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THE INTEREST IS NOT MUTUAL: EFFECT OF THE PERSONAL PROPERTY SECURITIES ACT 2009 (CTH) ON CONTRACTUAL RIGHTS OF SET-OFF

CAROLINE WOO*

ABSTRACT

In *Hamersley Iron Pty Ltd v Forge Group Power Pty Ltd (In Liquidation) (Receivers and Managers Appointed)*, the Supreme Court of Western Australia held that the rights of ANZ, a secured creditor of Forge Group Power Pty Ltd (Forge) holding a security interest under the Personal Property Securities Act 2009 (Cth) (PPSA), trumped Hamersley Iron Pty Ltd's rights of contractual and equitable set-off. Forge is in receivership and in liquidation. In answering the preliminary issues in dispute between the parties, the Supreme Court examined the complex interaction between contractual and equitable rights, the PPSA and section 553C of the Corporations Act 2001 (Cth) (the CA).

I INTRODUCTION

Hamersley Iron Pty Ltd v Forge Group Power Pty Ltd (In Liquidation) (Receivers and Managers Appointed),¹ concerned a dispute between Hamersley Iron Pty Ltd (*Hamersley*) and Forge Group Power Pty Ltd (*Forge*). Hamersley and Forge were parties to engineering contracts (*Contracts*), which included provisions governing payment and set-offs. Forge became insolvent and was placed in receivership and liquidation. Hamersley sought to set-off its claims against Forge, which were for a greater value than Forge's claims against it, and to prove for the balance in Forge's liquidation. Forge's case, however, was that its claims against Hamersley were subject to a security interest under the PPSA and accordingly, Forge argued that Hamersley was not entitled to set-off its claims and must pay the full amount it owed Forge.

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¹*Hamersley Iron Pty Ltd v Forge Group Power Pty Ltd (in Liquidation) (Receivers and Managers Appointed)* [2017] WASC 152 (2 June 2017).

Justice Tottle held that set-off was not available to Hamersley. Whilst the Contracts provided for Hamersley to have a right to set-off its claims against monies it owed Forge,² Hamersley was not able to rely on such rights because of section 553C of the *Corporations Act 2001 (Cth) (CA)*. Section 553C operates as a code regulating set-offs between an insolvent company and a person who wants to have a debt or claim admitted against that company and it operates to the exclusion of equitable set-off and contractual set-off.³ Nor could Hamersley rely on the right of set-off provided for under section 553C since any mutuality of interest between Forge's claims and Hamersley's claims ended when the security over Forge's claims was created in favour of ANZ.

II DID THE CONTRACTS PROVIDE FOR SET-OFF AND NETTING-OFF?

The first issue considered by Justice Tottle was whether clause 16 of the General Conditions (**GC**) of the Contracts between Forge and Hamersley provided for a netting-off or set-off. The clause sets out a three-step process for payments. Firstly, Forge was to submit monthly progress claims. Secondly, Hamersley was to issue Forge with a Payment Certificate stating its opinion of the money due from it to Forge pursuant to the monthly progress claim. Thirdly, for Hamersley to make payment.⁴ Subclause 16.6 governed delayed payments and subclause 16.12 provided that Hamersley may deduct from monies otherwise due to Forge any debt or other monies due, and any claim to money which Hamersley may have against Forge whether for damages (including liquidated damages) or otherwise, under or in connection with the Contract. Hamersley did not exercise its rights pursuant to subclause 16.12 before the appointment of administrators.⁵

Hamersley's case was that the payment terms amounted to, '...not so much a set-off but an agreement that, in that event (that is, if Hamersley exercised its contractual rights), only a net balance is due to or from Forge.'⁶ It contended that the reference to 'monies otherwise due' in subclause 16.12 was to give a base from which the netting-off or off-setting contemplated by

²Ibid [405].

³Ibid [407].

⁴Ibid [126].

⁵Ibid [139].

