealings, it would be unjust if the trustee in bankruptcy could insist upon having 100 cents in the dollar...but at the same time insist that the bankrupt’s debtor must be satisfied with a dividend of some few cents in the dollar...”: ***Gye v McIntyre*** at 618.
3. The provision should be given the widest possible scope.



Meaning of 'mutual'

'Mutual' conveys the notion of reciprocity.

It does not mean 'identical' or 'the same'.

Three aspects of mutuality:

1. Between the same parties
2. The same equitable or beneficial interests
3. Commensurable for the purpose of set-off i.e. must ultimately sound in money

The credits, debts or claims don't need to be vested, liquidated or enforceable.



Mutual credits

Byles J in ***Naoroji v Chartered Bank of India*** (1868) LR 3 CP 444 said that mutual credits are reciprocal demands which must naturally terminate in a debt.

The High Court in ***Gye v McIntyre*** said that given this definition, it was clear that liquidated demands arise in respect of mutual credits. It is also arguable that unliquidated demands also arise in respect of mutual credits.



Mutual debts

The term 'mutual debts' refers to debts that were both in existence and presently payable before the date of the winding up order.

It doesn't matter how the debts arise, whether by contract, statute or tort, voluntarily or by compulsion.

The expression doesn't include unliquidated damages claims, but may include, for example, an award of costs made by a court which is yet to be quantified by taxation or agreement.



Mutual dealings

The introduction of 'mutual dealings' was intended to:

1. Give a more extended right of set-off
2. Ensure the scope of the provision was not frustrated by a narrow or technical definition of 'credits' or 'debts'

The word 'dealings' is used in a non-technical sense.

It has been construed as referring to matters having a commercial or business flavour.

It encompasses commercial transactions and the negotiations leading up to them.





Notice required under 553C(2)

Timing of the Notice

- Whether a party is on notice of insolvency is to be determined not by reference to when the relevant debt became payable, but when the relevant obligation was incurred, usually being the date of any underlying pre-liquidation contract.





Notice required under 553C(2)

What is required for 'notice of the fact that the company was insolvent'?

- s 553C(2) requires more than reasonable grounds for suspecting insolvency.
- The test is whether the creditor had notice of facts that would have indicated to a reasonable person the fact that the company was insolvent.





Notice required under 553C(2)

- A person will have notice of the fact that a company is insolvent if the person has actual notice of facts which disclose that the company lacks the ability to pay its debts when they fall due.
- What is required is proof of facts known to the creditor which warrant the conclusion of insolvency.





