HIGH COURT OF AUSTRALIA

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Details of Filing

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IN THE HIGH COURT OF AUSTRALIA
BRISBANE REGISTRY

B19/2022

BETWEEN:

METAL MANUFACTURERS PTY LIMITED
(ACN 003 762 641)
Appellant

and

GAVIN MORTON AS LIQUIDATOR OF MJ WOODMAN ELECTRICAL CONTRACTORS PTY LTD (IN LIQUIDATION) (ACN 602 067 863)
First Respondent

MJ WOODMAN ELECTRICAL CONTRACTORS PTY LTD (IN LIQUIDATION)
(ACN 602 067 863)
Second Respondent

RESPONDENTS' SUBMISSIONS

Part I: Certification

This submission is in a form suitable for publication on the internet.

Part II: Issue on appeal

The appeal presents the same question which was determined by the Full Court of the Federal Court of Australia (**Full Court**) on a special case referral from the primary judge i.e. *Is statutory set-off, under s 533C(1) of the Corporations Act 2001(Act), available to the defendant in this proceeding against the plaintiff's claim as a liquidator for the recovery of an unfair preference under s 588FA of the Act?*

Part III: Section 78B of the *Judiciary Act 1903* (Cth)

The Respondents have considered whether any notice should be given in compliance with section 78B of the *Judiciary Act 1903*. No such notice is required.

Part IV: Material facts which are contested

The appeal involves no contested facts.

Part V: Statement of argument

A. *Summary of respondents' submissions*

1. The Full Court correctly decided that the answer to the special question is "no" where:

Taylor David Lawyers
Level 27, 10 Eagle Street,
Brisbane QLD 4000

Telephone: (07) 3229 9800
Ref: 82021
Email: s.taylor@taylordavid.com

a. the decision produces a just and principled outcome relying upon settled principles;[1]

b. the outcome avoids the flawed, arbitrary and unjust results which arise from the appellant's approach (**AS,**[14]);[2]

c. the Full Court took a conventional approach to preference claims in circumstances where there has been no indication from the legislature of a desire to reform the law in this area.[3]

2. **Ground 1** - The Full Court correctly held that there is a lack of mutuality between the interests of the creditor on the one hand and debtor company on the other, and correctly distinguished the interest in which the company receives funds in this context and the interest in which the creditor has its own claim against the company.

3. The appellant contends that the respective interests which the Full Court compared, and it is said wrongly found, to be "of a different right, nature and interest" were these:

a. the interest of the appellant qua a creditor, on the one hand; and

b. the interest of the second respondent (the company in liquidation) "in respect of *its* claim against the creditor", on the other.

4. Such a comparison is inapt, as it is the liquidator, and not the company, who has the countervailing claim against the creditor. But even if the countervailing claim is that of a company, and not of the liquidator, mutuality would still not be present for the purpose of a set-off.[4]

5. That claim is a statutory right which is vested in the liquidator. It is not a claim available to, or one which can be pursued by, anyone other than the liquidator.[5]

6. There is no provision permitting the application to be made by the company, nor is there any provision allowing the application to be made by some person on behalf of the liquidator, or as the assignee of the liquidator's right, or in any other capacity.[6]

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[1] **J** [31], **CAB** 22; **J** [99], **CAB** 48; **J** [134], **CAB** 55; **J** [155]-[156], **CAB** 66-67.

[2] See below [33] to [38].

[3] (**J** [101], **CAB** 48; **J** [152], **CAB** 64).

[4] See below at [14]-[32].

[5] *Fortress Credit Corporation (Australia) II Pty Ltd v Fletcher* [2014] 87 NSWCA 778 at [127]-[129] (Barrett JA) (decision affirmed *Fortress Credit Corporation (Australia) II Pty Ltd v Fletcher* (2015) 89 ALJR 425; [2015] HCA 10); **J** [139], **CAB** 58. The right may be compared to other rights which are not statutorily conferred, such as the right of a company in liquidation to recover a debt.

[6] The point is self-evident on a plain reading of the voiding provision itself which states that the court may make the relevant order "on the application of the company's liquidator": s 588FF. In addition, the fact that it is the liquidator, rather than the company, who is the proper plaintiff in a recovery action under s 588FF means that the court will not make a security for costs order under s 1335: *Jonas v Rocklea Spinning Mills Pty Ltd* (2000) VSC 93.

7. The Full Court applied established principles and found that a claim is one made by the liquidator, with any funds recovered being applied under statute for the benefit of creditors and those administering the estate (**J** [148] to [151], **CAB** 63-64). The Full Court correctly distinguished the interests and rights of the parties for the purpose of reciprocity and decided the issue consistently with the requirement that the benefit or burden of the two parties should lie in the same interest for the purpose of mutuality.[7]

8. **Ground 2** –The appellant contends that the Full Court erred in finding that "the Second Respondent [company] does not have an existing right or claim (vested or contingent)" against the creditor at the relevant date.

10 9. There are three fundamental problems with this ground:

a. First, it encounters precisely the same difficulty as the first ground i.e. the right to recover an unfair preference[8] is not a right held by the company;

b. Secondly, provable debts are to be determined at the "relevant date".[9] Section 553 makes provable "all debts payable by, and all claims against the company …. the circumstances giving rise to which occurred *before* the relevant date." The statute does not require a consideration of what claims are provable "on" the relevant date or "after" the relevant date. The governing word in the section is "before" the relevant date;[10]

c. Thirdly, the obligation to disgorge a preference payment can only arise after a
20 liquidator has commenced a proceeding and a court has made an order for payment under s 588FF, at which time a new obligation arises.[11]

10. **Ground 3** - The appellant contends that: "*The Full Court erred in finding that the failure of the Parliament to incorporate the recommendation of Australian Law Reform Commission as to the proposal with respect to the form of s 553C, did not evince an intention by the Parliament to permit the application of statutory set-off in circumstances involving the recovery of unfair preferences.*"[12]

