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Gye & Perkes v McIntyre

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Gye & Perkes v McIntyre

Abstract
[extract] It is well understood that the law which relates to the set-off of mutual dealings in bankruptcy, which has a long history, exists to prevent the injustice of a man who has had mutual dealings with a bankrupt from having to pay in full what he owes in respect of such dealings while only receiving a dividend on what the bankrupt owed him in respect of them: see Ex parte Barnett; Re Deveze (1874) 9 Ch App 293 at 297.

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Keywords
Gye & Perkes v McIntyre, bankruptcy, Bankruptcy Act 1966, mutual dealings

GYE & PERKES v McINTYRE

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Introduction

Prior to the date of bankruptcy, the bankrupt and a creditor of the bankrupt may have mutual dealings with one another which may result in mutual liabilities or debts. In this event s 86 of the *Bankruptcy Act* 1966 provides that:

> ... where there have been mutual credits, mutual debts or other mutual dealings between a person who has become a bankrupt and a person claiming to prove a debt in the bankruptcy -
> a) an account shall be taken of what is due from the one party to the other in respect of those mutual dealings;
> b) the sum due from the one party shall be set off against any sum due from the other party; and
> c) only the balance of the account may be claimed in the bankruptcy, or is payable to the trustee in the bankruptcy, as the case may be.

S 86(2) goes on to provide that a person is not entitled to claim the benefit of the section if at the time of giving credit he had notice of an act of bankruptcy.

An example of the operation of this section is as follows:

The debtor may have two bank accounts with the one financial organization. One account may have a credit balance of $1500 while the other account may have an overdraft of $3000. In the absence of s 86 the bank would be required to pay to the Official Trustee the sum of $1500 and then prove in the bankruptcy for the $3000. If a dividend of 10 cents in the dollar was declared the bank would only recover $300. In essence, despite being owed $1500, the financial organization would have paid out a net sum of $1200. What s 86 does is allow the bank to set-off the $1500 credit balance with the overdraft of $3000. The financial organization will then be able to prove in the bankruptcy for the remaining $1500.

The rationale of this provision was explained by Gibbs CJ in *Day & Dent Constructions Pty Ltd (In Liq) v North Australian Properties Pty Ltd.* [1]

1 (1982) 150 CLR 85.

> It is well understood that the law which relates to the set-off of mutual dealings in bankruptcy, which has a long history, exists to prevent the injustice of a man who has had mutual dealings with a bankrupt from having to pay in full what he owes in respect of such dealings while only receiving a dividend on what the bankrupt owed him in respect of them: see Ex parte Barnett; Re Deveze (1874) 9 Ch App 293 at 297. [2]

The purpose, construction and ambit of this right of set-off was recently considered by the full bench of the High Court in *Gye and Perkes v McIntyre*.[3]

The Facts

Gye and Perkes were members of a syndicate of five persons who purchased a hotel and related land for $1.25ml in Wilberforce, New South Wales. The vendor was Mawson Hotels Pty Ltd. To finance the venture the syndicate borrowed $600,000 from Mawson Hotels Pty Ltd, secured by a first mortgage over the property. A second mortgage of the property was given by Gye and Perkes in favour of Mrs McIntyre, to secure a loan to them, from her, of $200,000. Mrs McIntyre was a director of the vendor company, the licensee of the hotel business and tenant of the hotel property. Mrs McIntyre was involved in the negotiations between the company and the purchasers and had induced Gye and Perkes to enter into the contracts by fraudulent misrepresentations about the profitability and takings of the business.

The Litigation

The business operations failed and the company entered into possession of the mortgaged premises. Mrs McIntyre commenced proceedings on 7 June 1982 to recover the principal and interest due to her. On 24 June 1982, default judgment was entered in her favour for the amount of $224,000 plus costs of $215.

Gye and Perkes sought to have the default judgment set aside. This was unsuccessful, but on 13 December 1982, execution was stayed pending a cross-claim by Gye and Perkes against Mrs McIntyre. Proceedings on the cross-claim were commenced on 7 January 1983. The cross-claim was a claim in deceit for fraudulent misrepresentation. After this cross-claim was commenced, bankruptcy notices issued against Gye and Perkes, on the application of Mrs McIntyre, were set aside by order of the Federal Court.

On 8 March 1985 Gye signed an instrument pursuant to s 188 of the *Bankruptcy Act* 1966 authorizing a registered trustee to call a meeting of creditors for the purposes of Part X of the *Bankruptcy Act*. On 3 April 1985 a meeting of creditors passed a special resolution agreeing to a composition. On 12 June 1985 Perkes signed a similar authority and on the 28 June 1985 the creditors accepted the composition proposed by him. The claim against Mrs McIntyre in deceit was not included in the composition. In addition, Mrs McIntyre did not seek to prove as a creditor in either composition.

2 (1982) 150 CLR 85 at 95.
3 (1991) 98 ALR 393.

