THE CLARIFICATION OF EQUITABLE SET-OFF

MARTIN P VAN DER WALT*

The doctrine of equitable set-off, it appears, has never been clearly understood. Spry provided an invaluable guide to its operation in (1969) 43 ALJ 265. Unfortunately, in many instances this guidance has been ignored or overlooked. Gummow J has recently, in James v Commonwealth Bank of Australia (1992) 37 FCR 463, re-emphasised the stricter approach to the application of the doctrine. It is time to reconsider and clarify the role which this equitable defence has to play in today's legal environment, and to guard against another relapse into darkness.

Introduction

> "So it has come about that we have heard a learned debate, rich in academic interest ... on the subject as to whether certain claims could be proudly marshalled as set-off or could only be modestly deployed as counterclaim."[1]

This eloquently asserts the superiority of set-off over counterclaim, and with good reason: set-off carries with it many advantages which are not part of the make-up of a counterclaim. A right to set-off, albeit a shielding procedure, is a *substantive defence*[2] which allows a defendant to reduce (partially or wholly) a claim which a plaintiff brings against him.[3] It is not a denial of debt; it is a plea in bar, that is, a plea against enforcement of the plaintiff's claim to the extent of the defendant's claim.[4] Until judgment in favour of the defendant on the ground of set-off has been given, the plaintiff's claim is not extinguished.[5] The right to set-off at law depends upon the existence of an *actionable* debt being owed to the defendant.[6] Similarly, the right to set-off in equity depends upon the defendant having an *actionable* claim, whether it be liquidated or unliquidated,[7] and where the set-off overtops the plaintiff's claim the defendant must counterclaim for the balance if he wants a monetary judgment in his favour rather than just having the plaintiff's claim extinguished.[8]

A counterclaim on the other hand is merely a *procedure* allowing cross-actions, which may be of a completely different subject matter, to be determined at the same time.[9] The primary goal of set-off as created in courts of equity was to remedy injustice, rather than to be used as a vehicle (as was the counterclaim procedure) for the convenient disposal of two cross-claims in one proceeding. Thus set-off developed in equity as well as by statute, whereas the counterclaim procedure is statutory only.[10]

Although it is beyond the scope of this article to examine closely the significance of the distinction between set-off and counterclaim, it is at least pointed out that where the following issues are involved the distinction is of great importance:[11] (a) statutes of limitation;[12] (b) assignment of debts;[13] (c) costs;[14] (d) schemes of arrangement;[15] (e) garnishee proceedings;[16] (f) summary judgment;[17] and (g) winding-up petitions.[18]

*BCom, LLB (Hons)(Bond), LLM (Hons)(QUT), Barrister-at-Law

Legal set-off

Equitable set-off needs to be contrasted with the legal forms of set-off.

A right to set-off *at law* arises in one of three ways: by statute, by agreement, or by a defence analogous to set-off (that is, common law abatement).[19]

(1) Set-off by statute was allowed only in cases of *mutual* liquidated demands,[20] and was split into two different contexts: one was where bankruptcy or insolvency issues arose,[21] and the other was in the more general non-bankruptcy context.[22] It should be noted that there appears now to be no statutory right to set-off in Queensland or in New South Wales[23] (outside of the bankruptcy and insolvency context) because the *Statutes of Set-Off* were repealed in these jurisdictions without the utilisation of a savings clause such as was used in England and Victoria.[24]

(2) Parties may by agreement override the usual principles of set-off[25] except in the presence of bankruptcy issues.[26]

(3) Common law abatement,[27] analogous to — but clearly different from — set-off,[28] developed in respect of actions (a) for goods sold and delivered with a warranty,[29] (b) for work and labour,[30] and (c) for goods agreed to be supplied according to a contract. This rule is quite "anomalous"[31] in that it performs a function in the nature of an equitable set-off without the aid of statute or equity.[32] It also has various exceptions. For example, it does not extend to cases of work and labour done by an attorney (unless no benefit has been derived from it);[33] or to an action for payment of freight,[34] or where a bill of exchange is given as payment for the purchase of goods or for the performance of work — the bill must be honoured regardless of any breach of contract by the vendor which does not amount to a total failure of consideration.[35]

Equitable set-off is clearly different from all of these legal set-offs, as will now be demonstrated in the following discussion on the true application of equitable set-off.

Set-off in equity

The two major limitations of the right to set-off at law were the requirements that the debts be mutual[36] and liquidated;[37] and the courts of common law took a very narrow and strict view of these requirements. Equity, on the other hand, by not insisting on mutuality,[38] or that the amount be liquidated,[39] intervened to reduce instances of injustice[40] so long as a sufficient equity could be found.[41]

Meagher, Gummow and Lehane in their text *Equity: Doctrines and Remedies* propose another significant difference.[42] They say that set-off at law does not occur until judgment,[43] whereas set-off in equity may occur simply at the time of the making of a book entry.[44] It is submitted that the latter part of this statement is questionable. The authors cite *Stewart v Latec Investments Ltd*[45] as authority, but on reviewing that decision it becomes apparent that it considers the case of *analogous* equitable set-off[46] which, since it follows the law, cannot go beyond the law as stated in *Re Hiram Maxim Lamp Co*[47] and *Re KL Tractors Ltd*.[48] Unfortunately, the passage from Meagher et al has been quoted with seeming approval by Hutley JA in *Stehar Knitting Mills Pty Ltd v Southern Textile Converters Pty Ltd*,[49] and may well become entrenched.

A short discussion of analogous equitable set-off will facilitate understanding of the later discussion of classical equitable set-off.

Analogous equitable set-off

The simplest case of equitable intervention occurred where an equitable debt was allowed to be set-off against a legal debt if, had the equitable debt been a legal debt, set-off at law would have been permitted under the *Statutes of Set-Off*.[50] That is, equity followed the law. The operation of equity in this instance was identical to its operation in the bankruptcy jurisdiction where one of the debts was equitable.[51] Also, "where the plaintiff is suing merely as trustee, and the defendant has a claim against the cestui que trust which but for the intervention of the trust could have been set off at law, such claim can be set off in equity".[52] A very similar situation occurs where a creditor equitably assigns his debt and the assignee (in

the name of the creditor) later sues at law the debtor to recover the debt. On the surface there are mutual legal debts which can be set off pursuant to the *Statutes of Set-Off*, but sub-surface analysis reveals that the plaintiff assignor holds the legal title only, and the assignee holds the equitable interest which he took subject to the equity of a set-off available to the defendant against the plaintiff assignor.[53] In summary, equity looks to equitable or beneficial mutuality rather than to legal mutuality.[54] For analogous equitable set-off, mutuality, whether it be equitable or legal, is essential.[55]

This particular form of "analogous" equitable set-off was lost in New South Wales in 1971[56] and in Queensland in 1984[57] the *Statutes of Set-Off* were repealed. With respect to the repeal in New South Wales Sheppard J said:

> "The repeal of the *Statutes of Set-off* did not, in my opinion, leave behind any part of their provisions which courts of equity would apply by analogy."[58]

However, on appeal, the Court of Appeal made it clear that, although the *Statutes of Set-Off* had been repealed, s 78 of the *Supreme Court Act* 1970 (NSW) and Pt 15, r 25 of the *Rules of the Supreme Court* (NSW) replaced them, and expanded upon them, to allow "a defendant to raise against [a] plaintiff any legal or equitable claim, whether connected with the subject matter or not, and whether sounding in debt or damages".[59]

Does this mean that all counterclaims attain the status of set-offs with respect to, for example, statutes of limitation? Or is equitable set-off now, as in Queensland, the sole remaining defence of set-off? Derham claims that since the omission in 1984 of Pt 15, r 25 from the *Rules of the Supreme Court* (NSW), the position outlined in *Stehar* no longer applies, leaving only equitable set-off (apart from statutory bankruptcy set-off).[60] Regardless of the repeal of this rule, Derham cogently argues against the reasoning in *Stehar* which was based upon the premise that legal set-off was merely a procedural defence. This may be so, but it operated substantively, thus differentiating it from a counterclaim.

It must be remembered that where analogous equitable set-off is not appropriate (for example, where the *Statutes of Set-Off* have been repealed, or where there is a lack of mutuality), classical equitable set-off may lie, *but only where the defendant has an equity which impeaches the plaintiff's cause of action.*[61] Thus it is much more difficult to establish a classical equitable set-off than a legal set-off (and, as a corollary, an analogous equitable set-off).

Classical equitable set-off[62]

Equity would restrain the plaintiff from taking proceedings at law by issuing an injunction so long as the applicant could establish an equity to relief.[63] Such an equity would arise even when the applicant was entitled to damages at law against the plaintiff (rather than just a debt) AND *the applicant defendant could show additional circumstances such as to render it inequitable that the action at law should proceed.*[64] For example, in *Ex parte Stephens*[65] an equity to relief was founded upon the additional circumstance of fraud which rendered it inequitable to disallow set-off (albeit there was no mutuality), whereas in *Ex parte Blagden*[66] set-off was refused because there was no mutuality and there was no similar additional circumstance so as to create an equity. These two cases were decided by Lord Eldon LC who exhibited a stricter approach than had been taken earlier by Lord Loughborough LC in *Ex parte Quintin*[67] and in *James v Kynnier*[68] wherein set-off was allowed in the absence of mutuality and without any additional circumstances. The following discussion will demonstrate that Lord Loughborough LC's liberal approach was erroneous on any view of the principle.

Lord Cottenham and Rawson v Samuel

It was not until 1841 that the impeachment test was expressly formulated in *Rawson v Samuel*[69] by Lord Cottenham LC:

> "We speak familiarly of equitable set-off, as distinguished from the set-off at law; but it will be found that this equitable set-off exists in cases where the party seeking the benefit of it can shew some equitable ground for being protected against his adversary's demand. The mere existence of cross-demands is not sufficient: *Whyte v O'Brien* (1 S & S 551)....

> Several cases were cited in support of the injunction; but in every one of them, except *Williams v Davies*, it will be found that the equity of the bill *impeached* the title to the legal demand"[70] (emphasis added).

The cases his Lordship relied on to support this proposition were: *Beasley v D'Arcy*;[71] *O'Connor v Spaight*;[72] *Ex parte Stephens*;[73] *Piggott v Williams*;[74] and *Lord Cawdor v Lewis*.[75] It is necessary to examine these decisions to see whether they do, in fact, support an "impeachment" principle.

In *Beasley v D'Arcy*[76] the landlord sought at law to eject the tenant for non-payment of rent. The tenant however had sustained damage as a result of the landlord cutting timber on the land. Accordingly, Lord Clare held that the tenant had an equity to relief against the action for ejectment; namely, that the landlord ought not to recover possession of the land for non-payment of rent while he owed to the tenant a sum for damage to that same land. Spry, in an insightful article in *The Australian Law Journal*,[77] was rather ambivalent about identifying the factual basis giving rise to the equity in this case, but he did refer to *O'Mahoney v Dickson*[78] where Lord Redesdale "found the equity of the tenant in the fact that the landlord's wrong had prevented his paying rent, by affecting the produce of the land".[79] I submit that this is the appropriate equity.

O'Connor v Spaight[80] was another action of ejectment for non-payment on rent. This time, however, the landlord became indebted to the tenant in a different way: the tenant claimed that the landlord was indebted to him (by selling the landlord goods on credit; by accepting his bills; and by supplying him and his family with money) and sought an account in equity so that a correct statement of the indebtedness of each party could be ascertained. The Lord Chancellor, on the basis "that the account has become so complicated that a Court of Law would be incompetent to examine it upon a trial at Nisi Prius, with all necessary accuracy",[81] ordered that a Master in equity should take an account and should report the balance due at the time of bringing the ejectment proceedings. Unlike the other cases cited by Lord Cottenham, in this one the defendant's claim cannot be said to impeach the plaintiff's claim. It might not be fair that the tenant be ejected while the landlord owes him money on other accounts, but that does not make the landlord's claim conditional upon, or subject to, the tenant's claims. Meagher et al suggest, and I agree, that *O'Connor v Spaight* was rather a case of set-off by agreement.[82]

In *Ex parte Stephens*[83] Ann Stephens directed her bankers to sell her Exchequer Annuities and purchase Navy Annuities with the proceeds. The sale realised £3,320 odd which the bankers dishonestly applied to their own use, falsely representing to Ann that the Navy Annuities had been purchased. Subsequently, the bankers lent £1,000 to James Stephens, Ann's brother, on the security of a joint and several promissory note of himself and his sister. The bankers later went bankrupt, and the assignees in bankruptcy sued James alone on the note. A petition was presented by both Ann and James, and, notwithstanding that the action on the note was brought against her brother alone, Lord Eldon held that Ann could interpose her claim, and the assignees in bankruptcy were prevented from suing upon the note "by the clear demand of justice she had against them".[84] Lord Eldon explained the injustice giving rise to an equity to relief by referring to the fact that if Ann had discovered the misappropriation of her moneys after she had gone surety on the note,[85] and before the bankers went bankrupt, she could have sued the bankers for the £3,320 who could have set-off (by statute) her indebtedness on the note, which would give her a demand against her brother for the sum of £1,000, as paid to his use.[86] This is quite a persuasive argument, and it highlights the role of the fraud in creating an equity to relief. Absent the fraud, if the bankers had gone bankrupt Ann would have been able to take possession of the Navy Annuities which the bankers would have been holding for her in her name, and she would have suffered no loss. Clearly, the bankers' conduct impeached their claim on the note.

In Spry's[87] analysis of this case the sufficient equity arose because not only had there been fraud on the part of the bankers such as to give rise to Ann Stephens's claim against them, *"but that fraud had also led to the incurring of the obligation [on the note to the bankers]"*.[88] It is submitted that this comment goes too far when it says that the fraud *led to* the incurring of the

obligation on the note. The fraud (that is, the misappropriation) resulted in her losing her annuity moneys; it did not lead her to, or induce her to, incur the obligation on the note — her brother could have approached different bankers for the loan in which case she most likely would have become obligated on a different bankers' note. Nevertheless, the loss occasioned by the fraud created the strongest possible equity such that any moneys owed by Ann Stephens to the bankers on any other obligations should be allowed to be set off against her claim for the misappropriated moneys.[89]

In *Piggott v Williams*[90] a solicitor sued his client for the foreclosure of an estate pledged by the client as a security for the solicitor's costs of the action. The client cross-claimed (by a cross-bill in equity) that the costs resulted because of the negligence of the solicitor. Leach V-C, although referring to no authority, held this to be "a clear case of equitable set-off".[91] This case provides an excellent example of impeachment: the client's cross-claim impeached the solicitor's as it arose from, and was inseparably connected with, the same subject-matter of the solicitor's claim.[92] Spry agreed that this was a clear case of impeachment: "it was through the negligence or other wrong of the plaintiff (in respect of which the claim of the defendant was made) that the claim against the defendant had arisen."[93] It was not a case of legitimate or requested work being done negligently[94] (which I submit does not amount to impeachment) — it was a case of extra legal work having to be done because of the negligence of the solicitor. The client thus had a very strong equity which required protection against the solicitor's demand.

In *Lord Cawdor v Lewis*[95] Lewis succeeded in an action for ejectment against Lord Cawdor. Lord Cawdor then brought a bill in equity claiming compensation for having built, at his expense (thinking the property was his), a smelter and other buildings on the subject land. Upon the filing of this bill, Lewis commenced an action at law for mesne profits against Lord Cawdor who, however, filed a supplemental bill seeking an interim injunction restraining Lewis's action until after the hearing of the claim for compensation in equity. The injunction was granted, which prompted Lewis to apply to have it dissolved. The Lord Chief Baron was against this application, and allowed the injunction to continue until the hearing of Lord Cawdor's claim in equity for compensation, notwithstanding that both of the competing claims were unliquidated. In this way, Lord Cawdor could receive his compensation prior to Lewis's gaining and executing a judgment at law for mesne profits. By itself this does not seem a great victory, but if Lewis had obtained his common law judgment first, and then gone bankrupt, Lord Cawdor would have been left out-of-pocket. In this factual setting it is fair to say that Lord Cawdor's claim impeached Lewis's claim to mesne profits; that is, if Lord Cawdor had known it was Lewis's land, and not his own, then he probably would not have incurred the expense of building the smelter or exposed himself to Lewis's claim for mesne profits. Spry accepted this to be a case of impeachment: he cited it as an example of a case "where the behaviour of the plaintiff was such that his rights would be regarded as conditional on the allowing of the claim of the defendant".[96]

The foregoing discussion shows that Lord Cottenham's statement of an "impeachment" test,[97] apart from *O'Connor v Spaight*, was founded on adequate authority. To emphasise the impeachment requirement one may look to *Ex parte Blagden*[98] where set-off was refused because of the non-existence of any equity sufficient to impeach the plaintiff's claim. