ARTICLE INSOLVENCY

SET-OFF ON INSOLVENCY

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This article treats one aspect of the law relating to set-off in Ireland, namely set-off on insolvency. This applies when an individual becomes bankrupt or a company goes into liquidation. This article also deals in outline with the impact of receivership on rights of set-off, whether or not insolvency subsequently follows. The impact of set-off rules on insolvency in relation to secured rights, the date upon which set-off rights are determined and the assets available for set-off are all considered. The Irish law governing set-off on insolvency is substantially different to many other jurisdictions.

In bankruptcy matters and in the winding up of insolvent companies set-off is an aspect of the proof of debts. It gives the right to set up a personal claim against another claim owed to the person claiming it. Its significance in bankruptcy and in insolvent liquidation is that it allows unsecured creditors to obtain a full dividend on their claim even in cases where insufficient assets are present to pay creditors in full. In effect set-off acts as a form of security in that the insolvent creditor's claim can be paid or discharged by setting it off against the debtor's cross claim.

It represents a major invasion of the *pari passu* principle, for it enables an unsecured creditor with a cross-demand owing due to the debtor to obtain a full dividend on his claim upon the debtor's insolvency. To the extent that rights of set-off insulate the party's claim from the claims of the debtor's other creditors, it is of a value which can occasionally rank higher than the holder of a secured charge. This occurs where there are insufficient assets to discharge the claims of the secured creditors. In such instances, the rights of set-off can be relied upon regardless because of the self-help nature of the remedy of set-off. This sometimes places a premium on the value of a right to set-off because, to a considerable extent, the value of a security interest depends upon the degree to which it insulates the secured party from the claims of the debtor's other creditors.[1]

To the extent that the right of set-off acts as a security device, it is an exception to the general rule that security interests over the same chose in action are to be ranked temporally – the first in time, first in right. This rule is applicable even if the right of set-off arises subsequent to a floating charge.

Where a company goes into receivership but has not gone into insolvent liquidation, the right of set-off does not arise from the statutory provisions applicable in bankruptcy. It arises from the general law applicable as regards the general right of set-off where an assignment of a chose in action occurs.

RATIONALE FOR SET-OFF ON INSOLVENCY

Robb on Bankruptcy[2] stated the rationale for set-off insolvency as follows:

> "Set-off existed in bankruptcy long before any such right was given at common law by the statutes of set-off; and was allowed with a different object. Set-off at law aimed at preventing cross-actions; but in bankruptcy the object aimed at was to do substantial justice between a debtor to the bankrupt's estate and that estate, where the debtor was at the same time a creditor upon the estate: for it seemed unjust that in respect of what he owed to the estate the man who was also a creditor should have to pay 20s. in £1, while in respect of what was due to him he would receive no more than a dividend."[3]

One commentator has stated that it is surprising that the rules in relation to set-off have attracted so little criticism.[4] The arguments against set-off are that a creditor with a set-off gets paid in full, whilst other creditors do not, and that set-off is like an unpublicised security interest causing assets to disappear on insolvency.

However, given that the aim of the rules relating to set-off is to do justice between parties, with all its weighting of fairness, this lack of criticism is not surprising.[5] It seems unjust to a layman that a defaulting person should insist on payment, but not pay himself, even if he is insolvent. Any knock-on effect is avoided as knock-on effects of one debtor's insolvency are avoided.

STATUTORY PROVISIONS

The position in Ireland in relation to set-off on insolvency is similar for both personal and corporate insolvency. It is provided by s. 284(1) of the Companies Act 1963 that:

> "In the winding up of an insolvent company the same rules shall prevail and be observed relating to the respective rights of secured and unsecured creditors and to debts provable and to the valuation of annuities and future and contingent liabilities as are in force for the time being under the law of bankruptcy relating to the estates of persons adjudged bankrupt, and all persons who in any such case would be entitled to prove for and receive dividends out of the assets of the company may come in under the winding up and make such claims against the company as they respectively are entitled to by virtue of this section."[6]

1 See Kronman and Posner (1979) 88 Yale L.J. 1143.
2 (1907), Chap. X, p. 133.
3 Cited with judicial approval by Blayney J. in *Re Frederick Inns Limited* [1994] 1 I.L.R.M. 387 at 400.
4 Forde, *Bankruptcy Law in Ireland* (1988), p. 145.
5 See Goode, "Is the law too favourable to secured creditors?" [1981-82] *Canadian Business Law Journal* 171.
6 These provisions were first applied to companies by s. 28(1) of the Supreme Court of Judicature Act (Ireland) 1877, not by s. 27(3) of the same Act as stated by Kenny J. in *Freaney v. Bank of Ireland* [1975] I.R. 376 and *Murphy v. Revenue Commissioners* [1976] I.R. 15.