⁶Ibid [130].

the clause might be made.⁷ His Honour rejected Hamersley's argument and held that subclause 16.12 did not operate as a netting-off provision.⁸ Justice Tottle held that the language employed in clauses 16.4(a), 16.5 and 16.12 was clear and did not support Hamersley's position. His Honour stated that on its true construction, clause 16

'provides for amounts to be due and owing to Forge (debts) and cl 16.12 does not operate to convert them into a base for 'netting off' such that the amounts were never in fact due because they were subject to Hamersley's rights of set-off'.⁹

It was however, clear that subclause 16.12 gave Hamersley an entitlement to set-off. This raised the issue as to whether the right of equitable and contractual set-off is displaced by section 553C of the CA.

III DOES S 553C DISPLACE THE OPERATION OF EQUITABLE AND CONTRACTUAL SET-OFF?

Section 553C of the CA deals with insolvent companies and with mutual credit and set-off. In short, where section 553C operates, the original claims and cross-claims cease to exist and are replaced by a balance. If that balance is in the creditor's favour, the creditor may prove for the amount of the balance in the winding up.¹⁰

Hamersley accepted that the authorities supported the proposition that if section 553C applies, any contractual set-off inconsistent with section 553C would not operate. It argued, however, that where section 553C is inapplicable, contractual set-off and equitable set-off remained available. Justice Tottle rejected Hamersley's contentions. His Honour held that section 553C operates as an exclusive code that regulates set-off between an insolvent company and a person who wants to have a debt or claim admitted against the company to the exclusion of equitable set-off and contractual set-off.¹¹ His Honour reached this conclusion on the bases of the following:

7Ibid [129]-[133].

8Ibid [136]-[143].

9Ibid [142] (emphasis added).

10Ibid [153]; citing *GM & AM Pearce and Co Pty Ltd v RGM Australia Pty Ltd* [1998] 4 VR 888 (Batt JA); (1997) 143 FLR 1.

11Ibid [200], [210].

- (a) this conclusion is supported by the statutory text, that is, by the mandatory language used in the provision;¹²
- (b) the statutory context of section 553C, that is, the provision appears in a subdivision of the CA which sets out a detailed set of rules to be applied in relation to proofs of debt and claims evidencing a legislative intention that these provisions should regulate all debts and claims between the company, its debtors and its creditors;¹³
- (c) the finality of the process would be undermined if the party claiming to prove could improve its position by relying on a set-off outside the section 553C regime;¹⁴
- (d) the statutory purpose of section 553C and its predecessor provisions, which is to do substantial justice between the company and its debtors and its creditors as a whole, would be undermined if set-offs, whether equitable or contractual, that are not confined by the limits of section 533C could be invoked;¹⁵
- (e) there is persuasive support in the authorities that there can be no contracting out of section 553C and, from this proposition, it is logical to conclude that the section established a code and that there can be no reliance outside of that code on other forms of set-off;¹⁶ and
- (f) the weight of authority, particularly the judgment in *Day v Dent*,¹⁷ favours the view that section 553C constitutes a code and that other forms of set-off cannot be relied upon independently of the provision.¹⁸

Accordingly, contractual set-off and equitable set-off was not available to Hamersley. Any right to set-off would only be available if section 553C of the CA applied.

The parties raised a number of further arguments in the event that section 553C was not held to be an exclusive code. Whilst it was unnecessary for his Honour to do so, Justice Tottle dealt with these arguments before addressing whether set-off pursuant to section 553C of the CA was available to Hamersley.

¹²Ibid [211].

¹³Ibid [212].

¹⁴Ibid [213].

¹⁵Ibid [214].

¹⁶Ibid [215].

¹⁷*Day v Dent* [1981] FCA 37; (1981) 34 ALR 595.

¹⁸*Hamersley Iron Pty Ltd v Forge Group Power Pty Ltd (in Liquidation) (Receivers and Managers Appointed)* [2017] WASC 152 (2 June 2017), [217]-[218].