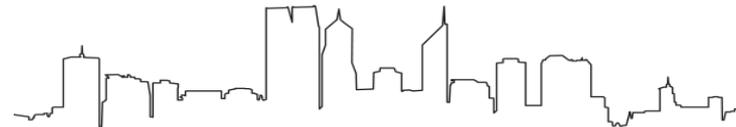
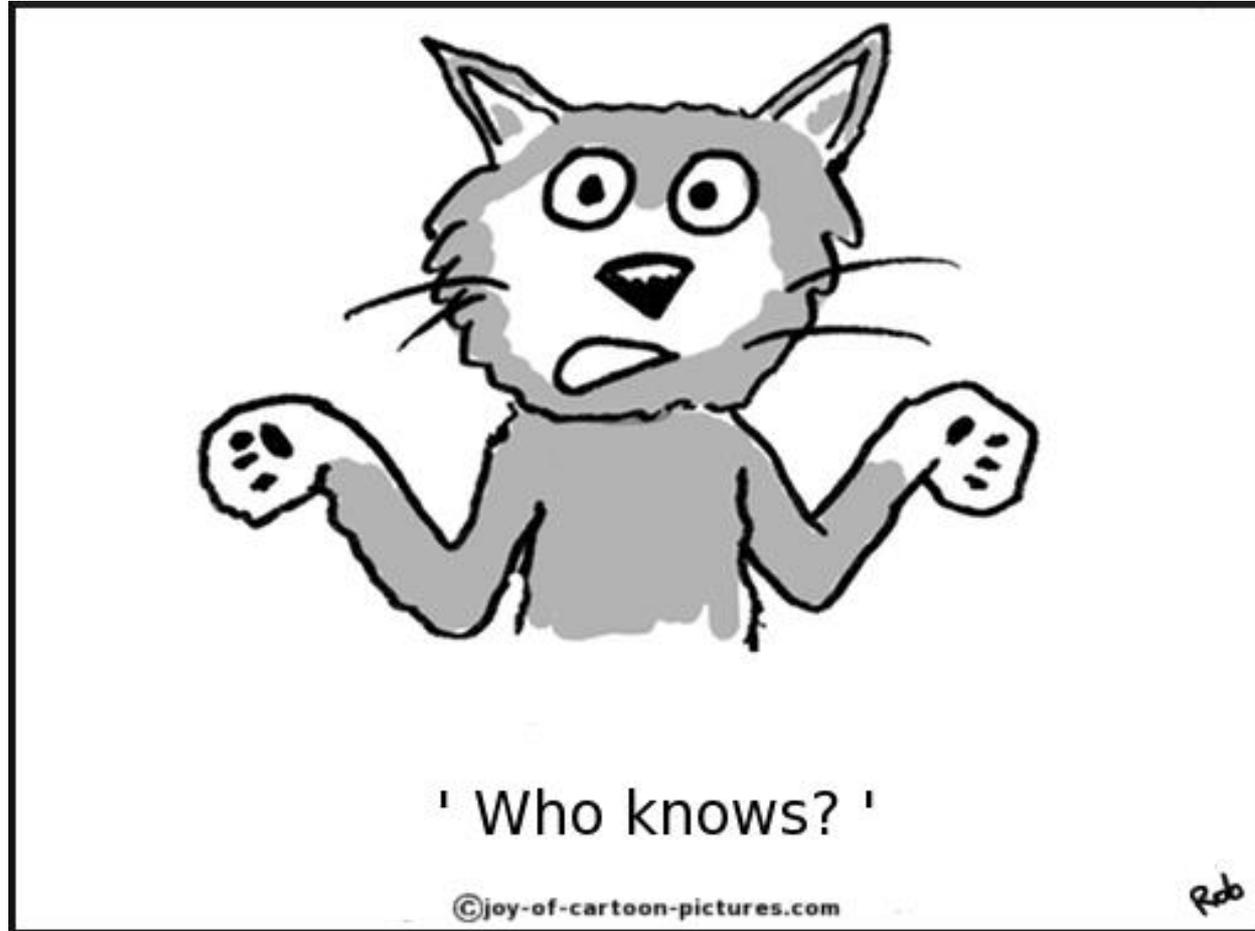
Preference payments

Can a set-off under s 553C be relied on as a defence to the various statutory recovery claims available to a company's liquidator under the Corporations Act (e.g. unfair preferences, uncommercial transactions, void dispositions and insolvent trading)?





Preference payments





Preference payments

The starting point in Australia is *Re Parker*
(1997) 80 FCR 1





Preference payments

Re Parker (1997) 80 FCR 1



Preference payments

Re Parker (1997) 80 FCR 1

- Facts
 - The applicant was one of two joint liquidators of Barossa Ceramics (SA) Pty Ltd.



Leading authorities

Ex parte Parker (1997) 80 FCR 1

- Facts
 - The applicant was one of two joint liquidators of Barossa Ceramics (SA) Pty Ltd.
 - Amber Ceramics (SA) Pty Ltd was the holder of all of the issued capital in Barossa.



Leading authorities

Ex parte Parker (1997) 80 FCR 1

- Facts
 - The applicant was one of two joint liquidators of Barossa Ceramics (SA) Pty Ltd.
 - Amber Ceramics (SA) Pty Ltd was the holder of all of the issued capital in Barossa.
 - On 30 May 1995, it was resolved under s 436A of the Corporations Law to appoint joint and several administrators to Barossa.





Leading authorities

- Facts (continued)
 - On 27 June 1995 the creditors of Barossa resolved that the company be wound up and that the joint and several administrators be appointed joint and several liquidators.



Leading authorities

- Facts (continued)
 - On 27 June 1995 the creditors of Barossa resolved that the company be wound up and that the joint and several administrators be appointed joint and several liquidators.
 - On 2 June 1995, Westpac appointed joint and several receivers and managers to the property of Amber pursuant to powers granted under a charge.



Leading authorities

- Facts (continued)
 - Amber lodged a formal proof of debt in the liquidation of Barossa.



Leading authorities

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 - Amber lodged a formal proof of debt in the liquidation of Barossa.
 - The liquidators admitted the bulk of the claim but expressed a tentative view that they may have a claim against Amber under s 588W in respect of breaches of s 588V.





Leading authorities

- Facts (continued)
 - Amber lodged a formal proof of debt in the liquidation of Barossa.
 - The liquidators admitted the bulk of the claim but expressed a tentative view that they may have a claim against Amber under s 588W in respect of breaches of s 588V.
 - The issue was whether the liquidators were permitted to set off against the admitted debt the amount of their claim under s 588W.



Leading authorities

- Amber's contentions

Amber argued there was no entitlement to set-off because the element of mutuality was lacking. The company put forward three arguments:



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Leading authorities

- Amber's contentions

Amber argued there was no entitlement to set-off because the element of mutuality was lacking. The company put forward three arguments:

1. The claim under s 588V was a statutory claim which didn't result in any mutual dealing;
2. The applicant's claim would only arise after the commencement of the winding up, whereas Amber's claim arose out of events before the winding up.





Leading authorities

3. By the date of the winding up resolution, Amber's claim had vested in Westpac and so there was no mutuality because the respective claims of Amber and Barossa were not in the same interests.





Preference payments

Findings:

1. The Court confirmed the general principles enunciated in *Gye v McIntrye*.



Preference payments

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2. Section 553C does not require that there must be mutual dealings between the parties in order to found a set off. Mutual debts are sufficient.



Preference payments

Findings:

1. The Court confirmed the general principles enunciated in *Gye v McIntrye*
2. Section 553C does not require that there must be mutual dealings between the parties in order to found a set off. Mutual debts are sufficient.
3. There is no logical or principled reason to exclude statutory debts from the compass of s 553C.



Preference payments

Findings (continued):

4. It did not matter that the claim was brought by the liquidator in his own name rather than in the name of Barossa. As a matter of substance, the claim under s 588V and 588W was the claim of Barossa. The fact that the claim is enforced by the liquidator is merely a procedural device for enforcing a claim of the company.



Preference payments

Findings (continued):

5. The fact that the claim under ss 588V and 588W is only perfected as a consequence of the liquidation does not disqualify it from being eligible for set off under s 553C.





Preference payments

Findings (continued):

6. The date for considering whether mutual debts exist for the purposes of s 553C is the cut off date for proof of debts in the winding up, not the date on which the creditors of Barossa resolved to wind up the company. This was the date on which Barossa resolved under s 436A to appoint the applicant as administrator of the company.





Preference payments

Findings (continued):

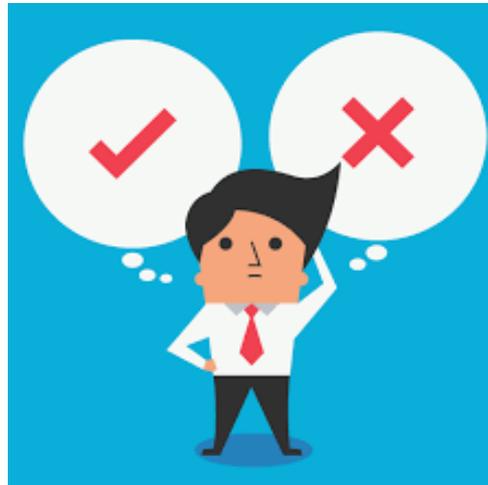
7. The applicant was entitled to set off, against the amount of Amber's admitted claim, the amount of the claim the liquidator had against Amber pursuant to s 588V and 588W.





Preference payments

Is this decision wrong?





Preference payments

Rory Derham, a Sydney barrister, and author of *Derham on the Law of Set-off* thinks so.





Preference payments

Derham puts forward **three reasons** as to why a set-off should not be available as a defence to the various statutory recovery claims:



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1. A set-off is contrary to the statutory purpose of the claims, being to benefit unsecured creditors.



Preference payments

Derham puts forward **three reasons** as to why a set-off should not be available as a defence to the various statutory recovery claims:

1. A set-off is contrary to the statutory purpose of the claims, being to benefit unsecured creditors.
2. Lack of mutuality.





Preference payments

3. The statutory claims do not arise until after the time for determining the availability of set-offs.





Construction Contracts

Facade Treatment Engineering Pty Ltd (in liquidation) v Brookfield Multiplex Constructions Pty Ltd [2016] VSCA 247





Construction Contracts

Facade Treatment Engineering Pty Ltd (in liquidation) v Brookfield Multiplex Constructions Pty Ltd [2016] VSCA 247

This case involved provisions of the *Building and Construction Industry Security of Payment Act 2002* (Vic) (**Act**).

WA has similar provisions in our *Construction Contracts Act 2004* (WA), although they are not exactly the same.





Construction Contracts

Facade Treatment Engineering Pty Ltd (in liquidation) v Brookfield Multiplex Constructions Pty Ltd [2016] VSCA 247

- Facts
 - Brookfield Multiplex was the head contractor.