Both are governed by the provisions of the First Schedule to the Bankruptcy Act 1988 which deals with proof of debts. Paragraph 17 provides:

> "(1) Where there are mutual credits or debts as between a bankrupt and any person claiming as a creditor, one debt or demand may be set off against the other and only the balance found owing shall be recoverable on one side or the other."

Particular provisions are applicable to all contributories, including shareholders, to the company upon winding up in respect of what debts they may set off against liabilities which they may owe to the company.[7]

NATURE OF SET-OFF ON INSOLVENCY

It is a moot point whether under paragraph 17 the provisions dealing with set-off are of mandatory effect. It merely states that one debt "may" be set off against another. Unlike the equivalent English provision,[8] the wording of paragraph 17 is not expressed in the mandatory form, that the debts "shall" be set off against one another. Under the previously existing provision whose wording was in the same general terms, it was held that the provisions for set-off on bankruptcy were not mandatory. In *Deering v. Hyndman*[9] Johnson J. stated:

> "I have always understood the settled law to be – *quilibet potest renunciare juri pro se introducto* – that a person who has a benefit given to him by statute may waive it if he thinks fit, but that an individual cannot waive a matter in which the public have an interest... The right of set off is a benefit to the individual creditor, and it in no way concerns the public or society whether he relies on it or waives it. And even if an individual creditor agrees for sufficient consideration to waive that right, I fail to see why he should not be at liberty to do so either without bankruptcy or in bankruptcy; and if a number of creditors of a firm which has suspended payment agree together, and with the firm, to buy the goods of the firm on hands for cash, and not to rely on set off of antecedent debts, even in the event of bankruptcy supervening, I fail to see why such an agreement should not be valid and binding, the mutual promise being the consideration."

There are many advantages to having a rule of set-off which is not mandatory and which may be contracted out of. Work-out agreements and pre and post-insolvency agreements are caught by it. Contractual subordination agreements have been judicially upheld in limited instances.

Specific provision is made by section 4 of the Netting of Financial Contracts Act 1995 for the validation of netting agreements excluding insolvency set-off rules in relation to financial contracts. The Act only validates netting agreements where these are made between two parties. So the form of set-off agreement between more than one party which was under review in *British Eagle International Airlines Limited v. Compagnie Nationale Air France*[10] would not be upheld under the Act.

"Netting" is defined to mean the termination of financial contracts, the determination of the termination values of those contracts and the setting off of the figures arrived at so as to give a net balance remaining due.[11] It is important to note that the Act is only applicable to financial contracts which contain a netting agreement or a guarantee provided as part of such an agreement. The Act, by its terms, validates such netting agreements notwithstanding anything contained in any rule of law relating to bankruptcy, insolvency or receivership, or in the Companies Acts or the Bankruptcy Act 1988. The Act reaffirms the rule laid down in *Deering v. Hyndman*[12] that the provisions of set-off on insolvency are not mandatory in the sphere of financial contracts. By section 4(3) it is provided that section II of the Statute of Frauds shall not apply in relation to financial contracts. This opens the possibility that parol evidence shall be admissible to show that the rules as to set-off on insolvency are not applicable and will apply in addition to the terms of the netting agreement.[13]

In New Zealand, where the relevant set-off provision was couched in terms of "may be set-off" as is paragraph 17(1) of the Irish legislation, it has been held that this statutory wording was an instance in which the word "may" should be given mandatory effect.[14] The basis for this reasoning must be doubtful given the New Zealand legislature's reluctance to import the word "shall" into its legislation. The secondary basis for his decision, namely that the mandatory nature of set-off on insolvency is essential for the orderly administration of estates, appears to be superseded by the decision of the New Zealand Court of Appeal in *Stotter v. Ararimu Holdings Limited*[15] which assumes that statutory priority may be waived on insolvency. If this can occur in relation to debt subordination, it is difficult to see how this can not occur in relation to set-off.

Recently, in *Stein v. Blake,*[16] Lord Hoffmann held that the insolvency provisions in English law were not only mandatory but were also self-executory. An interesting question is whether the relevant Irish provisions are to be so regarded. Given the non-mandatory nature of the Irish rules on set-off it is not likely that the bankruptcy provisions for set-off in Irish law are self-executory. Therefore, where mutual claims of a bankrupt and his creditor existed at the date of insolvency, an automatic extinguishment of the respective claims takes place, without the formal taking of an account or other procedural step, so that a single claim for the net balance remains.