III ARE HAMERSLEY'S RIGHTS TO CONTRACTUAL SET OFF NONETHELESS PRESERVED BY S
80(1) OF THE PPSA?

Hamersley argued that its rights to contractual set-off was preserved by section 80(1) of the PPSA. His Honour held, however, that Hamersley could not invoke section 80(1) to enable it to raise set-off (other than that permitted by section 553C of the CA) in Forge's liquidation.¹⁹

Section 80(1) of the PPSA provides that:

The rights of a transferee of an account or chattel paper (including a secured party or a receiver) are subject to:

- (a) *the terms of the contract between the account debtor and the transferor, and any equity, defence, remedy or claim arising in relation to the contract (including a defence by way of a right of set-off); and*
- (b) *any other equity, defence, remedy or claim of the account debtor against the transferor (including a defence by way of a right of set-off) that accrues before the first time when payment by an account debtor to the transferor no longer discharges the obligation of the account debtor under subsection (8) to the extent of the payment. (underline added)*

This raised an issue as to whether Forge's claims constituted accounts transferred to ANZ.²⁰

Section 10 of the PPSA defined 'Account' as follows:

account means a monetary obligation (whether or not earned by performance, and, if payable in Australia, whether or not the person who owes the money is located in Australia) that arises from:

- (a) disposing of property (whether by sale, transfer, assignment, lease, licence or in any other way); or
- (b) granting a right, or providing services, in the ordinary course of a business of granting rights or providing services of that kind (whether or not the account debtor is the person to whom the right is granted or the services are provided);

but does not include any of the following:

- (c) an ADI account;
- (d) chattel paper;
- (e) an intermediated security;
- (f) an investment instrument;
- (g) a negotiable instrument.

¹⁹Ibid [222].

²⁰Ibid [240].

His Honour held that a ‘monetary obligation’, in the context of the definition above, is

an existing legal obligation on one party to pay an identifiable monetary sum to another on an ascertainable date arising from the disposing of property or the granting of a right or providing services in the ordinary course of granting rights or providing services of that kind subject to the specified exceptions.²¹

Justice Tottle stated that:

... a claim for payment for services provided pursuant to an agreement is capable of constituting a monetary obligation provided that the agreement contains a mechanism for ascertaining the amount to be paid and the payment date. If there is a legally enforceable obligation and a corresponding existing liability to make payment then it is immaterial that enforcement by court proceedings is required or that a court is required to resolve a dispute as to the amount to be paid or the payment date. Contractual claims of this nature may be contrasted with a right to claim damages in tort or equity, which the court in *Strategic Finance* held did not constitute monetary obligations. In the case of a right to claim damages in tort or equity a legally enforceable obligation and corresponding liability does not arise until judgment. By way of contrast, a legally enforceable contractual obligation and corresponding liability arises when there is performance in accordance with the terms of the contract.²²

Forge’s claims against Hamersley were broadly categorised as claims for amounts certified for payment (*Payment Certificate Claims*), progress claims, and claims arising from securities it says were wrongfully drawn down by Hamersley (*Securities Claims*). Forge conceded that the Payment Certificate Claims were accounts.²³ His Honour held that the progress claims were also accounts for the purposes of the PPSA but that the Securities Claims were not.²⁴

His Honour stated that the purpose of section 80(1) of the PPSA was to protect account debtors who would otherwise be disadvantaged by the transfer of accounts in which they have an interest.²⁵ Justice Tottle held that there was no basis for concluding that Parliament intended section 80(1) of the PPSA to amend the statutory regime for mutual credit and set-

²¹Ibid [260] (emphasis added).

²²Ibid [261].

²³Ibid [263].

²⁴Ibid [265], [266].