11. Contrary to this contention, the Harmer Report did not recommend the incorporation of a provision to ensure that preference payments were not subject to set-off. It said only that it was necessary to identify circumstances where set-off, where it otherwise would apply,

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[7] *Gye v Mcintyre* [1991] HCA 6; (1991) 171 CLR 609 at 623.
[8] Referred to herein simply as a "preference", a "preferential payment" or a "preference payment".
[9] *Corporations Act 2001* (Cth) (**Act**), s 9.
[10] This is a small yet significant point which is explained below: [44]-[45], [52]-[53].
[11] **J** [154], **CAB** 66.
[12] Core Appeal Book, page 95 (Ground 3).

should be precluded. Its discussion concerned the scope of what would become s 553C(2).[13]

12. The amendment made by the *Corporate Law Reform Act 1992* (Cth) (***CLRA***) relevantly inserted s 553C which, according to both the Explanatory Memorandum to the amending legislation[14] and subsequent case law,[15] did nothing more than simply import the provisions of s 86 of the *Bankruptcy Act 1966* (Cth) into the Act, with no change being made to the pre-existing law: "The proposed provision [s 553C(2)] sets out the provision of the *Bankruptcy Act*, section 86 as it is applies at present to the winding up of insolvent companies by virtue of section 553."[16]

10 13. There was no proposal to alter the position that preference claims were not subject to a defence of set-off, as has been accepted for over a century.[17]

B. *The three grounds of appeal in more detail*

Ground 1-Mutuality

14. After analysing this point at some length (**AS**, [22]-[26]), the appellant concludes that "both the company and creditor assert claims against the others" (**AS**, [26]). The unstated assumption upon which this conclusion is based is that the liquidator's claim against the creditor requiring the disgorging of a preference, is to be disregarded, with the focus being on a claim by the company. It also ignores the difference in the interests between the two claims.

20 15. The question whether funds received from a preference recovery are held on a trust under the general law does not answer the question of mutuality for s 553C in its statutory context.[18] It is necessary to further consider the character of the funds to enquire whether they reflect an underlying mutuality.[19]

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[13] The Harmer Report went on to say that the ALRC proposed, consistently with the existing developed law, that set-off should not be permitted if at the time of the transaction the person had notice that a winding up application was pending or that the company was under administration (see ALRC Report 45 General Insolvency Inquiry, Vol 1, para [817].) That proposition is now embodied in s 553C(2).

[14] Explanatory Memorandum to the *Corporate Law Reform Bill 1992* at [867] – [869].

[15] *GM & AM Pearce &Co Pty Ltd v RGM Australia Pty Ltd* [1998] 4 VR 888; (1997) 143 FLR 1; (1997) 25 ACSR 639; (1997) 16 ACLC 429.

[16] Explanatory Memorandum to the *Corporate Law Reform Bill 1992* at [869].

[17] **J** [15]-[20], **CAB** 18-20; **J** [99], **CAB** 48. Apart from the Full Court's decision, the most recent Australian authority which considered whether set-off is a "defence" to a liquidator's preference claim is *Re Force Corp Pty Ltd (in liq)* (2020) 149 ACSR 451; [2020] NSWSC 1842 (19 December 2020), where Gleeson J at [93] referred to "a long line of authority that set-off under s 553C (and predecessor sections) is not available in unfair preference claims."

[18] **J** [151], **CAB** 64.

[19] **J** [143], **CAB** 60.

16. As the High Court noted in *Gye v Mcintyre*, for the purpose of reciprocity the benefit or burden of the credits, debits or claims must lie in the same interest.[20]

17. In adhering to established principle, the Full Court recognised that a company in liquidation receives funds from a preference recovery pursuant to a statutory scheme for the benefit of unsecured creditors and those charged with the administration of the liquidation.[21] This is not a claim in the same interest as the creditor is owed the debt and consequently, the requirement of reciprocity between the parties cannot be met.[22]

18. Indeed, the question arises as to whether the company has beneficial ownership in any relevant sense where the company is not free to deal with that right as if it were its own, by assigning it or charging it as future property.[23]

19. Simply stated, beneficial ownership imports the notion of the ability of the owner to deal with the property as if it were that person's own, to dispose of it and enjoy the fruits of such disposal.[24] Here, the claim is not given for the company's own benefit but for the benefit of unsecured creditors and the administrators of the estate.[25]

20. The appellant (at **AS**, [25]) challenges the statement of Barrett JA in *Fortress Credit Corporation (Australia) II Pty Ltd v Fletcher* (2014) 87 NSWLR 728, where (at [128]) his Honour observed that the "benefit of the recovery inures wholly for the benefit of the persons who will participate under the winding up." The appellant states that this comment "must be approached with caution" and refers to the decision of McHugh J in *Linter Textiles Australia Ltd (In Liq)* (2005) 220 CLR 592 at 624 [127] in which his Honour stated that "Australian authority has favoured the view that beneficial ownership of assets of a company in liquidation remains with the company." The appellant also (at **AS**, [25]) relies on what it describes as "more recent authority" which it says, "similarly

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

[21] **J** [151], **CAB** 64.

[22] **J** [143]-[154], **CAB** 60-66

[23] R Derham "Set-off against statutory avoidance and insolvent trading claims in liquidation" (2015) 89 ALJ 458, at pp 469-476.

[24] *Ayerst v C & K (Construction) Ltd* [1976] AC 167 at 177-178, per Lord Diplock; *Commissioner of Taxation (Cth) v Linter Textiles Australia Ltd (in liq)* (2005) CLR 592 at [225], per Kirby J (referring to *Wood Preservation Ltd v Prior* [1969] 1 WLR 1077 at 1096-7). (The rejection in Australia of the view expressed in *Ayerst*, that the winding up of a company divests the company of the beneficial ownership of its assets, does not detract from the correctness of what Lord Diplock said about beneficial ownership generally: *Trust Co of Australia v Commissioner of State Revenue* (2007) 19 VR 111 at [58].)