This has the effect, for example, that any charge obtained over monies to be received by the bankrupt, but against which a set-off occurs,

7 Sections 237 and 207(1) of the Companies Act 1963.
8 Section 323 of the Insolvency Act 1986.
9 (1886) L.R.(Ire.) 18 Q.B.D. 323.
10 [1975] 2 All E.R. 390.
11 Section 1.
12 (1886) 18 L.R.(Ire.) 467.
13 See Wylie, *Irish Conveyancing Statutes* (1994), p. 24 *et seq.*
14 *Rendell v. Doors & Doors Ltd* [1975] 2 N.Z.L.R. 191 at 198, *per* Chilwell J.
15 [1994] 2 N.Z.L.R. 655.
16 [1995] 2 All E.R. 961; *The Times*, May 19, 1995.

becomes worthless. This occurred in *Re Baltimore Boatyard Co. Ltd (in liq.)*,[17] where solicitors who acted for the insolvent debtor company in an arbitration obtained a charging order for their fees in respect of monies due to the company by the losing third party for costs. However, the losing third party had a valid right of set-off against these monies, so the effect was that the charging order was worthless.

WHEN ARE THE RULES OF SET-OFF ON INSOLVENCY APPLICABLE?

The rules in relation to set-off on insolvency are applicable to personal bankruptcy and corporate insolvency, whether voluntary or by order of the court. However, by definition the set-off clause is not applicable to a solvent winding up, nor is it applicable to a company insolvent at the commencement of the winding up but which subsequently turns out to be solvent.[18]

There is no provision made in the provisions dealing with voluntary arrangements for set-off and the accepted view[19] is that the insolvency provisions do not apply to voluntary arrangements or compromises, for they are expressed to apply only to the winding up of insolvent companies.

Similarly, insolvency set-off is not applicable to examinerships, for there are no winding up proceedings. However, there is a specific provision in s. 5(2)(h) of the Companies (Amendment) Act 1990 prohibiting set-off between separate bank accounts of the company in examinership without the consent of the examiner. The effect of this provision is that any credit balances standing due to the bank account of a company in examinership can be used for the company's benefit.

In relation to receiverships, the rules of set-off on insolvency are not applicable until such times as the company goes into liquidation. Upon a receivership, there is an assignment in equity[20] in favour of the debenture-holders of any debt owing to the company and coming within the scope of the charge. The rules relating to set-off on assignments accordingly determine whether there is a valid set-off.[21]

ASSETS AVAILABLE FOR SET-OFF

The category of assets which may be set off under the insolvency rules is wider for the insolvent than it is for the other party. In order that a debt be set off as against an insolvent, it is necessary that it be a debt which is provable in the insolvency.[22] There is no such limitation where the insolvent party to the set-off seeks to set off a debt as against a party who is not insolvent. Regardless of whether it is the insolvent or another party who is seeking to set off against the other party, the fundamental principle applicable is that the party seeking to assert a right of set-off must own that asset, whether it be in the nature of an absolute or a contingent right.

Assets which are subject to a trust or are held on trust[23] or for a specific purpose are not available for set-off. Where a company holds assets on trust for another, such as employees' or sub-contractors' monies, then they are not available for set-off,[24] for the monies do not belong to the company. However, where trust monies are received without notice of the existence of the trust or of their trust character, then they are available for set-off.[25]

It has also been held that monies paid as a result of a mistake to a party do not constitute part of his assets. Therefore no right of set-off can be asserted as against such monies, for they can not properly be regarded as part of that party's assets.[26] However, a change of position defence may be asserted against such a claim.[27]

Where monies which have been paid are recoverable at the instance of the liquidator, they are not properly to be regarded as being available for set-off against a debt due to the person against whom they were recovered.[28] This principle was applied into a solvent liquidation in *Re Greendale Developments*.[29] In that case monies had been recovered by a liquidator for having been misapplied by a director in breach of his fiduciary duties as a director. Keane J. held that the want of mutuality precluded a set-off taking place.[30]

Where a company owes both preferential debts and non-preferential debts to a particular creditor, it cannot select which element of these debts shall be the subject of set-off. Instead, the debts are set off rateably, in proportion to the amounts of the two kinds of debt.[31]

Regard must also be had to any equities subsisting over the assets which may affect the rights of the person in whose hands they exist. Where it is sought to assert a right of set-off against monies recovered pursuant to a judgment, regard must be had to the equity arising as a result of the solicitor's particular lien over the fund recovered.[32] However, where an alleged equity arises as a result of a contract, the party seeking to assert the right under the contract can only do so if it is a party to the contract remaining unperformed at the relevant date at which insolvency set-off arises.[33] A third party cannot seek to assert the rights arising under the contract.[34]

Where the obligation against which it is sought to set off is an insulated obligation and one party is not bound "to recognise any right in any other person", then set-off on insolvency may take place without reference to any rights acquired by a third party.[35]

Upon the insolvency of the debtor there is a notional acceleration of all

17 [1991] I.L.R.M. 817 at 822.
18 As in *Re Rolls Royce Ltd* [1974] 3 All E.R. 646.
19 *Gye v. McIntyre* (1991) 171 C.L.R. 609.
20 Assignment in Ireland of choses in action is governed by the provisions of the common law and by s. 28(6) of the Supreme Court of Judicature (Ireland) Act 1877.
21 See *Lynch v. Ardmore Studios (Ireland) Limited* [1966] I.R. 133.
22 See *Robb on Bankruptcy, op. cit.* above, n. 2, p. 135.
23 *Glow Heating Limited v. Eastern Health Board* [1988] I.R. 110.
24 See *Murphy v. Morris*, unreported, High Court, Kenny J., October 6, 1975.
25 *Union Bank of Australia Ltd v. Murray-Aynsley* [1898] A.C. 693; *Clarke v. Ulster Bank Ltd* [1950] N.I. 132.
26 *Re Irish Shipping* [1986] I.L.R.M. 518; *Chase Manhattan Bank NA v. Israel-British Bank (London) Ltd* [1981] Ch. 105.
27 *Lipkin Gorman v. Karpnale Limited* [1987] B.C.L.C. 159; [1989] B.C.L.C. 756.
28 *Re Anglo French Co-Operative Society, ex parte Pelly* (1882) 21 Ch. D. 492.
29 Unreported, Supreme Court, February 20, 1997.
30 At p. 11 of the transcript.
31 *Re Unit 2 Windows Ltd* [1985] 1 W.L.R. 1383.
32 (1914) 48 I.L.T. 175; see also *Re Baltimore Boatyard (in liq.)* [1991] I.L.R.M. 817.
33 *Palmer v. Day & Son* (1895) 2 Q.B. 618.
34 *Re Irish Shipping Limited* [1986] I.L.R.M. 518.
35 *Re Smith & Co.* [1901] 1 I.R. 73.

liabilities due and owing by it. So, if a debt is payable by instalments by the bankrupt debtor, the whole debt becomes due and owing as of the date of bankruptcy and is available for set-off by the creditor and not merely the instalments which have fallen due for payment before the bankruptcy of the debtor.[36] However, this does not mean that there is an acceleration of any contingency upon which a debt is payable. The contingent debt is to be valued as of the date of the bankruptcy order with due allowance being made for the occurrence or non-occurrence of the contingency.[37]

Monies recoverable by a company as a fraudulent preference are available for set-off after they have been recovered and they go to swell the pot of assets available for set-off.[38] However, a debtor from whom monies have been recovered by a liquidator as a fraudulent preference cannot then seek to set another debt off against those the sums recoverable by the liquidator, for there is a want of mutuality. In *Re Greendale Developments Limited (in liq.)*[39] it was held by Keane J. in the Supreme Court that the respondent director and shareholder could not seek to set off a debt due to him by the company against monies properly recoverable by a liquidator in an action for fraudulent preference. The principle is wider and extends to all situations in which monies have been misapplied by an officer of the company.[40]

RELEVANT DATE FOR DETERMINING RIGHTS OF SET-OFF

An issue arises as to whether rights of set-off on insolvency are to be determined as of the date of presentation of the petition for insolvency or whether they are to be determined as of the date the winding up or bankruptcy order is made.

Bankruptcy

Paragraph 17 makes no mention of the relevant insolvency date at which the credits and debts are to be determined for the purposes of set-off. It does not determine whether these are to be determined as of the date of the presentation of the petition or whether they are to be determined as of the date of the adjudication order. However, s. 75(1) of the Bankruptcy Act 1988 provides that the debts provable in the bankruptcy or arrangement are those "incurred by the bankrupt or arranging debtor before the date of adjudication or order for protection". It is not the date of presentation of the petition which is relevant. Therefore dealings occurring between the time of presentation of the petition and the order for adjudication are potentially able to override the statutory provisions on insolvency set-off. The issue of knowledge of the presentation of a petition is all-important.

Corporate insolvency

Where a company is being wound up, the relevant date for determining rights of set-off is determined by the date upon which the winding up commences. This follows from s. 218 of the Companies Act 1963 which provides:

> "In a winding up by the court, any disposition of the property of the company, including things in action,... made after the commencement of the winding up, shall, unless the court otherwise orders, be void."

The date of commencement of the winding up is different depending on the nature of the winding up proceedings. If there is a voluntary winding up, s. 220(1) provides that the winding up of the company shall be deemed to have commenced at the time of the passing of the resolution for the voluntary winding up.[41] In all other cases, the winding up is deemed to commence at the time of the presentation of the petition for the winding up.[42] Rights of set-off accordingly are to be determined as of this date.[43]

In summary, the relevant dates for determining rights of set-off on insolvency are:

(a) for bankruptcy – the date of adjudication or order for protection;
(b) for a voluntary winding up of a company – the date of the passing of the resolution by its members;
(c) for the winding up of a company by the court – the date of the presentation of the petition.

In relation to the winding up of a company by the court, this may lead to the need to apply to the court for approval of transactions under s. 280 of the Companies Act 1963 which have occurred since the petition for winding up was presented. The alternative course is to seek to unravel transactions which occurred between the date of the presentation of the petition and the date when the company was wound up.

There is no similar provision to the British statutory provision contained in s. 323(3) of the Insolvency Act 1986, which provides that anyone dealing in rights of set-off with knowledge of the presentation of a petition for winding up will be set aside. Formerly, under the pre-existing rules contained in s. 251 of the Bankruptcy (Ireland) Act 1857, if the creditor had notice of an act of bankruptcy committed by the bankrupt, set-off would be denied. However, this clause of the set-off provision was dropped. Why, is not clear.

This causes minor difficulty in relation to corporate insolvencies, where rights of set-off are determined as of the date of presentation of the petition for winding up. Difficulties of proof where a petition for winding up is pending would have made application of such a provision difficult in other cases. Why it was dropped in relation to bankruptcy is not clear.

36 See Blayney J. in *Re Baltimore Boatyard Co. Ltd (in liq.)* [1991] I.L.R.M. 817 at 822 on this point.
37 See *Ellis & Company's Trustee v. Dixon-Johnson* [1924] 1 Ch. 342 at 356.
38 See MacCann (1990) I.L.T. 6 at 111.
39 Unreported, Supreme Court, February 20, 1997.
40 *Re Anglo French Co-Operative Society, ex parte Pelly* (1882) 2 Ch. D. 492.
41 See also s. 253 of the Companies Act 1963.
42 S. 220(2) of the Companies Act 1963.
43 Millett J. in *Re Charge Card Services Ltd* [1987] Ch. 150 at 177C states, *obiter*, that under the relevant English legislation the correct date for determining rights of set-off in companies liquidation is the date of the winding up order. However, the case he refers to, *Barclays Bank v. T.S.O.G. Trust Fund* [1984] 1 A.C. 626, in which he acted as counsel, deals with the issue of double proof and the issue of the relevant date for set-off purposes is not dealt with.

The mischief underlying the clause was to prevent creditors improving their set-off provision where an insolvency is imminent. The clause prevented collusive trafficking in claims by creditors and debtors of the insolvent thereby creating set-offs after knowledge that a petition for bankruptcy was pending.[44] Such a clause is common in many jurisdictions.[45] Whether an equitable basis for such a provision might be found in the common law is doubtful. An amendment of the legislation in this area in similar terms might be appropriate.

Resort may be had, however, to the provisions relating to fraudulent preferences so as to call into doubt certain set-offs occurring before insolvency, where knowledge of the future presentation of the petition is an issue.[46] So, too, may the provisions dealing with transactions at an undervalue and other voluntary conveyances.

MUTUALITY

In order for set-off on insolvency to exist there must be mutuality.

> "The principle on which mutuality is based is that the claim of one person should not, without agreement, be used to satisfy the liability of another: 'one man's money shall not be applied to pay another man's debt' ".[47]

Mutuality in bankruptcy is less demanding than in other forms of set-off.[48] Mutuality has three aspects. The best statement of what is necessary for the requirement of mutuality in insolvency is contained in *Gye v. McIntyre*[49] in which the High Court of Australia stated:

> "So understood, there are three aspects of the... requirement of mutuality. The first is that the credits, the debts, or the claims arising from other dealings be between the same persons. The second is that the benefit or burden of them lie in the same interests. In determining whether credits, debts or claims arising from other dealings are between the same persons and in the same interests, it is the equitable or beneficial interests of the parties which must be considered... The third requirement of mutuality is that the credits, debts, or claims arising from other dealings must be commensurable for the purposes of set-off under the section. That means that they must ultimately sound in money."

It is also imperative that the debts are not statute barred when it is sought to set them off.[50]

Credits and debts must arise between the same parties

The requirement of the same parties is intended to ensure that one person's (A's) right to sue another for a debt is not set off against A's indebtedness to a third party.[51] It must be clear by what party the debt is payable and if a debt is payable only after a demand is made, that demand must have been made before the debt becomes due.[52]

An example where the debt of one party cannot be set off against a third party's obligation is the case of a joint debt which cannot be set off against a separate debt.[53] In *Fergus Reclamation Syndicate Limited v. Hewitt & Hunt*,[54] the plaintiff sued both defendants for a joint debt owed by them to the plaintiff. The first defendant sought to set off against this joint debt a debt owed to him personally by the plaintiffs. Haugh J. refused to allow the set-off, as the debt owed to the plaintiffs was a joint debt due by both defendants in respect of which judgment could be had against either of the defendants for the full amount. If set-off were allowed, this would reduce the amount legally due by the second defendant and the case was thus not one in which the set-off claim arose on a debt between the same parties.[55]

There is no mutuality between a liquidator acting within his powers under the Companies Acts to set aside transactions and a person from whom monies have been recovered who possesses another debt due to him by the company over whose assets the liquidator has been appointed.[56] The liquidator acting under his powers given by the Companies Acts is a different person from the company for the purposes of set-off.