Construction Contracts

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- Facts
 - Brookfield Multiplex was the head contractor.
 - Facade was the subcontractor.



Construction Contracts

Facade Treatment Engineering Pty Ltd (in liquidation) v Brookfield Multiplex Constructions Pty Ltd [2016] VSCA 247

- Facts
 - Brookfield Multiplex was the head contractor.
 - Facade was the subcontractor.
 - Facade issued two valid payment claims.





Construction Contracts

- Facts (continued)
 - The first was partly paid by Multiplex. The balance remained outstanding.





Construction Contracts

- Facts (continued)
 - The first was partly paid by Multiplex. The balance remained outstanding.
 - No valid payment schedule (which was a requirement under the Act) was issued by Multiplex.





Construction Contracts

- Facts (continued)
 - The first was partly paid by Multiplex. The balance remained outstanding.
 - No valid payment schedule (which was a requirement under the Act) was issued by Multiplex.
 - When no valid payment schedule is issued, Multiplex is liable for the entire payment claim.



Construction Contracts

- Facts (continued)
 - The purpose of the Act was to ensure, in effect, subcontractors received cash flow while they were a going concern.





Construction Contracts

- Facts (continued)
 - The purpose of the Act was to ensure, in effect, subcontractors received cash flow while they were a going concern.
 - The Act didn't prevent, for example, Multiplex making a counterclaim against Facade under the subcontract, it just prevented those counterclaims from being relied upon by Multiplex for not paying valid payment claims.





Construction Contracts

- Facts (continued)
 - Under the Act, Facade was entitled to enter judgment and enforce judgment against Multiplex for those payment claims which remained unpaid and for which no valid payment schedule was issued.





Construction Contracts

- Facts (continued)
 - Under the Act, Facade was entitled to enter judgment and enforce judgment against Multiplex for those payment claims which remained unpaid and for which no valid payment schedule was issued.
 - The question in this case was whether this provision applied in circumstances where the subcontractor, Facade, had been wound up.





Construction Contracts

- Facts (continued)
 - Multiplex argued that Facade could not enter judgment because the provisions of the Act were inconsistent with the Corporations Act (specifically s 553C) and so the Corporations Act (being Federal legislation) should prevail.



Construction Contracts

- Facts (continued)
 - Multiplex argued that Facade could not enter judgment because the provisions of the Act were inconsistent with the Corporations Act (specifically s 553C) and so the Corporations Act (being Federal legislation) should prevail.
 - Multiplex asserted it had significant counterclaims against Facade in connection with the subcontract, including:





Construction Contracts

- Facts (continued)
 - Additional costs to complete the work of the sub-contract, in the realm of \$1.85 million; and





Construction Contracts

- Facts (continued)
 - Additional costs to complete the work of the sub-contract, in the realm of \$1.85 million; and
 - Liquidated damages in the amount of \$52,870 per day, which equated to \$10,309,650





Construction Contracts

- Findings:
 - The Court of Appeal held in favour of Multiplex.





Construction Contracts

- Findings:
 - The Court of Appeal held in favour of Multiplex.
 - The Act does not create an entitlement to progress payments for companies in liquidation (that is, companies in respect of which a winding-up order has been made).





Construction Contracts

- Findings:
 - The provisions of the Act (which preclude a respondent in proceedings to recover an unpaid payment claim from bringing any cross-claims or defences) are inconsistent with the right to set-off under s 553C and so the Corporations Act prevails to the extent of that inconsistency.





Construction Contracts

- Findings:
 - The provisions of the Act (which preclude a respondent to proceedings to recover an unpaid payment claim from bringing any cross-claims or defences) are inconsistent with the right to set-off under s 553C and so the Corporations Act prevails to the extent of that inconsistency.
 - The court then considered the application, if any, of s 553C(2) and whether Multiplex is precluded from relying on s 553C(1) because of its knowledge of Facade's insolvency.





Construction Contracts

- Findings:
 - The Court of Appeal upheld the primary Judge's decision to conclude that the relevant time to assess whether Multiplex had notice under s 553C(2) was the date on which the subcontract was executed.



Construction Contracts

- Findings:
 - The primary Judge had relied upon *Grapecorp Management Pty Ltd (in liq) v Grape Exchange Management Euston Pty Ltd* in which it was held that “*the relevant time for assessing notice of insolvency, is not when the debt became payable, but when the obligation which arose from it was incurred. This is usually the date of the underlying antecedent pre-liquidation contract that underpins the contingency*”.



Questions