[25] **J** [151], **CAB** 64 and see Derham n 23, pp 469-76 dealing with the mutuality element of set-off, and at pp 474-5 in relation to statutory recovery claims.

holds that the proceeds of a recovery action by a liquidator (including unfair preference recoveries) remain the property of the company."

21. The decision in *Linter Textiles Australia Ltd (In Liq)* and the "more recent authority" require further examination. First, the effect of *Linter Textiles Australia Ltd (In Liq)*[26] has been analysed in the following terms:

> "It was held in *Linter Textiles* that a company does not cease to be the beneficial owner of its assets when it goes into liquidation, the asset in that case being a company's shareholding in its subsidiary. The critical point was that the change in control in the affairs of a company which occurs upon liquidation has no impact on the beneficial ownership of its assets.[27] As McHugh J expressed it: "On liquidation, the *ownership* of the shares [in the subsidiary] is not 'for the benefit of others'; rather the *administration* of the assets is for the benefit of the creditors" (original emphasis).[28] But in the case of a statutory insolvency claim the right itself (the "ownership") is given for the benefit of others (the general body of creditors).[29]"[30]

28. Second, the "more recent authority" to which the appellant refers (**AS**, [25]) is a decision of Finkelstein J in *Cook v Italiano Family Fruit Company Pty Ltd*[31] (***Cook***). The facts, briefly, were these:

a. Mr Cook and Mr O'Connor (**Liquidators**) were appointed liquidators of Italiano Family Fruit Company Pty Ltd (**Company**).

b. The Company had previously granted to the National Australia Bank Limited (**NAB**) a fixed and floating charge over all its assets and undertaking.

c. The Liquidators had realised assets which were the subject of the floating component of the NAB charge, and in purported compliance with s 561, paid employee entitlements [s 561 gives employees priority over a chargeholder in respect of assets subject to a floating charge where the unencumbered assets of a company are insufficient to meet those entitlements].

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[26] *Commissioner of Taxation (Cth) v Linter Textiles Australia Ltd (In Liq)* (2005) 220 CLR 592.
[27] *Commissioner of Taxation (Cth) v Linter Textiles Australia Ltd (In Liq)* (2005) 220 CLR 592 at [54]-[55], [58]; see also McHugh J at [125].
[28] *Commissioner of Taxation (Cth) v Linter Textiles Australia Ltd (In Liq)* (2005) 220 CLR 592 at [125].
[29] *Sheahan v Carrier Air Conditioning Pty Ltd* (1997) 189 CLR 407 at 428.
[30] Derham n 23 at 476.
[31] *Cook v Italiano Family Fruit Company Pty Ltd* (2010) 190 FCR 474.

d. Subsequently, the Liquidators successfully recovered various preference payments and after paying their costs, expenses and remuneration of the winding up, held a "surplus" of some $50,000.

e. At that point, NAB was still owed around $1.2 million and the unsecured creditors were owed some $3.8 million.

f. The Liquidators applied to the court for directions as to whether they should pay the surplus to NAB or distribute it to the general body of unsecured creditors.

29. The matter came before Finkelstein J who undertook an extensive examination of the historical case law in respect of a number of legal principles, both in England and Australia, and made various findings and observations including that:

a. "[t]he right to bring a preference or similar action….cannot be brought by any person other than the liquidator. That is, it is a right which cannot be assigned." (at 479 [12]).

b. "[i]t has been accepted that money recovered in preference actions that can only be brought by a liquidator are [sic] not caught by a charge over the company's current and future assets." (at 479 [13]).

c. In *NA Kratzmann Pty Ltd (in liq) v Tucker (No 2)* (1968) 123 CLR 295 (***Kratzmann***), the High Court drew a distinction between preferences in the form of monies recovered by the liquidator, and assets recovered in specie; the former do not fall within the ambit of a charge whereas the latter may. at 480 [16], 480 [17] – [18] and 485 [40].

d. There is a "*significant problem [which] concerns the liquidator's right to reimbursement of his/her costs and expenses*. Costs and expenses are usually only allowed to be recovered out of the company's "assets" or "property". *If preference action proceeds are not property of the company, then the liquidator is not entitled to recover his/her costs out of them.*" (at 480 [16], 481 [23] (emphasis added)).

e. Preference proceeds are however "property of the company" such that this difficulty is thereby avoided and "the liquidator can claim his/her costs and expenses of the winding up and his/her remuneration out of preference proceeds". (at 486 [42]).

30. In the result, Finkelstein J held that the liquidators were in breach of trust by paying the employee entitlements,[32] that NAB should be "subrogated" to the statutory rights of the

[32] *Cook v Italiano Family Fruit Company Pty Ltd* (2010) 190 FCR 474, 492 [78]-[79], 493 [80].

employees[33] and that a liquidator must pay employee entitlements only when the liquidator makes an assessment that there are insufficient available "free assets" to pay the s 561 entitlements.[34]

31. Following *Cook*, there has been a series of Federal Court decisions all of which have followed Finkelstein J and held that where there is a "surplus" in the liquidation following the payment of statutory employee entitlements under s 433 or s 561 out of assets secured by a floating security interest, then the surplus should be paid to the secured creditor by way of subrogation to the employees. None of these cases however adopts that part of the decision of Finkelstein J which concludes that preference recoveries are "property the company" or explains the meaning of that expression.[35]

32. Accordingly, neither the "more recent authority" of *Cook*, nor the Federal Court cases which follow it, cast doubt upon the observations of Barrett JA in *Fortress Credit Corporation (Australia) II Pty Ltd v Fletcher*.[36]

The appellant's practical example and the history of s 588FI considered

33. The appellant (at **AS**, [14]) gives an example of why it is said that set-off to a liquidator's preference claim gives rise to no "conflict or incoherence". The example is that of a creditor which was preferred over other creditors to the extent of $100. That creditor is still owed $75 when the company is wound up and the liquidator seeks to recover the preference. In "answer" to the liquidator's claim, the creditor sets off against the liquidator claim the amount it is owed, thereby asserting that it is obliged to disgorge only $25, in respect of which it can then prove in the liquidation for a dividend.[37]

34. The result is that while the other creditors are left to prove for, in most cases, a small to no dividend at all, the preferred creditor effectively receives a dividend of 100 cents in the dollar in respect of its $75 debt and is then able to prove in competition with the other creditors for the $25.

35. On any view this appears unfair and contrary to the *pari passu* principle. The result arises however as a consequence of a failure to accept a proposition which has been long-established, and which has been explained by the High Court[38] i.e., a creditor is not

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[33] *Cook v Italiano Family Fruit Company Pty Ltd* (2010) 190 FCR 474, 497-500 [110]-[115].
[34] *Cook v Italiano Family Fruit Company Pty Ltd* (2010) 190 FCR 474, 490 [67], 491 [72]- [73].
[35] See *Re Damilock Pty Ltd (in liq)* [2012] FCA 1445; *Re ExDVD Pty Ltd (in liq)* (2014) 223 FCR 409; [2014] FCA 696; *Currie v Auto Electrical Distributors Pty Ltd (in liq)* [2014] FCA 885; *Re Weston* [2015] FCA 742.
[36] *Fortress Credit Corporation (Australia) II Pty Ltd v Fletcher* (2014) 87 NSWLR 728.
[37] Section 588FI.
[38] *NA Kratzmann Pty Ltd v Tucker, Liquidator of Reid Murray Developments (Qld) Pty Ltd (No 2)* (1968) 123 CLR 295; [1968] HCA 44.

entitled to prove in the liquidation unless and until it has disgorged the amount of a preference *in full*. This position is peculiar to voidable preferences. It has no application to any of the other statutory insolvency claims, including uncommercial transactions.

36. Until the insertion of s 588FI into the Act in 1993,[39] the practice of the Australian courts in respect of preferences in corporate insolvency, as confirmed by the High Court in *Kratzmann*, was to prevent a creditor who had received a preference from proving in the liquidation until the preference had been repaid *in full*.[40]

37. The High Court in *Kratzmann* made both the relevant declaration (that liquidator was entitled to be repaid the amount of the preference *in full*) and the order (that the creditor was not entitled to prove unless the *full* amount of the preference was first repaid). The relevant legislation was the *Companies Act 1961 (Qld)*[41] which specifically imported various provisions of the *Bankruptcy Act 1924* (Cth), including the set-off provision, into the winding up area of the companies legislation.[42]

38. If set-off were allowed in answer to a liquidator's preference claim, the arbitrary and unjust outcome arising from the appellant's approach becomes apparent, as identified by the Full Court (**J** [31], **CAB** 22).

Summary

39. When considering a liquidator's preference claim, the requirement for the mutual claims to be "in the same interest" is not satisfied because:

    a. the appellant was a pre-existing creditor of the company in its own right (**J** [153], **CAB** 65);

    b. by contrast, the company in its own right did not have a contractual, legal, equitable or statutory right of any kind to call for repayment of the preference (**J** [118], **CAB** 53; **J** [152]-[153], **CAB** 64-65);

    c. rather, the position is that upon the liquidation of the company:

        i. the liquidator becomes subject to a statutory duty to gather in the estate of the insolvent company for the benefit of all unsecured creditors and

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[39] This occurred with the enactment of the *CLRA* which commenced on 23 June 1993.

[40] *NA Kratzmann Pty Ltd v Tucker, Liquidator of Reid Murray Developments (Qld) Pty Ltd (No 2)* (1968) 123 CLR 295 at 297; [1968] HCA 44, at 303.

[41] *NA Kratzmann Pty Ltd v Tucker, Liquidator of Reid Murray Developments (Qld) Pty Ltd (No 2)* (1968) 123 CLR 295 at 297; [1968] HCA 44 at 297.

[42] See *The Companies Act of 1961*, 10 Eliz 2 No. 55, s 291(2): "….in the winding up of an insolvent company, the same rules shall prevail…as are in force for the time being under the laws of the Commonwealth relating to bankruptcy…"; and note 4 thereto: "Mutual credits and set-off – see *Bankruptcy Act 1924-1960*, s 82".

the administration of the estate (**J** [7], **CAB** 16; **J**[143]-[144], **CAB** 60-61);

ii. as part of that role, the liquidator has a statutory right to seek a court order, not in order to vindicate any vested or contingent right of the company, but rather pursuant his or her own statutory right and duty to augment the estate for the benefit of all unsecured creditors (**J** [143]-[144], **CAB** 60-61; **J** [148], **CAB** 63); and

iii. as a matter of substance, any recovery proceeds are not held for the company's benefit (or for the benefit of its secured creditors) but for the benefit of all unsecured creditors and for the estate's administration under a statutory right (**J** [143]-[157], **CAB** 60-68).[43]

40. Finally, the requirement for the mutual claims to exist (actually or contingently) at the relevant date is not satisfied because:

a. prior to the commencement of the liquidation, the company lacked any right to recover the preference, and the creditor had no duty to disgorge it (**J** [7], **CAB 16**; **J** [39]-[42], **CAB** 26-27; **J** [118], **CAB** 53; **J** [138], **CAB** 58);

b. the right of a liquidator and the obligation of a creditor to disgorge a preference are a new right and a new obligation which are designed to cure the dislocation of priorities made by the preference payment and that right and obligation arise only on the winding up (**J** [154], **CAB** 66).