In determining whether the claims arise between the same parties, regard may be had to E.C. law in determining whether a government body acting in two different capacities is the same person for the purposes of set-off. In *Continental Irish Meats Limited v. Minister for Agriculture*[57] McMahon J. held, in the context of the granting of Monetary Compensation Amounts (MCAs), that the Minister for Agriculture in paying MCAs on behalf of the importing state did so as agent for the importing state and on its behalf. Therefore he was not acting in the same capacity when as intervention agent carrying out the common agricultural policy on behalf of the state he charged monetary compensation amounts on exports. So a set-off could not arise between the plaintiff and the defendant as regards levies outstanding and those paid.

This decision was reversed by the European Court of Justice.[58] It held that the capacity in which the Minister of Agriculture was acting must be determined in this instance in accordance with Community law. It held that the role of the intervention agency of the exporting Member State when it pays to the trader MCAs upon importation was no different from its role when it recovers MCAs upon exportation from the same trader.[59]

The rationale underlying this decision was applied by the Irish High Court in *Clover Meats Ltd v. Minister for Agriculture*,[60] where it held that a

44 An alternative rationale put forward by Wood, *English and International Set-Off* (1989), para. 7-232, that it controls compensation deals is weak, for these would be caught by alternative provisions of the bankruptcy and insolvency code.
45 See Wood, *ibid.*, paras. 24-114 to 24-120.
46 See *Citroen Sales (Ireland) Ltd v. Ashenhurst Williams & Co. Ltd* [1993] 2 I.R. 69.
47 Wigram V.-C. in *Jones v. Mossop* (1844) 3 Hare 568, 574.
48 See Blayney J. in *Re Baltimore Boatyard Co. Ltd (in liq.)* [1991] I.L.R.M. 817 at 821.
49 (1990-1991) 171 C.L.R. 609 at 623.
50 *Re Morris, Coneys v. Morris* [1922] 1 I.R. 81, 90 and 136.
51 See Derham, *Set-Off* (1987), p. 137.
52 *Loughnan v. O'Sullivan* [1922] 1 I.R. 103 at 108.
53 See *Loughnan v. O'Sullivan & O'Shea* [1922] 1 I.R. 103 at 160 and *Fergus Reclamation Syndicate v. Hewitt and Hunt* (1943) 78 I.L.T.R. 14.
54 (1943) 78 I.L.T.R. 14.
55 *ibid.* at 16.
56 *Re Greendale Developments*, unreported, Supreme Court, February 20, 1997.
57 [1983] I.L.R.M. 503; [1983] 3 C.M.L.R. 411.
58 [1985] E.C.R. 3441.
59 See above, para. 20.
60 [1992] J.I.S.E.L. 162.

set-off could arise where the Minister for Agriculture was acting in one instance on behalf of the European Commission, in paying out intervention monies, and in another instance as a national authority, in seeking the payment of inspection fees and bovine disease levies. What is important in this instance is whether the statutory body is the same person for the purposes of both claims. The source of the relevant payment obligation, whether it be E.C. law or Irish law, is irrelevant.[61] What is important is whether it is the same person who is party to the mutual obligations. This is to be determined by reference to Irish law, having regard in appropriate instances to E.C. law.

Claims should exist in the same interests

The requirement that the claims should exist in the same right requires that each of the parties, who is liable to the other, should be the beneficial owner of the claim which they are seeking to set off. Mutuality on insolvency is determined by the equitable interests of the parties and not by reference to bare legal rights.

In *Incorporated Law Society v. O'Connor*,[62] proceedings were taken by the applicant Society to recover monies paid out to clients pursuant to the statutory compensation scheme for compensating clients who suffered losses at the hands of recalcitrant solicitors. The defendant solicitor sought to set off claims which he held against the Law Society in respect of work done in winding up solicitors' practices. The Law Society were by statute[63] subrogated to the claims of the clients against the solicitors. It was held by Blayney J. in the Supreme Court that Mr O'Connor was not entitled to set off against the Society because the Society was not suing in its own right but in the right of Mr O'Connor's clients. The legal title to sue existed in the name of the Law Society but the equitable interest being asserted was that of the clients on whose behalf the Society paid out.

An important issue which arises is the time at which mutuality must exist. The beneficial title generally must have been acquired before the relevant date for determining rights of set-off.[64] For instance, a set-off may not be based upon an assignment made after that date. An example of this principle in action is *Lynch v. Ardmore Studios (Ireland) Ltd.*[65]

However, there are exceptions to this principle, such as where a beneficial title, though not actually acquired until after the relevant date, nevertheless reverts back to the time before then. An example is where the bankruptcy is annulled.[66]

Claims must sound in money

The requirement that the credits and debts must ultimately sound in money does not mean that they must be vested, liquidated or enforceable at the relevant date when set-off is to be determined.[67] Provided that they exist as contingent at that date and are of a kind which will ultimately mature into pecuniary demands susceptible of set-off, the requirement of mutuality may be satisfied in relation to them. Byles J. in *Naoroji v. Chartered Bank of India*,[68] when dealing with similar 1849 English bankruptcy legislation, stated that mutual credits are "reciprocal demands which must naturally terminate in a debt". However, where a person may become liable to pay money at a date in the future but as of the date of liquidation of a company to which they will become due, they have not fallen due, such as under a guarantee not yet called upon, these potential payments are not available for set-off as against a debt owing to a company.[69]

For instance, mutuality in bankruptcy does not require that there should be any connection between the claims. Nor is set-off excluded where the claims are of a different nature. For example, a liquidated debt can be set off against an unliquidated contractual claim in damages,[70] provided that the claims can be ascertained and admitted for proof. Also, a secured debt may be set off against an unsecured debt. It is also not necessary that the claims be debts arising from mutual obligation. Taxes may be set off against a debt arising from other dealings.[71]

SET-OFF AND SECURITY

Under Rule 24(1) of the First Schedule to the Bankruptcy Act 1988[72] a secured creditor can either surrender his security and prove in the liquidation or else realise it (or value it) and prove for the balance of the debt which remains outstanding. This is a re-enactment of the traditional rule that a secured creditor could not prove for the entire debt owing and at the same time realise his security. This provision is applied to insolvent companies by s. 284(1) of the Companies Act 1963. Accordingly, the general rule is that an insolvent debtor may not set off against its liabilities to a secured creditor unless that secured creditor elects to waive his security and prove in the liquidation.[73]

An example of this principle in operation is *Loughnan v. O'Sullivan*,[74] where the defendant sought to set off as against the plaintiff a debt which had been assigned to him by the National Bank who had held certain mortgages and deeds of charge over the lands which were the subject of the action. In the petition for the arrangement which had previously

61 See Duncan & McGowan (1994) I.J.E.L. 70, who wrongly see the source of the relevant obligation as being of importance.
62 Supreme Court, November 25, 1994; High Court, June 24, 1994.
63 Section 21(8) of the Solicitors (Amendment) Act 1960.
64 *ibid.*
65 [1966] I.R. 133.
66 See Derham, *Set-Off* (2nd ed., 1996), p. 323 on this point.
67 See *Hiley v. People's Prudential Assurance Co. Ltd* (1938) 60 C.L.R. 468 at 496, *per* Dixon J.
68 (1868) L.R. 3 C.P. 444 at 451.
69 See *Gresham Industries (in liq.) v. Matthew Cannon*, unreported, Finlay P., July 2, 1980, at p. 25 of the transcript.
70 See the judgment of Murphy J. in *Hegarty & Sons Ltd v. Royal Liver Friendly Society* [1985] I.R. 523.
71 *Murphy v. Revenue Commissioners* [1976] I.R. 15.
72 "If a secured creditor realises his security, he may prove for the balance due to him after deducting the net amount realised and receive dividends thereon but not so as to disturb and dividend then already declared. If he surrenders his security for the general benefit of the creditors, he may prove for the whole debt."
73 *Loughnan v. O'Sullivan & O'Shea* [1922] 1 I.R. 103, 160 at 107; *Re Norman Holding Co.* [1991] 1 W.L.R. 10.
74 [1922] 1 I.R. 103, 160.

taken place in relation to the plaintiff, the bank had elected to rest on their security and did not claim in the arrangement for the amount of their debt. The effect of this was that, on the assignment being carried through, the personal liability of the plaintiff ceased and no subsequent action lay whether brought by the bank or its assignee, the defendant, against the plaintiff. Hence no set-off arose, for there was no longer any specific debt in existence.

However, subject to this, a secured debt held by a creditor may be set-off against an unsecured debt held by the debtor in bankruptcy. Where the secured debt is held by the bankrupt, there is nothing to prevent the bankrupt setting this off against an unsecured debt held by the creditor.[75]

RECEIVERSHIP[76]

Upon the appointment of receiver to a company, the floating charge under which he is appointed crystallises. This has the effect of bringing about an equitable assignment in favour of the debenture holder of any debt owing to the company and coming within the ambit of the charge.[77] However, the company is not in liquidation, so the principles applicable to the case of insolvent liquidations or bankruptcy do not apply. The traditional principles of equitable and statutory set-off in assignment cases apply.

The fundamental rule is that the debtor cannot set off against the assignee cross-claims which have not accrued due before the debtor receives notice of the assignment to the receiver. An exception is made for connected claims which arise out of the same transaction or series of transactions. This was best summarised by Templeman J. (as he then was) in *Business Computers Ltd v. Anglo-African Leasing Ltd*[78] where he stated:

> "a debt which accrues due before notice of assignment has been received, whether or not it is payable before that date, or a debt which arises out of the same contract as that which gives rise to the assigned debt, or is closely connected with that contract, may be set-off against the assignee. But a debt which is neither accrued nor connected may not be set off even though it arises from a contract made before the assignment."

Crucially, it is the date of receipt of notice of the assignment which is the cut-off point, not the date of assignment of the charge. Accordingly, where a floating charge crystallises, claims arising after crystallisation of the charge but before the debtor receives notice of crystallisation, such as where crystallisation takes place under an automatic crystallisation clause, can be set off against the company. However, claims arising after notice of crystallisation cannot be set off.

Where a floating charge covers a future asset such as a debt which is in existence and accrues due after the charge crystallises, this debt will be available for set-off. In *Murphy v. Revenue Commissioners*[79] the Revenue Commissioners sought to set off corporation tax and other tax arrears against a terminal loss which the company in receivership sought to utilise to reduce the level of profits on which tax was payable. The receiver of the company sought to argue that as the terminal loss only arose in March 1968 while the tax arrears dated from January 1968 (the date upon which the charge over the company's assets crystallised), set-off could not take place. Kenny J. rejected this argument. He held that, as the terminal loss as a future asset of the company which was thereby assigned to the debenture holder upon crystallisation, this assignment could only take place subject to the right of the Revenue to set-off the debt due to them against this terminal loss.

The second part of the rule enunciated above may best be regarded as an illustration of the wider principle in the law of set-off that claims arising out of closely connected transactions are more freely subject to set-off. This is used by Wood[80] to assert a general principle of transactional set-off. An illustration of this second rule is provided by *International Factors (Ireland) Limited v. Midland International Limited*[81] where set-off of a breach of warranty claim by the debtor was allowed as against the creditor's assignee even though the defects in the goods supplied did not manifest themselves until some time after notice of assignment had been received. Lynch J. held that, as the claims all arose out of the same distribution agreement and were closely connected with one another, set-off would be allowed.

Where it is sought to set-off against the receiver as agent of the chargeholder, who is assignee of the debts, it is important to note that the purchaser of a debt, as with the purchaser of any other item at law, cannot acquire a better title than possessed by his assignor. He takes subject to any prior rights which the debtor may have had against the assignor at the time of assignment. This includes any prior rights of set-off. So the receiver as agent of the debenture holder takes subject to the rights subsisting against the company. In essence, an inchoate right of set-off existed, which set-off subsequently takes place.

Secondly, the assignee of a debt takes subject to any prior equities which may subsist in his title. This rule is stated in relation to statutory assignments in s. 28(6) of the Judicature (Ireland) Act 1877 under which a statutory assignment takes effect "subject to all equities which would have been entitled to priority over the right of the assignee".

Finally, a debtor may only set up against the receiver equities available against his assignor.

CONFLICT OF LAWS & SET-OFF

In *Continental Irish Meat Limited v. Minister for Agriculture*[82] McMahon J., in the context of an insolvent liquidation, stated that as set-off was a matter of procedure, whether a right of set-off arose was to be determined by

75 See *Hiley v. People's Prudential Assurance* (1938) 60 C.L.R. 468 at 498, *per* Dixon J.
76 O'Donovan (1978) 52 A.L.J. 562.
77 *N.W. Robbie & Co. v. Witney Warehouse Co.* [1963] 1 W.L.R. 1324.
78 [1977] 1 W.L.R. 578 at 586.
79 [1976] I.R. 15.
80 Wood, *op. cit.* above, n. 44, Chap. 4.
81 Unreported, High Court, December 9, 1993.
82 [1983] I.L.R.M. 503.

the *lex fori*. However, where a discharge under a bankruptcy has been made under the law of a foreign country, it will be effective if made under the law of the debt, but not otherwise.[83] In the Draft European Convention on Bankruptcy Proceedings, set-off rights are not to be affected by the opening of insolvency proceedings where set-off is permitted by the law applicable to the insolvent debtor's claim.[84]

CONCLUSION

There is a large body of case law dealing with issues of set-off on insolvency in Irish law, much of it often ignored. The basic principles are similar to those of other jurisdictions, although Irish law differs in fundamental aspects, notably in the areas of the dates upon which set-off rights are determined, contractual exclusion of insolvency rights and the extent to which assets are available for set-off.

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83 Binchy, *Irish Conflicts of Law* (Butterworths, 1988), p. 481.

84 Article 6 of the Convention. See further Barrett, "The Beef on the E.U. Convention on Insolvency Proceedings" (1997) 4 C.L.P. 12.