²⁵Ibid [219]-[221].

off in liquidation set out in section 553C of the CA.²⁶ Further, as Hamersley's rights were to be determined within the context of Forge's liquidation, they had to be determined by reference to the statutory provisions set out in the CA.²⁷ Accordingly, section 80(1) of the PPSA did not preserve Hamersley's right to contractual and equitable set-off.

IV IF THE RIGHTS TO SET-OFF ARE PRESERVED BY S 80(1), DOES THAT GIVE RISE TO AN INCONSISTENCY BETWEEN S 80(1) OF THE PPSA AND SECTION 553C OF THE CORPORATIONS ACT TO WHICH SECTION 258 OF THE PPSA APPLIES, WITH THE RESULT THAT S 553C PREVAILS?

His Honour also dealt with Forge's argument that even if section 80(1) of the PPSA preserved Hamersley's rights, to the extent to which section 80 is construed as having the effect of permitting an account debtor to raise a contractual set-off against a company in liquidation, it is inconsistent with section 553C and, by reason of the operation of section 258 of the PPSA, it would not have that effect.²⁸ Section 258 of the PPSA provides as follows (emphasis added):

- (1) *This Act (apart from Division 4), or any instrument made under this Act, does not have an effect covered by subsection (2) to the extent to which that effect would give rise (apart from this subsection) to a direct inconsistency between this Act, or the instrument, and a law covered by subsection (3)...*

The following effects of a law are covered by this subsection:

- (a) prohibiting or limiting a person creating, acquiring or dealing with personal property or a security interest in personal property;
 - (b) without limiting paragraph (a):
 - (i) prohibiting or limiting the right of a person to hold, transfer or assign a security interest in personal property; or
 - (ii) *imposing limitations or additional obligations or requirements in relation to the enforcement of a security interest in personal property.*
- (2) The following laws are covered by this subsection:
- (a) a law of the Commonwealth (other than this Act, or an instrument made under this Act);
 - (b) a law of a referring State (while the State is a referring State);
 - (c) a law of a Territory;
 - (d) the general law.

...

²⁶Ibid [222]-[223].

²⁷Ibid [222], [224].

²⁸Ibid [227].

His Honour held that section 258 did not apply in the circumstances. While section 80(1) had the effect of the nature covered by section 258(2), section 553C did not.²⁹ Since the effect of section 553C is confined to the determination of the debts and claims of a person proving within a liquidation, it does not have an effect in relation to the enforcement of a security interest in personal property. The enforcement of security interest takes place outside the liquidation.³⁰ In any event, his Honour had held that section 80(1) of the PPSA did not preserve Hamersley's rights, that section 553C of the CA established an exclusive code, and that there could be no reliance outside of the code on other forms of set-off.³¹

Accordingly, the only right to set-off which may have been available to Hamersley would have had to come from the operation of section 553C of the CA.

V SECTION 553C OF THE CA AND THE REQUIREMENT FOR MUTUALITY OF INTEREST

It was common ground that for section 553C of the CA to operate, there must be mutuality of interest between the parties.³² The rationale underpinning the mutuality principle is that one person's money should not be used to pay another's debts.³³ The proposition advanced against Hamersley was that ANZ's money (derived from Forge's claims against Hamersley and advanced in Forge's name on behalf of ANZ) should not be used to satisfy Forge's debts to Hamersley by allowing Hamersley to set-off those debts against the claims advanced in Forge's name for ANZ's benefit.³⁴ It was, therefore, necessary to consider the nature of ANZ's interest in Forge's claims.

Prior to the PPSA, there was a distinction between fixed charges and floating charges. His Honour quoted from Lord Scott's judgment in *Re Spectrum Plus Ltd (in liq)* 2 AC 680 at [111]:

²⁹Ibid [236]-[239].

³⁰Ibid [238].

³¹Ibid [240].

³²Ibid [289].

³³Ibid [394].

³⁴Ibid [293].

[T]he essential characteristic of a floating charge, the characteristic that distinguishes it from a fixed charge, is that the asset subject to the charge is not finally appropriated as a security for the payment of the debt until the occurrence of some future event. In the meantime the chargor is left free to use the charged asset and to remove it from the security.³⁵

Attachment and crystallisation have established meanings in the context of fixed and floating charges.³⁶ When a floating charge crystallises, the floating charge attaches to the collateral and the ability of the chargor to trade and manage the assets constituting security ends.³⁷ Prior to crystallisation, however, the existence of a floating charge had no effect upon the rights of set-off accruing to the debtor of the company. This was because the law recognised that it was unfair to trade creditors to allow a chargor to trade freely yet remain immune from the normal incidents of legal process.³⁸

Justice Tottle rejected Hamersley’s submission that section 8(1) of the PPSA insulated set-off rights from the changes brought about by the PPSA.³⁹ His Honour held that the role of section 8(1) is a limited one, that is, it excludes the stipulated interests from the operation of the PPSA and exempted those who holding such interests from the need to comply with the provisions of the PPSA. Further, his Honour held that the contractual set-off provisions did not operate as a netting-off provision. Accordingly, Hamersley’s argument that there were no monies due to Forge capable of forming part of the collateral also failed.⁴⁰ That is, the condition in section 19(2)(a) of the PPSA that the grantor has rights in the collateral was satisfied.

His Honour held that attachment rule in section 19 of the PPSA operated in such a way that mutuality of interest between Forge’s claims and Hamersley’s claims ceased to exist because:

³⁵Ibid [298].

³⁶Ibid [301].

³⁷Ibid [302].

³⁸Ibid [303].

³⁹Ibid [304].

⁴⁰Ibid [307].

- (a) the attachment rule operates to confer on the secured party a proprietary interest in the collateral upon satisfaction of the conditions in section 19(2) and not at a later time (ANZ and Forge had not agreed that attachment would take place at a later time);⁴¹
- (b) as such, the pre-PPSA concept of crystallisation and the floating charge as a device for taking security over personal property had been rendered redundant by the PPSA;⁴²
- (c) the security agreement provided that the security interest granted to ANZ was by way of a charge over all collateral (other than revolving assets) and accordingly, the charge had attached by reason of the operation of section 19(2) and conferred on ANZ an equitable and proprietary interest in Forge's claims;⁴³
- (d) a statutory proprietary interest of the nature conferred by a security interest under the PPSA was sufficient to destroy mutuality of interest for the purposes of set-off;⁴⁴ and
- (e) in light of the changes brought about by the PPSA, Hamersley's argument failed because the secured party acquires a proprietary interest in the collateral before the occurrence of a 'crystallising' event.⁴⁵

In short, on attachment, ANZ acquired a proprietary interest in Forge's claims and this ended the mutuality of interest between Hamersley's claims and Forge's claims and therefore, section 553C did not apply.

VI CONCLUSION

This case illustrates the fundamental changes that the PPSA has made in respect of security interests. Such changes have significant repercussions for parties contracting with a chargor under the PPSA. As Justice Tottle noted:

Hamersley's submission draws attention to the potential injustice to a trade creditor/account debtor who may be deprived of set-off rights by a company granting a security interest over its accounts. Under the pre-PPSA law, courts were astute to avoid this potential justice by construing those charges which conferred a trading power on chargors as floating charges

⁴¹Ibid [313], [396].

⁴²Ibid [314], [323]-[334].

⁴³Ibid [315], [336].

⁴⁴Ibid [394].

⁴⁵Ibid [396].

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with the result that the chargees' proprietary interest in collateral did not arise until crystallisation and thus mutuality of interest was preserved for set-off purposes. Under the PPSA regime, this potential injustice is ameliorated by s 80(1) of the PPSA, albeit subject to the limitation which I have referred earlier in these reasons. Whether the protection afforded to account debtors by s 80(1) is adequate may well be a matter for debate.⁴⁶

⁴⁶Ibid [397].