Ground 2

Contingent claim

41. The appellant contends (**AS**, [27]) that the Full Court erred in finding that a claim for an unfair preference under s 588FA does not exist as a contingent claim at the relevant date.

42. The appellant asserts that at the relevant date for the application of s 553C, the company had a contingent right or claim against the creditor for the recovery of a preference and that that claim is sufficient to satisfy the principle enunciated in in *Hiley v Peoples Prudential Assurance Co Ltd* (***Hiley***)[44] in respect of mutuality.

43. In *Gye v McIntyre*,[45] the High Court decided that for a set-off to be available, the credit, debt or claim must at least be contingent at the time for determining set-off.[46] That is

[43] See the analysis above: [15]-[32].
[44] *Hiley v Peoples Prudential Assurance Co Ltd* (1938) 60 CLR 468.
[45] *Gye v McIntyre* (1991) 171 CLR 609.
[46] *Gye v McIntyre* (1991) 171 CLR 609 at 623-624.

consistent with the earlier comments of Rich J in *Hiley* that mutual dealings involve "rights and obligations whether absolute or contingent of such a nature that afterwards in the events that happen they mature or develop into pecuniary demands capable of set-off."[47]

44. In this context, it is important to note that:

    a. Rich J in *Hiley* went on to refer to *rights* which are *vested* at the commencement of the winding up and which grow in the natural course of events into a claim capable of set-off; [48] and

    b. The circumstances supporting the set-off must have occurred *before* the relevant date, which should include vested rights:[49]

> "[t]he principle set out in s 553C for provable debts, that the circumstances giving rise to the claim should have occurred *before* the relevant date, should apply to both sides of the account in a set-off, that is to say, the company's claim against the creditor as well as the creditor's provable claim against the company."[50]

45. Although the concept of "relevant date" does not appear in s 553C(1), set-off entitlements are also to be determined at the relevant date. Set-off requires a provable debt, so that the time for determining whether a set-off is available under s 553C should be the same as that for determining whether a debt is provable under s 553 (being, "*before* the relevant date"). This should apply to the claims on both sides of the account, consistent with the view that a *pari passu* distribution among creditors requires a common date for the ascertainment and quantification of debts.[51]

46. The Full Court considered the established principles and found that mutuality could not be satisfied in this context where there were no rights vested nor was there any sufficient contingent right or obligation on the relevant date.[52]

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

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

[49] *Hiley v Peoples Prudential Assurance Co Ltd* (1938) 60 CLR 468 at 487 and see Derham, n 23, at 480.

[50] Derham, n 23, 478.

[51] *Re Elenin, dec'd* [2016] 1 WLR 2092 at [25]-[28] & [51]; *Re Parker* (1997) 80 FCR 1 at 15. See also R, Derham, *Derham on the Law of Set-off* (4th ed., OUP, 2010) pp 284-285 [6.45].

[52] **J** [157], **CAB** 68.

47. That point aside, there are a number of other difficulties with the approach adopted by the appellant.

48. *First*, the appellant's position is dependent upon the company, as distinct from the liquidator, having at some point in time prior to the winding up, a contingent right to recover a preference, with such contingency actualizing on the winding up.

49. *Second*, prior to a finding by a court, there is nothing inherently wrong with payments received by unsecured creditors.[53] In order for any liability to disgorge to arise, a court must be satisfied that the liquidator has met the requirements set out in ss 588FA, 588FC and 588FE before it makes an order under s 588FF.[54] So much is self-evident from the terms of the voiding provision itself which speaks of the court having jurisdiction to make a voiding order *if* it is "satisfied" that the payment is voidable "because of section 588FE." That is, the court's satisfaction as to the transaction being voidable by reason of s 588FE is a necessary condition precedent to it making of an order under s 588FF.

50. The necessary findings and court order create a new right and a new obligation which do not exist prior to the winding up and the obligation to disgorge a preference payment is founded upon a judgment or order of the Court which does not exist before the relevant date.[55]

51. *Third*, the appellant's reasoning (at **AS**, [28]-[30]) suggests that, as at the date of the commencement of the winding up, the only contingency is a subsequent decision of the liquidator to prosecute a claim for an order under s 588FF. This is not the only contingency and ultimately the obligation to repay a preference payment is founded upon a judgment or order of the Court.

52. Further, as stated by the Full Court (**J** [60], **CAB** 33) the binding connection between s 553 and s 553C of the Act means that the phrase "at the relevant date" must be understood as *before* the relevant date. The appellant's position appears to be based on Dixon J's comment in *Hiley*[56] that it "is enough that at the commencement of the winding up mutual dealings exist." (**AS**, [18] and [29]).

53. However, the reference to "the commencement of the winding up" must be understood in the context of the different legislation in issue in *Hiley*. Instead of the proof of debt

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[53] *Capital Finance Australia Ltd v Tolcher* (2007) 164 FCR 83 at [148].

[54] *BE Australia WD Pty Ltd v Sutton* (2011) 82 NSWLR 336 at [115]; *Rimfire Constructions (Qld) Pty Ltd (in liq) v CRCG-Rimfire Pty Ltd* (2020) 4 QR 266; [2020] QSC 92 at [34]-[38]; *Foots v Southern Cross Mine Management Pty Ltd* [2007] HCA 56; 234 CLR 52 at [36], [37].

[55] **J** [154], **CAB** 66.

[56] *Hiley v Peoples Prudential Assurance Co Ltd* 1938) 60 CLR 468, 497 (and see also at 499).

provision in the Act (s 553) which refers to the position "*before* the relevant date", the corresponding provision in the *Bankruptcy Act 1924*, s 81 (which was incorporated into the *Companies Act 1899* (NSW) and which was considered in *Hiley*) referred to the determination of provable debts "at the date of the sequestration order". Provable debts were determined by reference to the position *on* the winding up, and not, as in the current legislation, *before* that date. Under the Act, a winding up commences on (or after) the relevant date,[57] which therefore is after the time for determining the provable debts and the availability of a set-off. Looking at the position as at before the relevant date, a preference claim would be contingent not simply upon a liquidator prosecuting a claim under s 588FF. It is contingent also on the court being satisfied "that the transaction is voidable because of section 588FE" and, subject to the court being so satisfied, making an order under s 588FF.

54. Significantly, Kitto J, in the leading judgment in *Community Development Pty Ltd v Engwirda Construction Co* (1969) 120 CLR 455 (at 459), emphasised that for a contingent liability there must be an "*existing obligation*" out of which the ultimate liability will grow, and in *National Bank of Australasia Ltd v Mason (*1975) 133 CLR 191, Barwick CJ (at 200-201) stated that the "*possibility*" of having to pay money was insufficient to constitute money "owing contingently".

The cases referred to by the appellant

55. The appellant refers to the decision of Palmer J in *Hall v Poolman*[58] as authority for the proposition that "[t]he *possibility* of a future claim for the recovery of an unfair preference was held to be a contingent claim by Palmer J." (**AS**, [31]) However, the set-off in *Hall v Poolman* did not involve a creditor (in that case relevantly, the Commissioner of Taxation) asserting any right under s 553C when pursued by a liquidator for a preference.

56. Rather, in *Hall v Poolman*, one of the directors of the company, Mr Irving, had upon his appointment prior to the winding up, been provided with a broad indemnity by the company against any liabilities which might befall him by reason of his directorship.[59] There was therefore "a contingent entitlement on the part of Mr Irving which could crystallise into a present entitlement" on the occurrence of claims being made against him.[60] There was a possibility that the Commissioner would be pursued by the liquidator

[57] *Corporations Act*, s 9 (definition of "relevant date") and ss 513A-513D.
[58] *Hall v Poolman* [2007] NSWSC 1330; 65 ACSR 123.
[59] *Hall v Poolman* [2007] NSWSC 1330; 65 ACSR 123, [408], [429].
[60] *Hall v Poolman* [2007] NSWSC 1330; 65 ACSR 123, [429].

for a preference and, in turn, that the Commissioner would, if he had to disgorge money, sue the director for indemnity under s 588FGA(2) of the Act. Mr Irving had also been pursued for insolvent trading under s 588G. It was in these somewhat unusual factual circumstances that the court, perhaps not surprisingly, found that Mr Irving was entitled to set-off against his liability for insolvent trading under s 588M(2), the amount he might be required to pay to the Commissioner under s 588FGA(2), should the Commissioner pursue him.[61]

57. As for the three other authorities referred to by the appellant,[62] none considers the statutory framework or purpose of the unfair preference provision, and none recognises the significant points of distinction between preference actions and other proceedings. None of the authorities concern a liquidator's preference recovery claim. The difficulties with *Re Parker* and *Shirlaw v Lewis* were considered by the Full Court (**J** [184], **CAB** 76; **J** [189], **CAB** 78; **J** [211], **CAB** 83; and **J** [212], **CAB** 84) and all three decisions have previously been considered in detail in a comprehensive analysis by Dr Derham in his article on this subject,[63] whose discussion the respondents adopt.

58. As for *Shirlaw v Lewis* (**AS**, [34]-[35]), the justification given by Hodgson J that the claim consequent upon the void disposition could be subject to a set-off was this: "[w]hat "ultimately happened was the crystallization of mutual dealings arising from pre-liquidation dealings."[64]

59. The difficulty with this, however, is that the liability consequent upon the avoidance did not grow out of pre-contractual obligations. It arose out of the operation of statute, not the contract.[65] As such, it cannot be said, in the words of Rich J in *Hiley* that one is here dealing with rights which are vested in the company and the creditor "which without any new transaction, grow in the natural course of events into money claims capable of forming items in an account or capable of settlement by set-off."[66] Dixon J in *Hiley* spoke to a similar effect, referring to the pursuance of "rights subsisting at that time and [which] involved no new and independent transaction."[67] The foundation of a preference liability is the occurrence of a winding up, and that occurrence constitutes a new intervening event,

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[61] *Hall v Poolman* [2007] NSWSC 1330; 65 ACSR 123, [431].
[62] **AS**, [32]-[38]: *Vale v TMH Haulage* (1993) 31 NSWLR 702; *Shirlaw v Lewis* (1993) 10 ACSR 288 and *Re Parker* (1997) 80 FCR 1.
[63] Derham, n 23, 476-481, 488-490.
[64] *Shirlaw v Lewis* (1993) 10 ACSR 288, 296.
[65] Derham, n 23, 480-481.
[66] *Hiley v Peoples Prudential Assurance Co Ltd* (1938) 60 CLR 468, 487.
[67] *Hiley v Peoples Prudential Assurance Co Ltd* (1938) 60 CLR 468, 499.

independent of the previous dealings, which event arises after the relevant date for determining rights of set-off.

60. The decision in *Vale v TMH Haulage Pty Ltd* [68] (**AS**, [32]-[33]) concerned the question whether a claim against a director for insolvent trading, which had not been adjudicated or even litigated, was a provable debt in a director's composition under Part X of the *Bankruptcy Act 1966* (Cth), proposed prior to liquidation. The New South Wales Court of Appeal considered the claim to be provable in the composition. This conclusion was founded upon the perceived likelihood that a winding up would ensue.[69]

61. This decision encounters difficulties in view of the High Court's more recent decision in *Foots v Southern Cross Mines Management Pty Ltd*.[70] There, the question was whether a cost order made after bankruptcy was a provable debt in circumstances where an adverse judgment was made against the debtor prior to his bankruptcy. The relevant court rule stated that in any proceeding, costs were to follow the event, unless the court considered a different order should be made. The High Court (Gleeson CJ, Gummow, Hayne and Crennan JJ, Kirby J dissenting) held that the costs order was not provable on the basis that one was not dealing with a contingency (but rather a discretion), despite the high degree of likelihood that a costs order would be made following the judgment.[71]

Ground 3

The Harmer Report

62. Contrary to the appellant's assertion (**AS,** [40]), the Harmer Report did not recommend the incorporation of a provision to ensure that preference payments were not subject to set-off and the Full Court correctly found that there was no attempt by the Harmer Report to modify the notion of genuine mutuality (**J** [106], **CAB** 49).

63. The Harmer Report ([815]-[819]), properly identified the need for set-off and the necessity to identify those circumstances where set-off would not be available (at [817]). The recommendation is set out in the discussion (at [819]) and it is that there should be no set-off where a transaction was within 6 months prior to the winding up, if at the time of the transaction the person had reason to suspect that the company was unable to pay its debts. This recommendation concerned the scope of what would become s 553C(2).

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[68] *Vale v TMH Haulage* (1993) 31 NSWLR 702.
[69] *Vale v TMH Haulage* (1993) 31 NSWLR 702., 710.
[70] *Foots v Southern Cross Mines Management Pty Ltd* (2007) 234 CLR 52.
[71] *Foots v Southern Cross Mines Management Pty Ltd* (2007) 234 CLR 52 at [36].

64. The draft legislation (at Appendix A, pp153-154) included this exception to set off and made no reference to preferences or any other form of voidable transaction.

65. The appellant says that the Full Court's view that the introduction of s 553C did not herald a significant change in the law of voidable preferences, is "doubtful" (**AS**, [43]). That is because, it is said (**AS**, [46]), there are three "historic decisions" (from 1893, 1908 and 1927) which appear to conflict with the reasoning of the Full Court.

66. The three "historic decisions" are *Re Washington Diamond Mining Co* [1893] 3 Ch 95; *Lister v Hooson* [1908] 1 KB 175 and *Re A Debtor* [1927] 1 Ch 410 (**AS**, [47] – [51]).

67. Contrary to the appellant's suggestion (at **AS**, [48]), Lindley LJ in *Washington Diamond Mining Co*[72] was not addressing the question whether a set-off is available against a liquidator's preference claim. That question did not arise and was not in issue in the case. The point being considered was the availability of a set-off in a liquidation between the underlying debt of the company the subject of a preferential payment (the payment of a director's fees) and a cross-debt owing to the company (the payment by the director of unpaid calls).[73] If a set-off otherwise would have been available in the winding up in relation to those debts, the payment of the debt by the company before the winding up (either by agreed set-off in relation to those debts or an exchange of cheques) would not be voidable as a fraudulent preference because it would not have had a preferential effect. The company would not have been "injured". However, there could not be a set-off in a winding up where (as in that case) the debt to the company was for an unpaid call, given the disallowance of a set-off against a call in a winding up.[74]

68. Therefore, a payment by the company to the creditor before the winding up would not be protected from characterization as a fraudulent preference by the circumstance that a set-off would otherwise have been available in any event in the winding up. In that regard, Lindley LJ distinguished the situation in a winding up from the position in bankruptcy, where there is no such prohibition on a set-off.[75] If a set-off would have been allowable in any event in a bankruptcy in relation to the underlying cross-debts, a preferential

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[72] *Re Washington Diamond Mining Co* [1893] 3 Ch 95 at 108, 111-112.

[73] There was a "round robin" of cheques which occurred on 21 July 1891, with both cheques being in the amount of £70. One cheque was paid by the director to the company for unpaid calls on his shares and the other was countersigned by him as a director in payment of his director's fees. This occurred at a time when the company was insolvent and *prior* to liquidation i.e., within the 3-month preference period then applicable under the Bankruptcy Act, 1883, which was incorporated into the Companies Act, 1862, s 164. There was no question of a debt being raised in defence of the liquidator's subsequent preference claim.

[74] Sections 38(7) and 101 of the *Companies Act*, 1862.

[75] *Re Washington Diamond Mining Co* [1893] 3 Ch 95 at 111.

payment made by the bankrupt before the bankruptcy (either by agreed set-off in relation to those debts or an exchange of cheques) would not be fraudulent and void. Thus, the set-off discussed was in relation to the original underlying debts, not a liquidator's claim to recover a preference.

69. Insofar as Fletcher Moulton LJ in his dissenting judgment in *Lister v Hooson*[76] says that Lindley LJ in *Re Washington Diamond Mining Co* considered that a right of set-off was available in an action to recover a fraudulent preference (see **AS**, [49]), that statement overlooks the facts in *Re Washington Diamond* and that there was no injury to the estate by the round robin of cheques, as correctly identified and distinguished by the Full Court (**J** [75]-[77], **CAB** 40-41).

70. A similar explanation is available in relation to Astbury J's reference in *Re A Debtor*[77] to the *Washington Diamond Mining Co* case, however in any event, the appellant acknowledges that *Re A Debtor* (1927) is in "a class of case" with which the appeal is not concerned. (**AS,** [45(b)] and [50]).

The more recent cases

71. The defendant does not address the series of more recent cases in which the courts have either held that set-off is not available as defence to a preference claim or where, in obiter, the courts have seriously questioned the availability of set-off in any event in circumstances where the disentitling provision in as 553C(2) was present on the facts. These cases include *Calzaturificio Zenith Pty Ltd (in liq) v NSW Leather & Trading Co Pty Ltd* [1970] VR 605 (per Menhennitt J at 618*), Re Buchanan Enterprises Pty Ltd (No 2)* (1982) 7 ACLR 407, per Needham J at 409; *Hussain v CSR Building Products Ltd, in the matter of FPJ Group Pty Ltd (in liq)* (2016) 246 FCR 62; (2016) 112 ACSR 507; [2016] FCA 392 at [235], per Edelman J; *Bryant, in the matter of Gunns Limited (in liq) (receivers and managers appointed) v Bluewood Industries Pty Ltd* [2020] FCA 714, per Davies J at [130], citing the comments by Edelman J in *Hussain*; *Bryant, in the matter of Gunns Limited (in liq) (receivers and managers appointed) (2020)* 144 ACSR 423; [2020] FCA 713, per Davies J at [124] again citing the comments by Edelman J; *Re Force Corp Pty Ltd (in liq)* (2020) 149 ACSR 451; [2020] NSWSC 1842, per Gleeson J at [93].

72. The last and most recent of these Australian decisions is *Re Force Corp Pty Ltd (in liq)* (19 December 2020). In that case Gleeson J of the Equity Division of the New South

[76] *Lister v Hooson* [1908] 1 KB 175, 178.
[77] *Re A Debtor* [1927] 1 Ch 410, 416.

Wales Supreme Court stated unequivocally that set-off was not available as a defence to a liquidator's preference claim. His Honour referred (at [96]) to the "long line of authority that set-off under s 553C (and predecessor sections) is not available in unfair preference claims".

C. ***Costs of the appeal***

73. The question reserved by Derrington J for consideration by the Full Court was whether set-off, under s 533C(1) of the Act was available to the defendant against the plaintiff's claim as liquidator for the recovery of an unfair preference under s 588FA of the Act?[78]

74. The question was a preliminary question in the proceeding, and following its determination, the Full Court sought written submissions from the parties on the question of costs. Submissions were prepared and filed by the parties and following consideration of those submissions, the Full Court delivered further reasons and ordered that the costs be reserved and remitted to the docket judge for determination pending the determination of the remainder of the issues by that judge.[79]

75. As this appeal also concerns the same preliminary issue, it is respectfully submitted that such an order as was made by the Full Court is also appropriate in this case.

76. Therefore, the orders sought are that:

    a. The appeal be dismissed;

    b. The costs of the appeal be reserved and remitted to the docket judge for determination pending the determination of the remainder of the issues by that judge.

77. Alternatively, should the court not be minded to make those orders, it is submitted that in accordance with the usual order as to costs,[80] they should follow the event, such that the orders should be:

    a. The appeal be dismissed; and

    b. The appellant pay the costs of the appeal.

Part VI: Argument on notice of contention or cross-appeal

[Not applicable]

Part VII: Estimate of time for respondents' oral argument

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[78] **J** [4], **CAB** 16.

[79] Order 14 January 2022, Allsop CJ, Middleton and Derrington JJ, QUD31/2021.

[80] *Oshlack v Richmond River Council* (1998) 193 CLR 72, McHugh J (at [67]).

The respondents estimate that they will require 2 hours to present oral argument.

Dated: July 27, 2022

John McKenna QC
16 Quay Central Chambers
T: (07) 3360 3353

Paul O'Brien
McPherson Chambers
T: (07) 3210 1909

IN THE HIGH COURT OF AUSTRALIA
BRISBANE REGISTRY

B19/2022

BETWEEN:

METAL MANUFACTURERS PTY LIMITED
(ACN 003 762 641)
Appellant

and

GAVIN MORTON AS LIQUIDATOR OF MJ WOODMAN ELECTRICAL CONTRACTORS PTY LTD (IN LIQUIDATION) (ACN 602 067 863)
First Respondent

MJ WOODMAN ELECTRICAL CONTRACTORS PTY LTD (IN LIQUIDATION)
(ACN 602 067 863)
Second Respondent

ANNEXURE TO THE RESPONDENTS' SUBMISSIONS

Pursuant to paragraph 3 of the *Practice Direction No 1 of 2019*, the Respondents set out below a list of constitutional provisions, statues and statutory instruments referred to in these submissions.

No.	Title	Provision(s)	Version
Constitutional Provisions			
1.	*Nil*		
Legislation			
Commonwealth			
2.	*Bankruptcy Act 1924* (Cth)	ss 81, 82, 89, 95	Historical Version: No. 37 of 1924 (8 October 1924 to 4 March 1968)
3.	*Bankruptcy Act 1966* (Cth)	ss 58, 82, 86, 108, 122	Current (1 June 1966 - present)
4.	*Corporations Act 1989* (Cth) ('Corporations Law')	ss 82, 468, 511, 588V, 588W	Act no longer in force (14 July 1989 - 15 July 2001)

5.	*Corporations Act 2001* (Cth)	Pt 5.7B, ss 553, 553A, 553C, 556, 558, 561, 562, 562A, 563, 563AA, 563A, 588FA, 588FI, 588FE, 588FF, 588FG, 588M, 588V, 588W	Historical Versions: 1 July 2018 - 17 September 2018 (Comp No. 88); 18 September 2018 - 21 September 2018 (Comp No. 89); 22 September 2018 - 18 October 2019 (Comp No. 90); and 19 October 2018 - 12 March 2019 (Comp No. 91).
6.	*Corporate Law Reform Act 1992* (Cth)	s 92	Current (24 December 1992 - present)
7.	*Federal Court of Australia Act 1976* (Cth)	s 25	Current (9 December 1974 - present)
8.	*Judiciary Act 1903* (Cth)	s 78B	Current (25 August 1903 - present)
State			
9.	*The Companies Act 1961* (Qld)	ss 291 - 293	Historical Version: No. 55 of 1961 (1 July 1962 - 10 February 2010)
10.	*Companies (New South Wales) Code 1981* (NSW)	s 556	Subordinate instrument, no longer in force (30 December 1981 - 1 July 2008)

Other			
11.	*Bankruptcy Act 1883* (imp), 46 & 47 Vict c. 52	ss 37, 38, 40, 48	Historical version (1883 - 1890)
12.	*Companies Act 1862* (imp), 25 & 26 Vict c. 89	ss 38(7), 101, 164, 165	Historical version (1862 - 1908)
Statutory Instruments			
13.	*Nil*		