

**New South Wales
Law Reform Commission**

**Report
94**

SET-OFF

February 2000

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New South Wales Law Reform Commission

To the Honourable Jeff Shaw QC MLC
Attorney General for New South Wales

Dear Attorney

Set-off

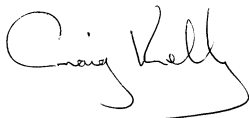
We make this final Report pursuant to the reference to this Commission dated
26 September 1997.



The Hon Justice Michael Adams
Chairperson



The Hon Justice David Hodgson
Commissioner



Mr Craig Kelly
Commissioner



Professor Michael Tilbury
Commissioner

February 2000

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Terms of reference

1.1 On 26 September 1997 the New South Wales Law Reform Commission received a reference from the Attorney General, the Honourable J W Shaw, QC, MLC, as follows:

1. To review the current law relating to set-off with a view to determining whether any change is needed.
2. In undertaking the review the Commission should have regard to the law relating to set-off that existed prior to the *Imperial Acts Application Act 1969* and to judicial comment on the operation of the provisions in this Act relating to set-off.

Participants

Pursuant to s 12A of the *Law Reform Commission Act 1967* (NSW) the Chairperson of the Commission constituted a Division for the purpose of conducting the reference. The members of the Division are:

The Hon Justice Michael Adams
The Hon Justice David Hodgson*
Mr Craig Kelly
Professor Michael Tilbury

(* denotes Commissioner-in-Charge)

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Administrative Assistance

Ms Wendy Stokoe

LIST OF RECOMMENDATIONS

Recommendation 1 (page 30)

That set-off as established by the Statutes of Set-off be reintroduced.

Recommendation 2 (page 41)

That the reintroduction of the law established by the Statutes of Set-off be by restatement in modern legislative form and style.

Recommendation 3 (page 47)

The restatement should contain a provision to the effect that set-off is available where the debts are due and payable at the time when the defence of set-off is filed.

Recommendation 4 (page 49)

That the restatement include express provision that parties may exclude set-off under the Statutes of Set-off by agreement.

Recommendation 5 (page 51)

That, subject to any agreement to the contrary, the new provision apply to any debt whether arising before or after its commencement. However, the courts shall have a discretion to disallow set-off in relation to a debt arising under an agreement entered into before the commencement of the provision, if it is satisfied that it would be in the interests of justice to make such an order.

1. Introduction

- The reference
- Definition of set-off
- Types of set-off

THE REFERENCE

1.1 On 26 September 1997 the New South Wales Law Reform Commission received a reference from the Attorney General, the Honourable J W Shaw, QC, MLC, as follows:

1. To review the current law relating to set-off with a view to determining whether any change is needed.
2. In undertaking the review the Commission should have regard to the law relating to set-off that existed prior to the *Imperial Acts Application Act 1969* and to judicial comment on the operation of the provisions in this Act relating to set-off.

1.2 This reference was made following a request from Justice K R Handley that consideration be given to rectifying the situation caused by the repeal of the Statutes of Set-off¹ by the *Imperial Acts Application Act 1969* (NSW). Justice Handley's view was that the repeal had been a mistake.²

1.3 The Commission published a Discussion Paper ("DP 40") in March 1998.³ Our tentative proposal was that a plain English restatement of the law of set-off as established by the Statutes of Set-off be enacted in New South Wales. Four submissions were received in response to DP 40,⁴ and four submissions were received on a draft bill which was circulated to interested parties.⁵

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1. 2 Geo II c 22 (1729) s 13 and 8 Geo II c 24 (1735) s 4 and 5.
 2. K R Handley, *Letter to the Chairman of the NSW Law Reform Commission* (28 February 1994).
 3. New South Wales Law Reform Commission, *Set-off* (Discussion Paper 40, 1998).
 4. W V Windeyer, *Submission*; Law Society of NSW, *Submission 1*; S R Derham and Victorian Bar Council, *Submission*; M Wormell, *Submission*.
 5. Law Society of NSW, *Submission 2*; S R Derham, *Submission*; J C Campbell, *Submission*; K R Handley, *Submission*.

DEFINITION OF SET-OFF

1.4 Set-off, at its most basic, is a mechanism whereby one party can apply a debt owed to him or her by another party to discharge all or part of a debt that he or she owes to that other party.⁶ The result is either that the debt is completely discharged, or a sum remains which represents the balance of the debt owed by one of the parties to the other.⁷ Although sometimes invoked as a self help remedy, it is usually applied as a countervailing claim in answer to a plaintiff's claim in proceedings before a court. In the context of such proceedings set-off is quite different from counterclaim.

Comparison with counterclaim

1.5 While set-off as a plea in bar is a defence in whole or in part to a claim, counterclaim is merely a procedural device (involving cross-claim) whereby actions by one party against the other and vice versa are heard as part of the one proceeding. Such actions are treated essentially as distinct actions, including for the purposes of striking out, summary judgment⁸ and costs in the proceeding.⁹ Although the economic result of counterclaim will often be the same as the one which would be achieved by set-off, the result of a hearing involving claim and counterclaim is separate judgments for each party against the other,¹⁰ whereas a single judgment only is issued when set-off is pleaded.

6. Where a joint debt is owed to a creditor, however, one of the joint debtors cannot set off a debt owed separately to him or her by the creditor: *Vale of Clwydd Coal Co v Garsed* (1885) 2 WN 14.

7. See M B Hapgood, "Rights of Set-off as Security" in F W Neate (ed), *Using Set-off as Security* (Graham & Trotman, London, 1990) at 22.

8. See P R Wood, *English and International Set-off* (Sweet & Maxwell, London, 1989) at para 6-46.

9. See P R Wood, *English and International Set-off* (Sweet & Maxwell, London, 1989) at para 6-42.

10. See R P Meagher, W M C Gummow and J R F Lehane, *Equity: Doctrines and Remedies* (3rd edition, Butterworths, Sydney, 1992) at para 3701.

TYPES OF SET-OFF

1.6 There is no general right to set-off at common law. The three basic types of set-off which have developed are:¹¹

- contractual set-off;
- set-off provided for by statute; and
- equitable set-off.

There are also some related remedies and procedures which cannot necessarily be said to be a type of set-off, but are analogous in certain respects.

Contractual set-off

1.7 Contractual set-off, or set-off by agreement, arises in the same manner as any other contractual term would, for example, expressly, by implication, from course of conduct, or by custom. This form of set-off is useful in circumstances where other forms of set-off are not available. Set-off by agreement has been recognised in New South Wales as not depending on any statutory foundation, but as being “in law equivalent to actual payment on each side”.¹²

1.8 A related issue is that of netting, which has recently been the subject of Commonwealth legislative action.¹³ The forms of netting dealt with by the Commonwealth are:

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11. See S McCracken, *The Banker's Remedy of Set-off* (Butterworths, London, 1993) at 47.
 12. *Re Application of Keith Bray Pty Ltd* (1991) 23 NSWLR 430 at 431 (McLelland J). See also *Pro-image Studios v Commonwealth Bank of Australia* (1991) 4 ACSR 586 at 589-590 (Vic SC). This may be an aspect of the “common law” set-off referred to by Young J who noted that the line of authorities relied on may have depended upon there being an “express or implied agreement that there would only be an account for the balance due”: *P Rowe Graphics Pty Ltd v Scanagraphix Pty Ltd* (NSW, Supreme Court, No 1429/1988, Young J, 6 September 1988, unreported) at 9.
 13. *Payment Systems and Netting Act 1998* (Cth).

- **Multilateral netting.** This is a form of set-off involving more than two parties, whereby parties with many dealings with each other agree to set-off at the end of each trading day; that is, each party's net obligation, as opposed to its gross obligations, is calculated.¹⁴
- **Close-out netting.** This is described as "a process which permits a party to a financial contract to terminate the contract if the counterparty becomes insolvent, to calculate the termination values of the obligations of the parties, and to set off the termination values so calculated to arrive at a net amount payable by one party to the other".¹⁵
- **Market netting.** Typically refers to netting undertaken in accordance with the rules of a stock exchange, futures exchange or clearing house. It commonly involves "the novation to a clearing entity of contracts entered into by exchange members and the setting off of obligations under those contracts in the event of default by the member and for the purposes of settlement".¹⁶

1.9 The aim of the Commonwealth legislation has been to provide legal certainty in relation to these forms of netting, particularly in circumstances where one of the parties becomes insolvent.¹⁷ The operation of this legislation is clearly within the Commonwealth's field of legislative competence and is principally concerned with ensuring that other Commonwealth laws do not hinder the operation of netting agreements.

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14. *Payment Systems and Netting Act 1998* (Cth) s 5 and Part 3.
 15. Australia, Netting Sub-committee of the Companies and Securities Advisory Committee, *Netting in Financial Markets Transactions* (Final Report, 1997) at para 1.1. See also *Payment Systems and Netting Act 1998* (Cth) s 5 and Part 4.
 16. Australia, Netting Sub-committee of the Companies and Securities Advisory Committee, *Netting in Financial Markets Transactions* (Final Report, 1997) at para 1.2. See also *Payment Systems and Netting Act 1998* (Cth) s 5 and Part 5.
 17. Australia, *Parliamentary Debates (Hansard)* House of Representatives, 1 April 1998, the Hon C G Miles, Parliamentary Secretary to the Prime Minister, Second Reading Speech at 2065-2066. See also Explanatory Memorandum to the *Payment Systems and Netting Bill 1998* (Cth).

Set-off provided for by statute

Set-off under insolvency legislation

1.10 Set-off provided for under insolvency legislation is the oldest form of statutory set-off.¹⁸ It dates from 1705 when 4 & 5 Anne c 17 (1705)¹⁹ s 11 was enacted. The modern Australian statement of this provision is s 86 of the *Bankruptcy Act 1966* (Cth).²⁰ This provision allows set-off where there are “mutual credits, mutual debts or other mutual dealings” and has been described as more comprehensive than the provisions in the Statutes of Set-off.²¹ Indeed, given its broad coverage, it has been held to be a code²² so that, in circumstances involving the insolvency of one of the parties, the set-off provided for by insolvency legislation is exclusive of all other forms of set-off, including in equity or under the Statutes of Set-off.²³

Set-off under the Statutes of Set-off

1.11 Set-off was provided for more generally in England by s 13 of 2 Geo II c 22 (1729) and s 4 and 5 of 8 Geo II c 24 (1735).²⁴ This kind

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18. Although there is a possibility that there may have been recognition of set-off in bankruptcy at common law: *Anonymous* (1676) 1 Mod 215; 86 ER 837; *Chapman v Derby* (1689) 2 Vern 117; 23 ER 684; *Green v Farmer* (1768) 4 Burr 2214 at 2221; 98 ER 154 at 158. See also the discussion on the origins of set-off in bankruptcy in *Gye v Davies* (1995) 37 NSWLR 421 at 424-425 (Powell JA); and W H Loyd, “The Development of Set-off” (1916) 64 *University of Pennsylvania Law Review* 541 at 547.
 19. Sometimes referred to mistakenly as 4 & 5 Anne c 4 which is, in fact, “An Act for the Naturalization of the most Excellent Princess Sophia, Electress and Duchess Dowager of Hanover, and the Issue of her Body”.
 20. See also s 553C of the *Corporations Law* (Cth) which reproduces the substance of s 86 for the purposes of the winding up of companies. Set-off is not available if a company enters voluntary administration under Part 5.3A of the *Corporations Law* (Cth).
 21. See *Gye v McIntyre* (1991) 171 CLR 609.
 22. *Day & Dent Constructions Pty Ltd v North Australian Properties Pty Ltd* (1981) 34 ALR 595 at 601.
 23. But see *McIntyre v Perkes* (1990) 22 FCR 260 at 271-272 (Gummow and Von Doussa JJ).
 24. Statutes dealing with set-off can be traced in the American colonies to the enactment of a statute in Virginia in 1645: W H Loyd,

of set-off is limited to mutual claims that are liquidated or ascertainable with certainty and which are due and payable at the time the plaintiff commenced his or her action at law. As a result of the *Imperial Acts Application Act 1969* (NSW) this form of set-off is no longer applicable in New South Wales. Set-off under the Statutes of Set-off is discussed more fully in the rest of this Report.

Set-off under the Supreme Court Act and Rules

1.12 Set-off was also found to have been available in New South Wales under s 78 of the *Supreme Court Act 1970* (NSW) and the now omitted Part 15 r 25 of the *Supreme Court Rules 1970* (NSW) which provided:

Where a claim by a defendant to a sum of money (whether of an ascertained amount or not) is relied on as a defence to the whole or part of a claim made by a plaintiff, it may be included in the defence and set off against the plaintiff's claim, whether or not the defendant also cross-claims for that sum of money.²⁵

1.13 Part 15 r 25 was omitted from the *Supreme Court Rules 1970* (NSW) in 1984.²⁶ This followed recommendations by the Rule Committee of the Supreme Court who concluded that the only set-off then recognised in New South Wales was equitable set-off and that, therefore, the term "set-off" should be "banned from procedural law because of its capacity to suggest that a legal claim being set-off is by nature defensive".²⁷

"The Development of Set-off" (1916) 64 *University of Pennsylvania Law Review* 541 at 553-562.

25. Cf *Rules of the Supreme Court 1965* (Eng) O 18 r 17. This ties in with s 91(2) of the *Supreme Court Act 1970* (NSW) which provides:

"Where there is a claim by a plaintiff and a claim under section 78 by a defendant, the Court may:

(a) give judgment for the balance only of the sums of money awarded on the respective claims; or

(b) give judgment in respect of each claim
and the Court may give judgment similarly where several claims arise between plaintiffs, defendants and any other parties."

26. *Supreme Court Rules (Amendment No 154) 1984* (NSW).

27. H H Glass, *Memorandum to McClelland J, Rogers J and Secretary of the Rule Committee* (9 May 1984) attached to A Rogers, *Letter to C Phegan* (23 July 1984). See also P W Young, K F O'Leary and

Equitable set-off

1.14 Meagher, Gummow and Lehane have identified four distinct kinds of equitable set-off.²⁸

- Where equity recognises a right of set-off which exists at law (that is, in the case of set-off, under statute).
- Where an equitable set-off exists by analogy with statutory set-off.
- Where an equitable set-off exists by agreement.
- Where true equitable set-off can be said to exist.

1.15 The early cases on “true” equitable set-off have been interpreted as requiring:

- (i) clear cross-claims for debts or damages, which
- (ii) were so closely related as to subject-matter that the claim sought to be set-off impeached the other in the sense that it made it positively unjust that there should be recovery without deduction.²⁹

1.16 Another aspect of the “equitable jurisdiction” of the court is that it can order that the costs of the parties to a proceeding be set off. This right was once supposed to originate under the Statutes of Set-off, but since 1791 it has been recognised as part of the equitable jurisdiction of the court.³⁰ Justice Young in a recent case quoted *Montagu on Set-off* as stating:

Opposite demands arising upon judgments may upon motion be set-off against each other, whenever such set-off is equitable though the judgments are in different courts, and though the

A E Hogan, *Supreme Court Civil Procedures: New South Wales* (2nd edition, Butterworths, Sydney, 1987) at para 14.104.

28. R P Meagher, W M C Gummow and J R F Lehane, *Equity: Doctrines and Remedies* (3rd edition, Butterworths, Sydney, 1992) at para 3707.

29. *D Galambos & Son Pty Ltd v McIntyre* (1974) 5 ACTR 10 at 18. See also *Lord v Direct Acceptance Corporation Ltd* (1993) 32 NSWLR 362 at 367; and S R Derham, *Set-off* (2nd edition, Clarendon Press, Oxford, 1996) at 53-56. But see *AWA Ltd v Exicom Australia Pty Ltd* (1990) 19 NSWLR 705.

30. *Mitchell v Oldfield* (1791) 4 TR 123; 100 ER 929.

parties to the different records are not the same. Costs may be set-off against costs only, or against debt and costs.³¹

Justice Young has noted that this basis for the setting off of costs is important in light of the repeal of the Statutes of Set-off in New South Wales.³²

Rights analogous to set-off

1.17 There are several rights which, while they cannot strictly be classified as forms of set-off, are closely analogous and have even, on occasions, been taken to be forms of set-off. They may be of particular interest to jurisdictions, such as New South Wales, where set-off is no longer generally available by statute, for example, in situations where the assignee of a debt takes subject only to any equitable set-off or such analogous rights as may be available.³³

Liability arising from a running account

1.18 Liability arising from a running account does not involve a question of competing claims. The sum owed by either party is only determined once a balance has been struck between the parties' transactions,³⁴ that is usually when a bank exercises it as a self-help remedy.³⁵

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31. *Wentworth v Wentworth* (NSW, Supreme Court, No 3748/1989, Young J, 12 December 1994, unreported) at 3-4 quoting *Montagu on Set-off* (American edition, 1825) at 6-8.
 32. *Wentworth v Wentworth* (NSW, Supreme Court, No 3748/1989, Young J, 12 December 1994, unreported) at 4.
 33. See S R Derham, *Set-off* (2nd edition, Clarendon Press, Oxford, 1996) at 573; and para 3.12 below.
 34. R P Meagher, W M C Gummow and J R F Lehane, *Equity: Doctrines and Remedies* (3rd edition, Butterworths, Sydney, 1992) at para 3702.
 35. Wood, however, has identified it as a form of set-off called "current account set-off": P R Wood, *English and International Set-off* (Sweet & Maxwell, London, 1989) at para 3-4.

Abatement

1.19 The common law right of abatement is a defence which is generally limited to contracts for sale of goods or for work or labour³⁶ and can be invoked by a defendant to reduce the value of goods and services supplied by the plaintiff where, for some reason, the goods and services in fact supplied did not justify the payment of the full agreed price by the defendant.³⁷ Abatement has been identified by some as a form of set-off,³⁸ and has been seen as an attempt on the part of the common law to avoid the rigours of the Statutes of Set-off.³⁹

The rule in *Cherry v Boulton*

1.20 The rule in *Cherry v Boulton*⁴⁰ applies where there is a person who is liable to contribute to a fund such as a deceased estate, trust fund, or insolvent estate⁴¹ and that person seeks to take a part of the net assets of that fund without first contributing to it. The rule prevents the person from receiving anything from the fund without first making

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36. See P R Wood, *English and International Set-off* (Sweet & Maxwell, London, 1989) at para 4-35.
 37. See *Mondel v Steel* (1841) 8 M&W 858 at 871-872; 151 ER 1288 at 1293-1294; and *Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd* [1974] AC 789 at 699 (Lord Morris) and at 717 (Lord Diplock). See also P R Wood, *English and International Set-off* (Sweet & Maxwell, London, 1989) at para 4-32 - 4-37. Abatement with respect to contracts for sale of goods is now provided for by s 54(1)(a) of the *Sale of Goods Act 1923* (NSW).
 38. Young J has identified abatement as one of seven probable types of set-off: *P Rowe Graphics Pty Ltd v Scanagraphix Pty Ltd* (NSW, Supreme Court, No 1429/1988, Young J, 6 September 1988, unreported) at 6. See also P R Wood, *English and International Set-off* (Sweet & Maxwell, London, 1989) at para 1-20 - 1-25.
 39. See P R Wood, *English and International Set-off* (Sweet & Maxwell, London, 1989) at para 1-20 - 1-25.
 40. (1839) 4 Myl & Cr 442; 41 ER 771.
 41. See P R Wood, *English and International Set-off* (Sweet & Maxwell, London, 1989) at para 8-30 - 8-78 for a full discussion of situations where the rule may be applied. See also S R Derham, *Set-off* (2nd edition, Clarendon Press, Oxford, 1996) at 436-451.

the required contribution.⁴² It is applied in situations where set-off is not available.⁴³

42. A recent application of the rule was *Saltergate Insurance Co Ltd and the Companies Act (No 2)* [1984] 3 NSWLR 389 at 393.

43. While classing it as one of seven different types of set-off, Justice Young has noted that strictly speaking the application of the rule in *Cherry v Boulton* is not a set-off, although it is “closely analogous to it”: *P Rowe Graphics Pty Ltd v Scanagraphix Pty Ltd* (NSW, Supreme Court, No 1429/1988, Young J, 6 September 1988, unreported) at 12. Wood has identified the rule in *Cherry v Boulton* as “retainer” or “fund set-off”: P R Wood, *English and International Set-off* (Sweet & Maxwell, London, 1989) at para 8-6. On the distinction between the right under *Cherry v Boulton* and set-off see S R Derham, *Set-off* (2nd edition, Clarendon Press, Oxford, 1996) at 439-442.

Set-off

2. The Statutes of Set-off

- History
- Interpretation of the Statutes of Set-off
- Nature of the right established by the Statutes of Set-off
- Application and repeal in New South Wales

HISTORY

2.1 The provisions conventionally referred to as the Statutes of Set-off are contained in two statutes from the reign of George II. The first is s 13 of 2 Geo II c 22 (1729) which states:

And be it further enacted by the Authority aforesaid, That where there are mutual Debts between the Plaintiff and Defendant, or if either Party sue or be sued as Executor or Administrator, where there are mutual Debts between the Testator or Intestate and either Party, one Debt may be set against the other, and such Matter may be given in Evidence upon the General Issue, or pleading in Bar, as the Nature of the Case shall require, so as at the Time of his pleading the General Issue, where any such Debt of the Plaintiff, his Testator or Intestate, is intended to be insisted on in Evidence, Notice shall be given of the particular Sum or Debt so intended to be insisted on, and upon what Account it became due, or otherwise such Matter shall not be allowed in Evidence upon such General Issue.

This allowed set-off in two circumstances:

1. Where there are mutual debts between an ordinary plaintiff and ordinary defendant; and
2. Where either the plaintiff or defendant is the executor or administrator of a deceased person with whom the other party has a mutual debt.

2.2 The provision dealing with actions by or against executors or administrators was necessary to cover situations in the administration of deceased estates where mutual debts could not be set off because all the assets of the estate had been applied to other debts of higher priority.¹ This was clearly to the disadvantage of the creditors of such deceased estates, in

1. See the report of *Hutchenson v Sturges* (Trin 14 & 15 Geo 2 in CB) in C Viner, *A General Abridgement of Law and Equity* (2nd edition, London, 1791) at 561 (notes to para 30) which states: “Now in the case of an executor, if he sues a common person upon a bond given to the testator, he must recover; whereas if the defendant was to sue him upon a simple contract of the testator, he might possibly not recover, upon account of superior debts.” This is a more detailed version of the judgment of Willes LCJ which is also reported as *Hutchinson v Sturges* (1741) Willes 261 at 262; 125 ER 1163.

the same way that it was to creditors of insolvent estates before the statute of 1705² remedied matters in respect of insolvency.

2.3 However, s 13 of the 1729 Act was interpreted by the courts as not allowing a debt to be set off against another debt deemed at law to be of a different nature. So, in the period immediately following 1729, it was held that a simple contract debt could not be set off against a specialty debt,³ a debt upon bond,⁴ or a debt for rent upon a parol lease.⁵ Section 13 of the 1729 Act was also subject to a sunset clause.⁶

2.4 These two deficiencies were resolved by the second set of provisions contained in s 4 and 5 of 8 Geo II c 24 (1735) which state:

4. And whereas Provision for setting mutual Debts one against the other, is highly just and ‘reasonable at all Times;’ Be it therefore further enacted by the Authority aforesaid, That the said Clause in the said first recited Act, for setting mutual Debts one against the other, shall be and remain in full Force forever.
5. And be it further enacted and declared by the Authority aforesaid, That by virtue of the said Clause in the said first recited Act contained, and hereby made perpetual, mutual Debts may be set against each other, either by being pleaded in Bar, or given in Evidence on the General Issue, in the Manner therein mentioned, notwithstanding that such Debts are deemed in Law to be of a different Nature; unless in Cases where either of the said Debts shall accrue by reason of a Penalty contained in any Bond or Specialty; and in all Cases where either the Debt for which the Action hath been or shall be brought, or the Debt intended to be set against the same hath accrued, or shall accrue, by reason of any such Penalty, the Debt intended to be set off, shall be pleaded in Bar, in which Plea shall be shewn how much is truly and justly due on either Side; and in case the Plaintiff shall recover in any such Action or Suit, Judgment shall be entred for no more than shall appear to be truly and justly due

2. 4 & 5 Anne c 17 (1705). See para 1.10 above.

3. *Kemys v Betson* (Trin 6 Geo 2) in C Viner, *A General Abridgement of Law and Equity* (2nd edition, London, 1791) Vol 8 at 561 (para 30).

4. *Stephens v Loftyn* (Mich 6 Geo 2 CB) in C Viner, *A General Abridgement of Law and Equity* (2nd edition, London, 1791) Vol 8 at 562 (para 31).

5. *Brown v Holyoak* (7 Geo 2) in C Viner, *A General Abridgement of Law and Equity* (2nd edition, London, 1791) at 562 (para 32).

6. 2 Geo II c 22 (1729) s 14.

to the Plaintiff, after one Debt being set against the other as aforesaid.

Section 4 made the provisions relating to set-off in the 1729 Act perpetual and s 5 allowed a debt to be set off against another debt even though it was of a different nature.

Reasons for their introduction

2.5 Before the passing of the Statutes of Set-off the common law did not allow set-off. This was noted by Lord Mansfield in 1759:

At common law, before these Acts, if the plaintiff was as much or even more indebted to the defendant than the defendant was indebted to him, yet the defendant had no method to strike a balance: he could only go into a Court of Equity, for doing what is most clearly just and right to be done.⁷

2.6 The precise reasons for the enactment of the Statutes are somewhat obscure, owing not least to the fact that publication of the debates of Parliament was, for most of the eighteenth century, considered to be a breach of privilege.⁸ Those who have attempted to ascertain the reasons for the enactment of the statutes have essentially arrived at two reasons which, stated broadly, are:⁹

- the idea that an injustice is done to the defendant in refusing the right to set-off; and
- the idea that unnecessary law suits are undesirable.

Injustice to defendants

2.7 Lord Mansfield, in 1768, observed that the refusal of the common law to allow set-off of mutual debts was shocking to the “natural sense of mankind”, and noted in particular in respect of pre-insolvency set-off:

7. *Collins v Collins* (1759) 2 Burr 820 at 826; 97 ER 579 at 582-583. See also *Sir William Darcy's Case* (1677) 2 Freeman 28; 22 ER 1037.

8. M F Bond, *Guide to the Records of Parliament* (HMSO, London, 1971) at 36.

9. See W H Loyd, “The Development of Set-off” (1916) 64 *University of Pennsylvania Law Review* 541 at 562.

the injustice of not setting off, (especially after the death of either party) was so glaring that Parliament interposed ...¹⁰

This may, however, have been no more than an assumption based on the wording of s 13 of the Act of 1729.

2.8 One particular aspect of the question of injustice to defendants related to the old practice of imprisoning debtors. The Act of 1729, which first introduced pre-insolvency set-off, was entitled:

An Act for the Relief of Debtors with respect to the Imprisonment of their Persons.

This aspect has come to be emphasised by more recent commentators.¹¹ McCracken, in her work on set-off, has also pointed to the fact that the first statute was enacted following reports to Parliament on the conditions in various (privately-run) debtors' prisons. Particular attention was paid to the means of preventing gaolers from extorting their prisoners.¹² McCracken acknowledges that none of the reports on imprisonment of debtors referred to set-off, but considers that the practical effect of the section on set-off was to keep a debtor out of gaol when it could be shown that a substantial amount was also owed the debtor by the creditor.¹³

Elimination of unnecessary law suits

2.9 The undesirability of unnecessary law suits has been the reason most often referred to by the courts as the rationale for statutory set-off. The earliest pronouncement was in 1741, just six years after the passing of the second statute, when Chief Justice Willes held:

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10. *Green v Farmer* (1768) 4 Burr 2214 at 2221; 98 ER 154 at 158.
 11. See S R Derham, *Set-off* (2nd edition, Clarendon Press, Oxford, 1996) at 9.
 12. A problem which continued into the 19th century: See, for example, C J H Dickens, *Little Dorrit* (1857); C J H Dickens, *David Copperfield* (1850); and C J H Dickens, *The Posthumous Papers of the Pickwick Club* (1837).
 13. S McCracken, *The Banker's Remedy of Set-off* (Butterworths, London, 1993) at 55. In the month immediately following the assent to the 1729 Act (*London Gazette* (13 May 1729-17 May 1729) at 1-2) many hundreds of imprisoned debtors gave notice of an intention to apply for relief under the Act: See especially the issues starting with *London Gazette* (20 May 1729-24 May 1729) at 3-8.

The true reason is that this was only substituted in the room of an action, to prevent circuity or a bill in equity.¹⁴

He again noted, in 1744, that the aim of the Statutes of Set-off was to prevent “multiplicity of actions”.¹⁵ This reason has been taken up by the courts throughout the succeeding centuries.¹⁶

INTERPRETATION OF THE STATUTES OF SET-OFF

2.10 Set-off under the Statutes of Set-off has been interpreted as:

- requiring that there be mutuality between the parties, that is, that the demands must be between the same parties and that the debts not be due to the parties in different rights;¹⁷
- only being available where the debts are liquidated or where money demands could be ascertained “readily and without difficulty” at the time of pleading;¹⁸
- not operating to extinguish or reduce a claim until judgment is given;¹⁹ and
- only being available where both debts are due and payable when the plaintiff commences his or her action at law.²⁰

14. *Hutchinson v Sturges* (1741) Willes 261 at 262; 125 ER 1163 at 1163.

15. *Pilgrim v Kinder* (1744) 7 Mod 463 at 467; 87 ER 1357 at 1360.

16. See, for eg, *Forster v Wilson* (1843) 12 M&W 191 at 203-204; 152 ER 1165 at 1171; *Day & Dent Constructions Pty Ltd v North Australian Properties Pty Ltd* (1981) 34 ALR 595 at 637; *Stehar Knitting Mills Pty Ltd v Southern Textile Converters Pty Ltd* [1980] 2 NSWLR 514 at 518 (Hutley JA); and *Gye v Davies* (1995) 37 NSWLR 421 at 425-427.

17. See S R Derham, *Set-off* (2nd edition, Clarendon Press, Oxford, 1996) at 319.

18. *Stooke v Taylor* (1880) 5 QBD 569 at 575 (Cockburn CJ). See also *Hanak v Green* [1958] 2 QB 9 at 17 and 23; and P R Wood, *English and International Set-off* (Sweet & Maxwell, London, 1989) at para 2-68 - 2-130.

19. *Stehar Knitting Mills Pty Ltd v Southern Textile Converters Pty Ltd* [1980] 2 NSWLR 514 at 518 (Hutley JA). See also *Covino v Bandag Manufacturing Pty Ltd* [1983] 1 NSWLR 237 at 238 (Hutley JA); and *Re John Dillon Ltd (In Liq); ex parte Jefferies* [1960] WAR 30.

NATURE OF THE RIGHT ESTABLISHED BY THE STATUTES OF SET-OFF

2.11 Traditionally set-off under the Statutes of Set-off has been characterised as procedural, whereas equitable set-off has been regarded as substantive. A classification as either substantive or procedural has, however, not been easy to make and some commentators have tended towards the view that set-off under the Statutes of Set-off is not purely procedural.²¹ The main reason for the characterisation as procedural has been that set-off under the Statutes of Set-off takes effect as at the date of judgment and separate and distinct debts remain until that time.²² Another reason has been seen as the early understanding of set-off as a means of avoiding circuity of court actions.²³ The New South Wales Court of Appeal in 1980 came down in favour of a procedural classification.²⁴ However, notwithstanding its characterisation as procedural, set-off under the Statutes of Set-off remains a defence, unlike counterclaim which is merely a procedural mechanism allowing separate actions to be tried together.²⁵ A consequence of the characterisation as procedural is that proceedings in court are required to effect set-off under the Statutes of Set-off.

2.12 Set-off under the Statutes of Set-off does, however, have some substantive effect as a defence, for example, where an assignee of a debt takes subject to any defence available to the debtor.²⁶ Derham has, therefore, noted that “any increase in the ambit of the defence of set-off will interfere with substantive rights, in the sense that it will have a substantive effect upon

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20. See P R Wood, *English and International Set-off* (Sweet & Maxwell, London, 1989) at para 2-131 - 2-185.
 21. See especially S R Derham, *Set-off* (2nd edition, Clarendon Press, Oxford, 1996) at 136; and S McCracken, *The Banker's Remedy of Set-off* (Butterworths, London, 1993) at 133.
 22. S R Derham, “Recent Issues in Relation to Set-off” (1994) 68 *Australian Law Journal* 331 at 339; and S McCracken, *The Banker's Remedy of Set-off* (Butterworths, London, 1993) at 115.
 23. See para 2.9 above. See also S McCracken, *The Banker's Remedy of Set-off* (Butterworths, London, 1993) at 117-121.
 24. *Stehar Knitting Mills Pty Ltd v Southern Textile Converters Pty Ltd* [1980] 2 NSWLR 514.
 25. S R Derham, “Recent Issues in Relation to Set-off” (1994) 68 *Australian Law Journal* 331 at 339.
 26. See para 3.12 below.

the rights of third parties such as assignees of debts, undisclosed principals and subrogated insurers”.²⁷

2.13 Another consequence of the characterisation as procedural can be felt in the area of conflict of laws. Set-off under the Statutes of Set-off has been said to be procedural for the purposes of conflicts of laws. Its operation is therefore governed by the *lex fori*, that is, according to the law of the court in the place where the matter is tried.²⁸ Wood has, however, noted that this characterisation was arrived at in the period before the “flowering of English private international law” and would prefer to characterise set-off under the Statutes of Set-off as substantive,²⁹ noting, amongst other things, that there is little sense in applying the *lex fori* in a situation where both claims, for example, are governed by a foreign system of law.³⁰

APPLICATION AND REPEAL IN NEW SOUTH WALES

2.14 The application of the Statutes of Set-off in New South Wales was confirmed by s 24 of the *Australian Courts Act 1828 (Imp)*.³¹ In the review of the application of Imperial Acts by the New South Wales Law Reform Commission, the provisions of the Statutes of Set-off³² were labelled, in a list of Imperial Acts proposed for repeal, as “now unnecessary”.

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27. S R Derham, “Recent Issues in Relation to Set-off” (1994) 68 *Australian Law Journal* 331 at 342.
 28. *Myer v Dresser* (1864) 16 CB (NS) 646 at 665; 143 ER 1280 at 1288 (Willes J); and 16 CB (NS) 646 at 666; 143 ER 1280 at 1288 (Byles J).
 29. P R Wood, *English and International Set-off* (Sweet & Maxwell, London, 1989) at para 23-2 and 23-3.
 30. P R Wood, *English and International Set-off* (Sweet & Maxwell, London, 1989) at para 23-9.
 31. 9 Geo IV c 83 (Imp). Early New South Wales cases in which set-off under the Statutes of Set-off was referred to include: *R v Mackaness* (NSW Supreme Court, Full Court, January 1829: Dowling J, *Select Cases: Volume 2* (NSW AO 2/3462) 123) at 127; and *Belcher v Dences* (NSW Supreme Court, Full Court, 29 December 1829: Dowling J, *Select Cases: Volume 2* (NSW AO 2/3462) 264) at 266. The early decisions of the Supreme Court of New South Wales are being made available on the internet by Associate Professor Bruce Kercher of Macquarie University at « www.law.mq.edu.au/scnsw ».
 32. 2 Geo II c 22 (1729) and 8 Geo II c 24 (1735).

No further explanation was offered for this decision.³³ The recommendation for their repeal was carried into effect by s 8 of the *Imperial Acts Application Act 1969* (NSW). The savings clause in s 9(2)(c) of the *Imperial Acts Application Act 1969* (NSW) does not, like other savings clauses,³⁴ operate to preserve set-off or any other principles of law established by the repealed provisions.

2.15 It has been assumed that the Statutes of Set-off were then considered unnecessary because of the availability of Part 15 r 25 of the *Supreme Court Rules 1970* (NSW). Part 15 r 25 was recommended by the Law Reform Commission as part of its draft Supreme Court Bill in 1969, but again, no specific mention was made regarding this provision in the explanatory references to the Bill.³⁵ It should also be remembered that the *Supreme Court Rules 1970* (NSW) commenced on 1 July 1972, eighteen months after the repeal of the Statutes of Set-off came into effect on 1 January 1971.³⁶ In any case Part 15 r 25 has since been omitted from the *Supreme Court Rules 1970* (NSW).³⁷ The consequence of this omission is that in New South Wales there is now no statutory set-off available except that provided for by the *Bankruptcy Act 1966* (Cth).

33. New South Wales Law Reform Commission, *Application of Imperial Acts* (Report 4, 1967) at 107 and 108.

34. See para 4.2 on “Westbury savings” clauses.

35. New South Wales Law Reform Commission, *Supreme Court Procedure* (Report 7, 1969) at 21-22.

36. Cf S R Derham, *Set-off* (2nd edition, Clarendon Press, Oxford, 1996) at 137.

37. *Supreme Court Rules (Amendment No 154) 1984* (NSW).

3. The need for reintroduction

- Difficulties arising from the repeal of the Statutes of Set-off
- The Commission's view

3.1 Opinion is divided amongst those who have considered the appropriateness of the repeal of the Statutes of Set-off in New South Wales. Some have considered the repeal of the Statutes to be part of a natural progression of procedural reforms¹ and that there had been no “blunder” in recommending their repeal.² However, others have noted the repeal of the Statutes with some regret. Justice Young has considered that the repeal was “perhaps unintended”,³ while Meagher, Gummow and Lehane state that the Statutes may have been repealed “one suspects, unwittingly”.⁴ Parties to litigation have even contemplated applying for a proclamation to revive the Statutes of Set-off.⁵

DIFFICULTIES ARISING FROM THE REPEAL OF THE STATUTES OF SET-OFF

3.2 There are a number of specific matters which have been brought to the attention of the Commission which show what are thought to be the undesirable effects of the absence of the Statutes of Set-off in New South Wales.

Matters involving original parties to a transaction

Procedural practicality

3.3 There are some important practical differences between what is possible through set-off and what can be achieved by a cross claim. Most significantly, a cross claim by a defendant, being merely an independent

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1. *Stehar Knitting Mills Pty Ltd v Southern Textile Converters Pty Ltd* [1980] 2 NSWLR 514 at 522-524 (Glass JA).
 2. *Stehar Knitting Mills Pty Ltd v Southern Textile Converters Pty Ltd* [1980] 2 NSWLR 514 at 520 (Hutley JA).
 3. *Wentworth v Wentworth* (NSW, Supreme Court, No 3748/89, Young J, 12 December 1994, unreported).
 4. R P Meagher, W M C Gummow and J R F Lehane, *Equity: Doctrines and Remedies* (3rd edition, Butterworths, Sydney, 1992) at para 3704.
 5. Under s 11 of the *Imperial Acts Application Act 1969* (NSW). The option was not pursued because the re-introduction of the Statutes may have only had a future effect: *Southern Textile Converters Pty Ltd v Stehar Knitting Mills Pty Ltd* [1979] 1 NSWLR 692.

action, can never be a defence to a plaintiff's claim.⁶ However, set-off can be used, where available, by a defendant to avoid entry of a summary judgment in favour of the plaintiff, a result which could not be achieved by the defendant raising a mere counterclaim. Set-off would, therefore, prevent unnecessary additional procedures. The Commission is of the view that it is preferable to have such matters dealt with in one action.

Costs

3.4 The non-availability of set-off as provided for by the Statutes of Set-off has meant that in situations where defendants now only have counterclaim available to them, each party may be liable to costs depending on the outcome of their individual claims. Where a plaintiff is successful, that plaintiff is *prima facie* entitled to costs in his or her claim. And, if the defendant is successful in his or her counterclaim, the defendant is also *prima facie* entitled to costs in the counterclaim. That is, where the defendant is successful, in effect, in defeating the plaintiff's claim by counterclaim, he or she is only entitled *prima facie* to additional costs incurred by reason of the cross-claim. However, when set-off is successfully pleaded as a defence, normally the defendant will be awarded costs.⁷

Matters involving third parties to an original transaction

Joinder of principal debtors by guarantors

3.5 In situations not involving insolvency set-off,⁸ where a creditor took action against a guarantor under a contract of guarantee and the Statutes of Set-off allowed for set-off between the creditor and principal debtor, it appears to have been the case that the guarantor could rely on the availability of set-off to reduce his or her liability to the creditor without the need to join

6. See Hutley JA in *Stehar Knitting Mills Pty Ltd v Southern Textile Converters Pty Ltd* [1980] 2 NSWLR 514 at 519.

7. The effect of set-off on costs was noted by Morris LJ in *Hanak v Green* [1958] 2 QB 9 at 16. See also P R Wood, *English and International Set-off* (Sweet & Maxwell, London, 1989) at para 6-42.

8. The availability of insolvency set-off would mean that the guaranteed debt is extinguished to the extent of the set-off which occurs automatically on the date of liquidation: S R Derham, *Set-off* (2nd edition, Clarendon Press, Oxford, 1996) at 641. See also *Langford Concrete Pty Ltd v Finlay* [1978] 1 NSWLR 14 at 19.

the principal debtor to the proceedings.⁹ The availability of set-off to the guarantor extended only to instances where the debts existing between the parties were liquidated. Set-off was, therefore, not available for a guarantor to exercise against the creditor where the debts between the creditor and principal debtor were unliquidated.¹⁰

3.6 With the repeal of the Statutes of Set-off in New South Wales, the availability, albeit limited, of so simple a remedy to a guarantor has been removed. Justice Handley has suggested that the need now to join the principal debtor to proceedings between a creditor and guarantor is one of the unfortunate side effects of the repeal of the Statutes of Set-off.¹¹ This is particularly so where the guarantor is resisting an application for summary judgment by the creditor.¹²

3.7 Chief Justice Stawell of Victoria in 1867 considered it desirable to allow a guarantor to rely on a right to set-off between a creditor and principal debtor:

If there is a sum which may be set-off in reduction, it must be set-off; for if the setting-off were to depend on the option of either the creditor or the principal debtor, the surety might be compelled to pay the creditor more of the original debt, than the creditor himself could have recovered from the principal debtor.¹³

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9. J O'Donovan and J Phillips, *The Modern Contract of Guarantee* (3rd edition, LBC Information Services, Sydney, 1996) at 551 suggest that *Bechervaise v Lewis* (1872) LR 7 CP 372 especially at 377 and *Murphy v Glass* (1869) LR 2 PC 408 provide some support for this proposition. But see S R Derham, *Set-off* (2nd edition, Clarendon Press, Oxford, 1996) at 649-652.
 10. *Cellulose Products Pty Ltd v Truda* (1970) 92 WN (NSW) 561. The position in England may be different: see *National Westminster Bank plc v Skelton* [1993] 1 All ER 242 at 250-251.
 11. K R Handley, *Letter to the Chairman of the NSW Law Reform Commission* (28 February 1994) at 5 (attachment). Justice Handley has also suggested that, although no authority exists on this point, where there has been a voluntary release of a liquidated claim by the principal debtor, a guarantor could, before the repeal of the Statutes of Set-off, have relied upon set-off of that claim.
 12. J O'Donovan and J Phillips, *The Modern Contract of Guarantee* (3rd edition, LBC Information Services, Sydney, 1996) at 549.
 13. *Murphy v Glass* (1867) 4 WW & A'B (L) 199 at 203. The case was affirmed on appeal to the Privy Council which considered the set-off point immaterial: *Murphy v Glass* (1869) LR 2 PC 408 at 418.

3.8 Derham has suggested that the preferred approach is for the guarantor to be able to defend him or herself “on the basis of any defence of set-off available to the debtor”.¹⁴ Others, however, have argued that the availability of the right of a guarantor to plead a set-off existing between the creditor and principal debtor is not desirable on a number of grounds. Some have suggested that it is unreasonable, as a matter of policy:

for the guarantor to be able to reduce her or his clear liability on the guarantee by reason of a debt owed by the creditor to the debtor which might be quite unrelated to the principal transaction. Without an assignment of such a claim by the principal debtor to the guarantor, it is difficult to find any justification for allowing the guarantor to invoke the claim against the creditor by way of defence.¹⁵

3.9 It has also been argued that there is some difficulty in finding the necessary mutuality, for the purposes of the Statutes of Set-off, between the creditor and guarantor when the mutual debts are in fact between the creditor and principal debtor.¹⁶

3.10 The above discussion should, however, be considered in light of the policy of the law to protect guarantors by ensuring that, subject to the right of the creditor to be paid, the burden of relief should fall on those primarily liable, namely the principal debtors.¹⁷

Limitation of actions

3.11 Originally, there was a distinction between set-off and counterclaim for the purposes of limitation of actions so that, in the case of counterclaim, the period of limitation was calculated back from the date of the counterclaim and not from the date of the commencement of the principal action, as would be the case with the defence of set-off.¹⁸ This situation was altered by s 74 of

14. S R Derham, *Set-off* (2nd edition, Clarendon Press, Oxford, 1996) at 642.

15. J O'Donovan and J Phillips, *The Modern Contract of Guarantee* (3rd edition, LBC Information Services, Sydney, 1996) at 552.

16. J O'Donovan and J Phillips, *The Modern Contract of Guarantee* (3rd edition, LBC Information Services, Sydney, 1996) at 552.

17. See S Rowlatt, *Rowlatt on the Law of Principal and Surety* (4th edition, Sweet & Maxwell, London, 1982) at 131; and J O'Donovan and J Phillips, *The Modern Contract of Guarantee* (3rd edition, LBC Information Services, Sydney, 1996) at 533-534.

18. See *McDonnell & East Ltd v McGregor* (1936) 56 CLR 50 at 57 (Dixon J; McTiernan J agreeing).

the *Limitation Act 1969* (NSW) under which, for the purposes of limitation of actions, defendants claiming by way of either set-off or counterclaim, are taken to have made the claim on the date on which they became parties to the principal action (usually at its commencement).¹⁹ However, Justice Handley has suggested this has left guarantors in a worse position since the repeal of the Statutes of Set-off, because guarantors can no longer plead a set-off which is available to the principal debtor.

Set-off against an assignee

3.12 It is a general rule that an assignee of a chose in action takes subject to all the equities, including such rights of set-off and other defences which may have been available against the assignor. A debtor can, therefore, plead set-off against an assignee of a debt up until such time as the debtor receives notice of the assignment.²⁰ The mutuality necessary for set-off under the Statutes of Set-off would not, in such circumstances, be destroyed.²¹ Counterclaim, on the other hand, is not available to a debtor against an assignee of a creditor's claim because while a debtor usually has a cross claim against the creditor he or she generally does not have one against the assignee. Set-off under the Statutes of Set-off may, therefore, be the only remedy available to debtors in such a situation,²² although equitable set-off and other analogous rights may be available in

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19. For a discussion of the effect of the equivalent English provision (s 28 of the *Limitation Act 1939* (Eng)) see *Henriksens Rederi A/S v T H Z Rolimpex "The Brede"* [1974] QB 233 at 245-247.
 20. *Roxburge v Cox* (1881) 17 ChD 520 at 526 (James LJ); *Edward Nelson & Co Ltd v Faber & Co* [1903] 2 KB 367 at 375 (Joyce J). See also R P Meagher, W M C Gummow and J R F Lehane, *Equity: Doctrines and Remedies* (3rd edition, Butterworths, Sydney, 1992) at para 699. For a discussion of a number of English cases involving set-off by a debtor after an assignment of a debt see *Business Computers Ltd v Anglo-African Leasing Ltd* [1977] 1 WLR 578 at 583-585.
 21. The requirements to maintain set-off are summarised by P R Wood, *English and International Set-off* (Sweet & Maxwell, London, 1989) at para 16-38. In Canada, however, it has been held that any assignment destroys the necessary mutuality so that the assignment of a debt prevents a debtor from raising set-off against an assignee: *Holt v Telford* (1987) 41 DLR (4th) 385 at 394.
 22. P R Wood, *English and International Set-off* (Sweet & Maxwell, London, 1989) at para 6-35 and 14-83.

some cases.²³ Wood considers this to be the most important reason for the existence of set-off:

In practice, the non-availability of counterclaims against an intervener is by far the most important distinguishing characteristic between set-off and counterclaim: otherwise there is often little difference in the actual result if both claims are for the payment of money.

Administration of estates

3.13 As already noted, one of the reforms implemented by the provisions of the 1729 statute was to allow set-off in situations where either the plaintiff or defendant is the executor or administrator of a deceased person with whom the other party has a mutual debt. This was needed to cover situations in the administration of deceased estates where mutual debts could not be set off because all the assets of the estate had been applied to other debts of higher priority. This was enacted notwithstanding the availability of set-off under insolvency legislation from as early as 1705.²⁴

3.14 Today in New South Wales it is still possible to administer a deceased estate that is insolvent without recourse to the *Bankruptcy Act 1966* (Cth).²⁵ The priority of debts established under the New South Wales provisions may, therefore, when combined with the absence of set-off under the Statutes of Set-off, lead to injustice to some creditors of insolvent deceased estates.

23. *Roadshow Entertainment Pty Ltd v (ACN 053 006 269) Pty Ltd* (1997) 42 NSWLR 462 at 481-484. See also S R Derham, *Set-off* (2nd edition, Clarendon Press, Oxford, 1996) at 573.

24. 4 & 5 Anne c 17 (1705).

25. See *Wills Probate and Administration Act 1898* (NSW) s 46C(1) and Sch 3 Pt 1. Administration in accordance with the *Wills Probate and Administration Act 1898* (NSW) may be undertaken because one of the grounds for bringing a petition under the Commonwealth regime is absent, or there may simply be no creditor who wishes to bring a petition: New South Wales Law Reform Commission, *Uniform Succession Laws: Administration of Estates of Deceased Persons* (Discussion Paper 42, 1999) at para 15.12-15.15.

THE COMMISSION'S VIEW

3.15 The Commission has decided, in light of the difficulties posed by the repeal of the Statutes of Set-off in New South Wales, to affirm the conclusion in DP 40 that set-off under the Statutes of Set-off be reintroduced.

Recommendation 1

That set-off as established by the Statutes of Set-off be reintroduced.

4 ■ Implementation of the reintroduction

- Options considered in DP 40
- The Commission's conclusion

OPTIONS CONSIDERED IN DP 40

4.1 In recommending the reintroduction of set-off under the Statutes of Set-off in New South Wales, the Commission has considered the options which were outlined in DP 40:

- insert a savings provision in the *Imperial Acts Application Act 1969* (NSW);
- revive the Statutes of Set-off by proclamation;
- re-insert a provision in the rules of court;
- introduce a new limited statutory form of set-off; and
- restate the law established by the Statutes of Set-off.

Insert a savings provision in the Imperial Acts Application Act 1969

4.2 This option would involve framing a “Westbury Savings”¹ clause which preserves the doctrines and principles of law established by the Statutes of Set-off and would involve a near complete revival of the type of set-off established by the former statutes, without the need for re-enactment. “Westbury Savings” clauses have been applied in England to preserve the effect of the Statutes of Set-off.² For example, s 4(1)(b) of the *Civil Procedure Repeal Act 1879* (Eng) provided:

The repeal effected by this Act shall not affect ... Any jurisdiction or principle or rule of law or equity established or confirmed, or right or privilege acquired, or duty or liability imposed or incurred, or compensation secured, by or under any enactment so repealed.

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1. “Westbury Savings” clauses are so named after Lord Westbury, the sponsor of the first Act to contain such a proviso: *Statute Law Revision Act 1863* (Eng) s 1. On Westbury Savings clauses generally see New South Wales Law Reform Commission, *Application of Imperial Acts* (Report 4, 1967) at 33-34; and P M McDermott, “Statute Law Revision Statutes-Westbury Savings” [1988] *Statute Law Review* 139.
 2. *Civil Procedure Repeal Act 1879* (Eng) s 4(1)(b) and *Statute Law Revision and Civil Procedure Act 1883* (Eng) s 4.

A similar provision has been enacted in Victoria³ and proposed by the Western Australian Law Reform Commission.⁴

4.3 In its 1967 report on the application of Imperial Acts, the New South Wales Law Reform Commission noted the wide-reaching effects of such a clause and recommended against the general enactment of one as part of the *Imperial Acts Application Act 1969* (NSW) on a number of grounds, including that:

- (2) The wider the saving clauses, the greater the problems will be of ascertaining the extent of the repeal.
- (3) The wider the saving clauses, the more need there will be to refer to the repealed Imperial Acts. The utility of the Bill will be measured by the extent to which it makes such reference unnecessary.⁵

4.4 One suggestion put to the Commission was that a limited savings clause, confined to the law established by the Statutes of Set-off, could be drafted as follows:

The repeal of the Imperial Act 2 Geo II c 22 s 13 and 8 Geo II c 24 ss 4, 5. (The Statutes of Set-off 1729 and 1735) shall not affect and be deemed never to have affected any jurisdiction or principle or rule of law or equity established or confirmed.⁶

4.5 One submission rejected this proposal as undesirable, arguing that it would potentially change “the basis upon which people have

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3. *Imperial Acts Application Act 1922* (Vic) s 7. See also *Imperial Acts Application Act 1980* (Vic) s 5. But see discussion of the effect of r 13.14 of the *Supreme Court Rules 1986* (Vic) (now the *Supreme Court (General Civil Procedure) Rules 1996* (Vic)) by S R Derham, “Set-off in Victoria” (1999) 73 *Australian Law Journal* 754 at 756-759.
 4. Law Reform Commission of Western Australia, *Report on United Kingdom Statutes in Force in Western Australia* (Project 75, 1994) at 63. The Western Australian proposals have not yet been implemented although they were being actively considered by the Western Australian government: Law Reform Commission of Western Australia, *Annual Report, 1 July 1996 - 30 June 1997* at 19.
 5. New South Wales Law Reform Commission, *Application of Imperial Acts* (Report 4, 1967) at 34.
 6. Attachment (by K R Handley) to J W Shaw, *Letter to the Chairman of the New South Wales Law Reform Commission* (26 September 1997).

been dealing with each other over the last 30 years” and “would throw considerable doubt upon existing financial and commercial arrangements”.⁷

4.6 The Commission considers that reintroducing the law relating to statutory set-off by means of a savings clause is not satisfactory, not least because Westbury Savings clauses were specifically rejected by the Commission in its 1967 report. Such clauses are, therefore, not so familiar to New South Wales practitioners in relation to Imperial Acts as they would be in, say, Victoria where a Westbury Savings clause was used to preserve the effects of certain Imperial enactments.

Revive the Statutes of Set-off by proclamation

4.7 Section 11 of the *Imperial Acts Application Act 1969* (NSW) provides that the Governor may, by proclamation, declare that the whole or any part of a repealed Imperial enactment shall be revived.⁸ The proclamation is, however, subject, under certain conditions, to disallowance by resolution of either House of the New South Wales Parliament.⁹ Any provision revived in this way will have such effect as it had in New South Wales immediately before the commencement of the *Imperial Acts Application Act 1969* (NSW).¹⁰ Counsel for the defendant at first instance in *Southern Textile Converters Pty Ltd v Stehar Knitting Mills Pty Ltd* had contemplated seeking an adjournment to make application for such a proclamation. This course was ultimately not taken because the proclamation would only have had prospective application and could not have assisted the client.¹¹

4.8 The Commission in 1967 recommended the inclusion of a provision allowing revival by proclamation in place of a comprehensive Westbury Savings clause:

7. M Wormell, *Submission* at 3.

8. Imperial Acts listed in Schedule 1 to the Act are excluded from the operation of s 11.

9. See *Imperial Acts Application Act 1969* (NSW) s 11(4) and (5).

10. *Imperial Acts Application Act 1969* (NSW) s 11(2).

11. *Southern Textile Converters Pty Ltd v Stehar Knitting Mills Pty Ltd* [1979] 1 NSWLR 692 at 700.

If, despite the attention which we have given to the problems, the repeals turn out to have gone too far, the position can be restored by proclamation under clause 11. This is better than reliance on the necessarily vague words of a saving clause.¹²

4.9 The Commission in DP 40 noted that if mere revival of the Statutes of Set-off was all that was required, then the procedure under s 11 of the *Imperial Acts Application Act 1969* (NSW) had much to commend it, since it would not require legislative action to effect the change. However, one submission to the Commission expressed an in principle objection to law-making by proclamation or regulation, taking the view that such enactments would make it more difficult to ascertain the law.¹³

Re-insert a provision in the rules of court

4.10 The use of the former Pt 15 r 25 of the *Supreme Court Rules 1970* (NSW) to establish a defence of set-off is supported by a decision of the New South Wales Court of Appeal, which saw this provision as a partial restoration of a statutory-based form of set-off.¹⁴ There are a number of reasons why the re-insertion of such a provision is undesirable.¹⁵

4.11 First, if the current interpretation is maintained, the defence may have too broad an effect. Derham has noted that the effect of the Court of Appeal's position would be that:

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12. New South Wales Law Reform Commission, *Application of Imperial Acts* (Report 4, 1967) at 34.
 13. W V Windeyer, *Submission* at 1.
 14. *Stehar Knitting Mills Pty Ltd v Southern Textile Converters Pty Ltd* [1980] 2 NSWLR 514. This is contrary to the interpretation of the English equivalent of this provision (*Rules of the Supreme Court 1965* (Eng) O 18 r 17): *Hanak v Green* [1958] 2 QB 9 at 26 (Morris LJ) which dealt with the earlier O 19 r 3 of the *Rules of the Supreme Court 1883* (Eng). See also *West Street Properties Pty Ltd v Jamison* [1974] 2 NSWLR 435 at 438.
 15. See also S R Derham, "Set-off in Victoria" (1999) 73 *Australian Law Journal* 754 at 756-759.

any monetary cross-demand which was due and payable, whether it was liquidated or unliquidated and whether or not it was connected with the plaintiff's claim, could be the subject of a set-off in an action at law. It was not necessary to show mutual debts, or, if one of the demands was unliquidated, that the cross-demands were sufficiently closely connected so as to give rise to an equitable set-off.¹⁶

This expansion of the defence could affect the rights of third parties, such as assignees of debts, undisclosed principals, subrogated insurers, and factors and other receivables financiers.¹⁷

4.12 The expansion of the defence of set-off established by the *Supreme Court Rules* could also have undesirable procedural effects. Delays may be caused in obtaining summary judgments if the defence is extended to unliquidated and unconnected cross-demands.¹⁸ Other outcomes might include: creating delay in more general terms; adding to the costs of litigation; encouraging the use of spurious defences; and the bringing together of unrelated claims.¹⁹

4.13 Finally, the Court of Appeal's interpretation of the *Supreme Court Rules* is contrary to those in other jurisdictions with respect to the ability of rules of court to set up a defence.²⁰ Use of the rules of court would not be a sound basis on which to rest the re-introduction of statutory set-off.²¹

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16. S R Derham, *Set-off* (2nd edition, Clarendon Press, Oxford, 1996) at 133.
 17. S R Derham, "Recent Issues in Relation to Set-off" (1994) 68 *Australian Law Journal* 331 at 342; and S R Derham and Victorian Bar Council, *Submission* at 2.
 18. S R Derham and Victorian Bar Council, *Submission* at 2; and N H Andrews, "The Proper Limits of Set-off" (1992) 51 *Cambridge Law Journal* 239 at 240.
 19. N H Andrews, "The Proper Limits of Set-off" (1992) 51 *Cambridge Law Journal* 239 at 240; and Law Society of NSW, *Submission 1* at 2.
 20. *Hanak v Green* [1958] 2 QB 9 at 26. See also *West Street Properties Pty Ltd v Jamison* [1974] 2 NSWLR 435 at 437-438.
 21. The Law Society also particularly opposed this approach: Law Society of NSW, *Submission 1* at 2.

New limited statutory form of set-off

4.14 A new limited statutory form of set-off has been proposed by McCracken, essentially to give statutory recognition to contractual rights analogous to set-off. The proposed statutory provision would be in addition to existing rights to set-off and would imply the statutory right into particular specified contracts in absence of an agreement to the contrary.²² This would be similar to, and probably a broader expression of, netting transactions which are already the subject of Commonwealth legislation.²³

4.15 Is there a demonstrated need for this? The Netting Sub-committee of the Companies and Securities Advisory Committee, while observing that there was no basis for doubting the effectiveness of netting arrangements, stated that it was “very desirable that the legal position be clarified beyond doubt”:

This is because of the high value of many of the transactions which are subject to netting arrangements, and the potentially disastrous consequences of adverse rulings by the courts.²⁴

Such arguments may not, however, apply to many areas in which New South Wales is competent to legislate, given that insolvency, banking, corporate law and insurance lie in the realm of the Commonwealth’s legislative power. However, a new statutory form of set-off could be useful in the areas of personal finance and non-bank financial institutions. The Netting Sub-committee favoured limiting their proposed legislation to financial contracts or transactions because the effect of a more broadly expressed law was uncertain.²⁵

22. The ability to contract out of set-off is dealt with at para 5.15 below.

23. See above at para 1.8-1.9.

24. Australia, Netting Sub-committee of the Companies and Securities Advisory Committee, *Netting in Financial Markets Transactions* (Final Report, 1997) at para 3.1. See also Australia, Corporate Law Economic Reform Program, *Electronic Commerce: Cutting Cybertape – Building Business* (Proposals for Reform: Paper No 5, 1997) at 37-40.

25. Australia, Netting Sub-committee of the Companies and Securities Advisory Committee, *Netting in Financial Markets Transactions* (Background Paper, 1996) at 24.

4.16 The Australian Law Reform Commission gave some brief consideration to set-off in part of its Report on legal risk in international transactions.²⁶ In a section dealing with netting and set-off as part of finance law reform,²⁷ although dealing largely with issues relating to companies and securities law and remedies in cross border banking, the Commission expressed its agreement with a submission that suggested a review of the law of set-off in Australia with a view to creating a “new limited *statutory* right to set off pre-insolvency.”²⁸ It was noted that:

This would make the law on set off simpler and more certain and would extend the benefits of set off to firms which had not considered including it in their contracts.²⁹

The Commission has decided not to proceed down this path.

Restatement

4.17 The Commission’s preferred option in DP 40 was that there be a restatement of the law established by the Statutes of Set-off in plain English. The reasons given for this preference were that the Statutes themselves (enacted in 1729 and 1735) are relatively obscure and their restatement would ensure easy access to the law by practitioners.

4.18 It was suggested that the restatement could cover at least the following points:³⁰

- that there be mutuality between the parties, that is, that the demands must be between the same parties and that the debts not be due to the parties in different rights;³¹

26. Australian Law Reform Commission, *Legal Risk in International Transactions* (Report 80, 1996).

27. Australian Law Reform Commission, *Legal Risk in International Transactions* (Report 80, 1996) at para 5.40-5.45.

28. Australian Law Reform Commission, *Legal Risk in International Transactions* (Report 80, 1996) at para 5.45.

29. Australian Law Reform Commission, *Legal Risk in International Transactions* (Report 80, 1996) at para 5.45. See also the proposals of McCracken at para 4.14 above.

30. DP 40 para 2.8.

- that set-off be available only where the debts are liquidated or where money demands could be ascertained “readily and without difficulty” at the time of pleading;³²
- that it cannot operate to extinguish or reduce a claim until judgment is given;³³ and
- that it can only be available where both debts are due and payable when the plaintiff commences his or her action at law.³⁴

4.19 The restatement proposal was supported by two submissions.³⁵ Others, however, expressed some caution.³⁶

Some cautions

4.20 Availability where both debts are due and payable.

Traditionally, set-off under the Statutes of Set-off has been held to be available where both debts are due and payable when the plaintiff commences his or her action at law.³⁷ It was suggested in DP 40 that this characteristic could be included in the restatement.³⁸ However, there is now some doubt about the traditional position. This is discussed more fully in the next chapter.³⁹

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31. See S R Derham, *Set-off* (2nd edition, Clarendon Press, Oxford, 1996) at 319.
 32. *Stooke v Taylor* (1880) 5 QBD 569 at 575 (Cockburn CJ). See also *Hanak v Green* [1958] 2 QB 9 at 17 and 23; and P R Wood, *English and International Set-off* (Sweet & Maxwell, London, 1989) at para 2-68 - 2-130.
 33. *Stehar Knitting Mills Pty Ltd v Southern Textile Converters Pty Ltd* [1980] 2 NSWLR 514 at 518 (Hutley JA). See also *Covino v Bandag Manufacturing Pty Ltd* [1983] 1 NSWLR 237 at 238 (Hutley JA); and *Re John Dillon Ltd (In Liq); ex parte Jefferies* [1960] WAR 30.
 34. See P R Wood, *English and International Set-off* (Sweet & Maxwell, London, 1989) at para 2-131 - 2-185.
 35. Law Society of NSW, *Submission 1*; and W V Windeyer, *Submission*.
 36. M Wormell, *Submission*; and S R Derham and Victorian Bar Council, *Submission*.
 37. *Richard v James* (1848) 2 Ex 471 at 473-474; 154 ER 577 at 578; *Bennett v White* [1910] 2 KB 643 at 648; and P R Wood, *English and International Set-off* (Sweet & Maxwell, London, 1989) at para 2-131 - 2-185.
 38. DP 40 at para 4.14 and 2.8.
 39. At para 5.5-5.9.

4.21 **Definition of mutuality.** The Statutes of Set-off require that there be mutuality between the parties for set-off to be available. This has been interpreted as requiring that the demands must be between the same parties and that the debts not be due to the parties in different rights.⁴⁰ It has been put to the Commission that any attempt to render the concept of mutuality in plain English should be resisted:

The meaning of mutuality in various situations has attracted a vast amount of case law, and we suspect that an attempt to provide an all-encompassing definition of it would lead to uncertainty, and ultimately litigation.⁴¹

4.22 The magnitude of the task of rendering the Statutes of Set-off into plain English may well have been the reason for the only slightly altered restatement (involving the removal of some minor pieces of 18th century verbiage) contained in the Australian Capital Territory's *Imperial Acts Application Ordinance 1986 (ACT)*.⁴²

THE COMMISSION'S CONCLUSION

4.23 The Commission remains of the view that a restatement of the law established by the Statutes of Set-off is to be preferred. We consider that it would be undesirable to multiply the provisions to which practitioners must refer to determine the current law with respect to statutory set-off – which would be the case with both a “Westbury Savings” clause and a proclamation under the *Imperial Acts Application Act 1969 (NSW)*. Ease of access by practitioners was, presumably, one of the reasons for a tentative proposal by the Australian Capital Territory's Attorney General's Department that the Statutes of Set-off be repealed and “the substantive provisions incorporated into ACT debt law”.⁴³

40. S R Derham, *Set-off* (2nd edition, Clarendon Press, Oxford, 1996) at 319.

41. S R Derham and Victorian Bar Council, *Submission* at 5.

42. Sch 3 Pt 15 and 16.

43. Australian Capital Territory, Attorney General's Department, *Law Review Program: Audit of ACT and NSW Law Reform Initiatives* (1993) at para 338 and 341.

4.24 We are also of the view that the task of restating the law relating to statutory set-off will not be so difficult as suggested by some. The case law attaching to mutuality should be preserved by the retention of the phrase “mutual debts” in the restated provision. A bill to implement the restatement, incorporating the amendments discussed in the next chapter, is reproduced at Appendix A to this Report.

Recommendation 2

That the reintroduction of the law established by the Statutes of Set-off be by restatement in modern legislative form and style.

Set-off

5. Reform of the law under the Statutes of Set-off

- Narrow coverage
- Effect on securitisation arrangements
- Operation of the new enactment

5.1 Having decided that there is a need to reintroduce the law established by the Statutes of Set-off, the Commission then considered whether there are any aspects of this law which require reform.

NARROW COVERAGE

5.2 The proliferation and separate development of the many different types of set-off has not prevented situations arising where a form of set-off is not available but where justice might expect it to be. This situation, particularly with regard to the availability of equitable set-off and set-off under the Statutes of Set-off, has recently been considered absurd by some Judges of the English Court of Appeal.¹ For example, Lord Justice Leggatt observed:

I would add ... the comment that the state of the law is unsatisfactory that allows a set-off at law of debts which are liquidated, even if unconnected, and in equity of debts which are connected, even if unliquidated, but not a set-off of debts which are both unliquidated and unconnected.²

5.3 This view has, however, been criticised by at least one commentator who suggests that the law is not wrong to refuse set-off where debts are both unliquidated and unconnected because there is no merit in making such a right available and in particular such a change in the law would:

- create delay, especially with respect to summary judgments;
- encourage the raising of spurious defences; and
- couple together unrelated claims.³

5.4 Lord Justice Staughton's more limited criticism of the current arrangements concerning set-off, made in the same judgment, has been better received. He stated that the historical development of set-off:

1. *Axel Johnson Petroleum AB v M G Mineral Group AG* [1992] 1 WLR 270.
2. *Axel Johnson Petroleum AB v M G Mineral Group AG* [1992] 1 WLR 270 at 274 (Leggatt LJ).
3. N H Andrews, "The Proper Limits of Set-off" (1992) 51 *Cambridge Law Journal* 239 at 240. See also S R Derham, "Set-off in Victoria" (1999) 73 *Australian Law Journal* 754 at 756-759.

has led to results which appear to lack logic and sense. Legal set-off is available if both claims are for liquidated sums. Thus if a plaintiff has a claim for unliquidated damages, the defendant cannot at law seek to set-off a liquidated claim. I can see no sense in that today. This rule was mitigated by the Court of Chancery through the doctrine of equitable set-off which is available in broad terms if there is a sufficient degree of connection between the two transactions, whether or not either or both claims are unliquidated. But, as Leggatt LJ has pointed out, it is questionable whether the remedy is wholly effective as a cure for the disease.⁴

The two main issues arising are dealt with in the following paragraphs.

Requirement that both claims be due and payable

5.5 Traditionally, set-off under the Statutes of Set-off has been held to be available where both debts are due and payable when the plaintiff commences his or her action at law.⁵ This means that where a debtor's liquidated cross-claim becomes due and payable only after the commencement of the creditor's proceedings, the cross claim cannot be set-off against the original claim. This position should be considered in light of the fact that rules of court now allow a party to plead any matter which has arisen since the commencement of the action:

A party may plead any matter notwithstanding that the matter has arisen after the commencement of the proceedings.⁶

Wood has also suggested that the traditional position is difficult to reconcile with current practice.⁷

5.6 There have been judicial statements, including from the House of Lords, that call into question the traditional position and some decisions have allowed set-off of debts assigned to a defendant after the commencement of the plaintiff's action.⁸

4. *Axel Johnson Petroleum AB v M G Mineral Group AG* [1992] 1 WLR 270 at 275-276 (Staughton LJ).

5. See para 2.10 above.

6. *Supreme Court Rules 1970* (NSW) Pt 15 r 16. See S R Derham and Victorian Bar Council, *Submission* at 4.

7. P R Wood, *English and International Set-off* (Sweet & Maxwell, London, 1989) at para 6-30 - 6-31. See also DP 40 at para 2.15-2.16.

8. See *Wood v Goodwin* [1884] WN 17; and *Ingleton v Coates* (1896) 2 ALR 154. See also *McCull's Wholesale Pty Ltd v State Bank of NSW* [1984] 3 NSWLR 365 at 381 (Powell J).

For example, Lord Hoffman has stated that set-off under the Statutes of Set-off is confined to debts “which at the time when the defence of set-off is filed were due and payable”.⁹

5.7 The practical problem caused by the traditional position can be seen by considering a situation where there has been an assignment of a creditor’s claim and the assignee then seeks enforcement of the claim. The debtor may have a cross claim against the original creditor, but to qualify for set-off the debtor’s cross claim must have become due and payable before the commencement of the assignee’s action. Set-off can, therefore, be precluded simply by the assignee taking action before the debtor’s cross claim becomes due and payable.¹⁰

5.8 There appears to be no compelling reason why the statement of Lord Hoffman should not represent the law instead of the traditional position.¹¹ Since the law is progressing this way, two options present themselves: first, recommending no mention of when debts become due and payable and leaving the issue to the courts; and secondly, including a provision along the lines of Lord Hoffman’s statement.

5.9 The Commission accordingly prefers to avoid any doubt which may exist in this regard by recommending a provision to the effect that set-off be available where the debts are due and payable at the time when the defence of set-off is filed. Care will need to be taken in drafting the new provision to ensure that the operation of s 74 of the *Limitation Act 1969* (NSW)¹² is not adversely affected.

Recommendation 3

The restatement should contain a provision to the effect that set-off is available where the debts are due and payable at the time when the defence of set-off is filed.

9. *Stein v Blake* [1996] AC 243 at 251.

10. P R Wood, *English and International Set-off* (Sweet & Maxwell, London, 1989) at para 6-30 - 6-31. For the position where equitable set-off is available see *Roadshow Entertainment Pty Ltd v (ACN 053 006 269) Pty Ltd* (1997) 42 NSWLR 462 at 481-482.

Requirement that claims be liquidated

5.10 Set-off under the Statutes of Set-off differs from equitable and insolvency set-off in not allowing unliquidated claims to be pursued. It has been questioned whether the requirement that claims be liquidated or readily ascertainable is justified. The requirement is seen as arising from an unwillingness on the part of the courts to deal with two different claims in the one action so as to avoid delay. This is particularly so where a creditor's claim is clear and undisputed.

5.11 One result is that, where a claim is unliquidated, the defendant will need to raise a counterclaim and, if the claim is unrelated, he or she may be forced to institute separate proceedings. This means that a defendant may be subject to the whole of the judgment in the first proceedings before the defendant's own claim against the plaintiff has been adjudicated.

5.12 On balance and, in particular, because of the delays that may be brought into otherwise clear cut cases of liquidated demands, the Commission has decided not to extend the availability of statutory set-off to cases involving unliquidated demands.

EFFECT ON SECURITISATION ARRANGEMENTS

5.13 One submission has pointed out that set-off, in particular statutory set-off, may be a cause of concern with respect to the practice of securitisation.¹³ Securitisation refers to the selling of marketable securities backed by expected income streams from specific assets. The assets may be debts (mortgages in particular, but also credit card receivables, motor vehicle loans and other forms of consumer credit) or equity (for example, shares). Usually the securities are pooled together for more efficient operation. The most common form in Australia are called "mortgage backed securities" while those backed by assets other than mortgages are called "asset backed securities". A "special purpose vehicle" (often a trustee) is created by the "originator". The special purpose vehicle receives repayments and ensures that the holders of the securities (the investors) are paid the appropriate return. It also ensures that managers are paid the appropriate commission.

11. See S R Derham and Victorian Bar Council, *Submission* at 5.

12. See para 3.11.

13. M Wormell, *Submission*.

Credit rating agencies assess and assign ratings to proposed securitisation arrangements.¹⁴ The securitisation market in Australia was valued at \$12.4 billion in June 1996.¹⁵

5.14 It has been the practice of ratings agencies involved in the securitisation market to require that the relevant agreements exclude set-off. The submission to the Commission has urged the necessity of making clear that statutory set-off can be negated by contract since uncertainty in this area will be to the disadvantage of banks and financial institutions engaging in securitisation.

It has been argued that there are considerable cost savings arising from securitisation and that if banks and financial institutions are prevented by statutory set-off from taking part, “it is reasonable to expect that their charges and/or interest costs will increase”.¹⁶

5.15 The law is uncertain in this regard.¹⁷ Traditionally it has been held that an agreement to exclude set-off under the Statutes of Set-off cannot be enforced.¹⁸ However, there have been decisions to the contrary.¹⁹ Derham has noted that in guarantee situations, debtors and creditors can contract to exclude set-off with respect to a guaranteed debt and that the guarantor cannot claim (barring insolvency proceedings) what the debtor could never have in the first place.²⁰

5.16 Statutory recognition of agreements excluding set-off appears to be desirable, especially given the fact that complex commercial arrangements may be involved. Therefore, to remove any doubt in this regard the

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14. See Australia, *Financial System Inquiry Final Report* (AGPS, 1997) at 161-165; Organisation for Economic Co-operation and Development, “Finance, Investment, Taxation and Competition: Securitisation” (as at 9 February 1999) <www.oecd.org/daf/fin/netsecu.htm>.
 15. Australia, *Financial System Inquiry Final Report* (AGPS, 1997) at 165.
 16. M Wormell, *Submission* at 4.
 17. See R P Meagher, W M C Gummow and J R F Lehane, *Equity: Doctrines and Remedies* (3rd edition, Butterworths, Sydney, 1992) at para 3704.
 18. *Lechmere v Hawkins* (1798) 2 Esp 625; 170 ER 477 (on the grounds that equity would grant relief anyway); and *M’Gillivray v Simson* (1826) 2 C&P 320; 172 ER 145.
 19. *Re Agra & Masterman’s Bank* (1867) LR 2 Ch 391 at 397 (Cairns LJ); *Re Northern Assam Tea Co* (1870) LR 10 Eq 458 at 464 (Lord Romilly MR); *Phoenix Assurance Co Ltd v Earls Court Ltd* (1913) 30 TLR 50.
 20. S R Derham, *Set-off* (2nd edition, Clarendon Press, Oxford, 1996) at 652.

Commission recommends that it be possible to exclude set-off under the Statutes of Set-off by agreement between the parties.

Recommendation 4

That the restatement include express provision that parties may exclude set-off under the Statutes of Set-off by agreement.

OPERATION OF THE NEW ENACTMENT

5.17 Some difficulty exists regarding the commencement of the new provisions. This arises from the fact that set-off has technically not been available in New South Wales for the past 30 years.

5.18 A number of points need to be considered. The first is that, at least *prima facie*, there is an assumption that agreements entered into over the 30 years since the repeal of the Statutes of Set-off have been finalised on the understanding that set-off was not available. There would, therefore, have been no need to agree to exclude set-off under the Statutes of Set-off.²¹ On the other hand, the legal position has been far from clear. It is reasonable to assume that many thought that set-off established by the Statutes of Set-off did continue to exist since it had been an established and important common law doctrine over the previous two centuries and was still in force in many other common law jurisdictions.²²

5.19 A further point to be considered is that the reintroduction of set-off under the Statutes of Set-off is clearly premised upon its general desirability. Indeed two submissions recognised this to the extent that they were prepared to advocate that the new provision apply to debts arising before its commencement,²³ with one of these prepared to do so notwithstanding an otherwise general opposition to the concept of retrospectivity in legislation.²⁴

21. M Wormell, *Submission* at 3.

22. Not least of which are Victoria and England.

23. Law Society of NSW, *Submission 2*; and K R Handley, *Submission* at para 10.

24. Law Society of NSW, *Submission 2*.

5.20 The Commission has considered a number of options for protecting agreements entered into on the understanding that statutory set-off was not available, while extending set-off to situations where it would otherwise be desirable and possibly assumed in any case. These options included defining the types of agreements which would have been entered into on the understanding that set-off was not available and setting up a rebuttable presumption.

5.21 In the end, the Commission has decided that, on balance, the transitional provision which best achieves a fair and just outcome in the cases mentioned in paragraph 5.18 is one which allows a general application of the new provision by stating that, subject to any agreement to the contrary, it applies to any debt whether arising before or after the commencement of the new provision. However, the Commission has also decided to give the courts a discretion to disallow set-off in relation to agreements entered into before the commencement of the new provision where it is in the interests of justice to do so. We make this recommendation in the expectation that the courts will exercise their discretion in situations where it is clear that set-off under the Statutes of Set-off was not expressly excluded because it was assumed that the law no longer applied. We particularly have in mind securitisation and other similar transactions.

5.22 The exercise of the discretion to disallow set-off will be available only with respect to set-off arising under an agreement entered into before the commencement of the new provisions. The provision granting the discretion will, therefore, be transitional in nature as the number of agreements will be finite and the agreements themselves will eventually cease to have effect.

Recommendation 5

That, subject to any agreement to the contrary, the new provision apply to any debt whether arising before or after its commencement. However, the courts shall have a discretion to disallow set-off in relation to a debt arising under an agreement entered into before the commencement of the provision, if it is satisfied that it would be in the interests of justice to make such an order.

APPENDIX A

SET-OFF BILL

[1] Set-off

- (1) In any proceedings where there are mutual debts between a plaintiff and a defendant, the defendant may, by way of defence, set off against the plaintiff's claim a debt owed by the plaintiff to the defendant that was due and payable at the time the defence of set-off was filed, whether or not the mutual debts are different in nature.
- (2) Subsection (1) extends to proceedings where one or more of the mutual debts is owed by or to a deceased person represented by a legal personal representative.
- (3) Subsection (1) does not apply to the extent that the parties have agreed that debts (whether generally or in relation to specific debts) may not be set off against each other.
- (4) Subsection (1) does not apply:
 - (a) to a debt arising under an agreement entered into before the commencement of this section, or
 - (b) to any other debt arising before the commencement of this section.
- (5) Despite subsection (4), the court may order that subsection (1) applied to a debt referred to in subsection (4) if it is satisfied that it would be in the interests of justice to make such an order.
- (6) In this section:

court, in relation to any proceedings, means the court or tribunal determining the proceedings.

plaintiff includes:

 - (a) a cross-claimant, and
 - (b) an applicant or cross-applicant.

debt means any liquidated demand.

defendant includes:

 - (a) a cross-defendant, and
 - (b) a respondent or cross-respondent.

Note. This section reinstates, with some minor differences, the right to set off mutual debts that was abolished with the repeal of the Statutes of Set-off (2 Geo II c 22 and 8 Geo II c 24) by the *Imperial Acts Application Act 1969*. The substantive changes are:

- (a) Set-off is available for debts that are due and payable at the time the defence of set-off is filed. Under the Statutes of Set-off, set-off was available for debts that were due and payable when the plaintiff commenced the action.
- (b) Parties may contract out of the section. Although this was probably also the case under the Statutes of Set-off, there was no express provision for the exclusion of set-off by agreement.

[2] Effect on other rights or obligations

Section [1] does not affect any other rights or obligations of a debtor or creditor in respect of the mutual debts (whether arising in equity or otherwise).

APPENDIX B

Submissions

The Hon Justice W V Windeyer, Supreme Court of New South Wales
(5 June 1998)

Law Society of New South Wales (1 July 1998) *Submission 1*

Mr S R Derham, barrister-at-law and Victorian Bar Council
(21 July 1998)

Mr M Wormell, Partner, Allen Allen & Hemsley (25 August 1998)

Mr S R Derham, barrister-at-law (20 May 1999)

Mr J C Campbell, barrister-at-law (21 May 1999)

Law Society of New South Wales (17 June 1999) *Submission 2*

The Hon Justice K R Handley, Supreme Court of New South Wales (7
July 1999)

TABLE OF LEGISLATION

Commonwealth

Bankruptcy Act 1966	2.15, 3.14
s 86	1.10
Corporations Law	
Part 5.3A	1.10
s 553C	1.10
Payment Systems and Netting Act 1998	1.8
Part 3	1.8
Part 4	1.8
Part 5	1.8
s 5	1.8

New South Wales

Imperial Acts Application Act 1969	1.1, 1.2, 1.11, 4.1, 4.3, 4.23
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