In 1988 the cross-claim came to trial in the commercial division of the New South Wales Supreme Court and on 12 September 1988, judgment was entered in favour of Gye and Perkes in the sum of $214,600.89 plus costs. An appeal against this decision was dismissed on 31 May 1985.

After these proceedings were completed, four applications were made to the Federal Court. One each by Gye and Perkes and two by Mrs McIntyre. Gye and Perkes sought a declaration that Mrs McIntyre was not entitled to set-off the amount payable to her under the 1982 judgment, against the amount payable under the judgment on the cross-claim. Mrs McIntyre sought orders that the compositions entered into by Gye and Perkes were void, and that they be terminated, and that a sequestration order be made against their respective estates.

At first instance[4] the applications by Mrs McIntyre were dismissed with costs. In each of the applications by Gye and Perkes, it was held that Mrs McIntyre was not entitled to set-off the respective judgments. Mrs McIntyre appealed to the Full Court of the Federal Court.[5] The appeal was conducted on the basis that if she succeeded on the set-off issue, she would have no interest in pursuing a challenge to the compositions, or the issue of whether she had been entitled to prove in the composition. The Full Court held that Mrs McIntyre was entitled to set-off the two judgments. Gye and Perkes appealed against this decision to the High Court.

The High Court Decision: *Gye and Perkes v McIntyre* [6]

The issue squarely before the High Court, was whether the judgment in favour of Mrs McIntyre in respect of the second mortgage, could be set-off against the judgment in favour of Gye and Perkes for deceit?

The unanimous decision of the seven judges of the High Court was that the claims could be set-off; thus affirming the decision of the Full Court of the Federal Court. The judgment of the High Court was detailed and the following observations were made in respect of s 86.

The Object of s 86 of the Bankruptcy Act 1966

The High Court reiterated that the purpose of set-off was to achieve fairness between the parties.

> It has often been pointed out that the object of set-off in bankruptcy is, in the words of Parke B in *Forster v Wilson* (1843) 12 M & W 191 at 204; 152 E R 1165 at 1171, 'to do substantial justice between the parties, where a debt is really due from the bankrupt to the debtor to his estate'. Where there are genuine mutual debts, credits or other dealings, it would be unjust if the trustee in bankruptcy could insist upon having 100 cents in the dollar upon the whole of the debt owed to the bankrupt but at the same time insist that the bankrupt's debtor must be satisfied with a dividend of some few cents in the dollar on the

4 (1989) 89 ALR 460 (Hill J).
5 (1990) 22 FCR 260; 92 ALR 577 (Pincus, Gummow and von Doussa JJ).
6 (1991) 98 ALR 393 (Full Bench).

> whole of the debt owed by the bankrupt to him....To the extent necessary to achieve that legislative purpose of 'substantial justice' to the parties, it is established by authority that a provision such as s 86 of the Act should be given 'the widest possible scope' (see, eg. per Mason J in *Day & Dent Constructions* (CLR at 108) quoting Lord Esher MR in *Eberle's Hotels & Restaurant Co Ltd v Jonas* (1887) 18 QBD 459 at 465). [7]

The Requirements of s 86 of the Bankruptcy Act

The first requirement of s 86 is that there be two persons of the kind described in the section. That is, there be a person who has become a bankrupt and also a person claiming to prove a debt in the bankruptcy. By virtue of s 243 of the *Bankruptcy Act*, Gye and Perkes were both considered to be persons who had become bankrupt. However the question that arose on this point was whether Mrs McIntyre could be considered to be a 'a person claiming to prove a debt in the bankruptcy'? This point arose because Mrs McIntyre had not lodged a proof of debt in either composition. The Court quickly dismissed this argument.

> [T]he words 'a person claiming to prove a debt in the bankruptcy' in s 86 should not be construed in the technical sense of referring only to a person who lodges a formal proof of debt. The words should be, and have been, construed as extending to a person who seeks to answer a claim brought against him, by a trustee in bankruptcy, by a set-off of a claim against the person who has become bankrupt which would have otherwise been provable in the bankruptcy.[8]

The second requirement of s 86 was that there be mutuality between the claims. This involved three elements:

- the claims must be between the same persons. This was satisfied as Gye and Perkes had a claim against Mrs McIntyre and similarly Mrs McIntyre had a claim against Gye and Perkes;

- the benefit or burden of the claims must lie in the same interest. In determining this the important factor to be considered was the equitable or beneficial ownership of the claims. For example, the claims must not be held as trustee for another person. Again, this requirement was satisfied, Gye and Perkes were personally liable for the mortgage debt and Mrs McIntyre was personally liable for deceit even though she was involved in the transactions as director of the vendor company;

- the third element of mutuality was that the claims must ultimately sound in money. This was satisfied as the claim on the mortgage debt, and the claim for deceit, were both capable of reduction to a pecuniary sum.[9]

It followed that on the facts before the High Court the respective claims satisfied the criteria of mutuality.

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7 (1991) 98 ALR 393 at 398-399.

8 (1991) 98 ALR 393 at 400.

9 See the comments by the High Court (1991) 98 ALR 393 at 402-403.

The third requirement is that the transactions be considered 'dealings' within the terms of s 86.

> The word 'dealings' is used in a non-technical sense in s 86. It has been construed as referring to matters having a commercial or business flavour: if 'one man assaults another or injures him through negligence, that gives rise to a claim, but is not a dealing' (Per Lord Esher MR, *Eberle's Hotels*, at 465). The word is, none the less, one of very wide scope which embraces far more than a legally binding contract or 'deal'. Even if it be correct to construe 'dealings' in s 86 as confined to a commercial or business setting, it covers the communings, the negotiations, verbal and by correspondence, and other relations which occur or exist in the setting.[10]

This element was easily satisfied as all the parties were involved in one or more capacities in the negotiations leading up to the sale and purchase of the Wilberforce properties.

The Arguments by the Appellants

The appellants put forward three arguments as to why the set-off should not be permitted in the circumstances before the Court.

First, they argued that set-off is not allowed where their respective claims did not pass to the registered trustee under the compositions. The High Court considered that this conclusion was not supported by the language of the legislation,[11] nor was the argument supported by considerations of justice and policy.

> In these circumstances, it would be quite contrary to the considerations of substantial justice which, as has been seen, provide the rationale of s 86 if a statutory majority of the creditors could, by excluding a claim of the debtor against a particular creditor from the property vesting in the trustee of the composition, deprive that creditor of the benefit of a set-off to which he would have been entitled if a sequestration order had been made.[12]

The second submission put forward by the appellants was to the effect that set-off under s 86 would not be allowed in respect of an unliquidated claim in tort of the bankrupt which could not be proved in a bankruptcy. The High Court quickly disposed of this argument.

> There is nothing at all in the Act which requires that a claim of a person who has become bankrupt which vests in his trustee should, for the purposes of s 86 (or, for that matter, any other section), be subjected to the additional test of whether, if the debtor of the bankrupt had himself become bankrupt, the claim would have been a provable debt in the debtor's bankruptcy. Nor is there any reason in fairness or common sense why such an additional test should be imposed.[13]

10 (1991) 98 ALR 393 at 403.
11 (1991) 98 ALR 393 at 404-405.
12 (1991) 98 ALR 393 at 405.
13 (1991) 98 ALR 393 at 405-406.

In the opinion of the High Court, provided that the three criteria of mutuality were present, a liquidated claim of a creditor could be set-off against an unliquidated claim in tort of the bankrupt.[14]

The third submission by the appellants was that no set-off was permissible where the claim by the trustee against the third party arises after the date of the sequestration order and is not a claim in contract. The Court found no support for this proposition in the language of the section nor was there any support for this argument by a consideration of the policy behind s 86.[15] Furthermore the cases cited[16] in support of this argument did not, properly understood, provide a foundation for such a premise, and in addition gave no reasoned justification for such a rule.[17]

One additional point considered by the High Court was whether s 86 could be overridden by contrary agreement of the parties? While the matter was not directly before the High Court, the comment was made that 'the traditional and better view would appear to be that the statutory rule of set-off contained in s 86 will, where the requirements of the section are satisfied, prevail over a contrary agreement of the parties."[18]

Conclusion

The High Court in dismissing the appeal have reaffirmed that the rationale of s 86 of the *Bankruptcy Act* 1966 is to provide substantial justice between the parties and that in achieving this objective s 86 should be given the widest possible scope. Accordingly the wording of s 86 should not be construed in a technical sense and thus there was no requirement for a person to have lodged a formal proof of debt before they can claim the right of set-off. In addition the requirement of mutuality was directed to the relationship between the claims which had arisen from the dealings. It did not require that the claims be 'identical' or the 'same'. Furthermore the concept of 'dealings' was to be used in a non-technical sense and includes the negotiations leading to commercial transactions. Finally the High Court was of the view that s 86 is not confined to claims in contract and that a liquidated claim of a creditor could be set-off against an unliquidated claim of the bankrupt.

14 (1991) 98 ALR 393 at 406.

15 (1991) 98 ALR 393 at 406-407.

16 *Jack v Kipping* (1882) 9 QBD 113; *Palmer v Day & Sons* [1895] 2 QB 618; *Re Canada Cycle and Motor Agency* (Queensland) Ltd (1931) 4 ABC 27.

17 (1991) 98 ALR 393 at 406-409.

18 (1991) 98 ALR 393 at 401, quoting with approval the House of Lords decision in *National Westminister Bank Ltd v Halesowen Presswork & Assemblies Ltd* [1972] AC 785 at 803, 808-809 and 824.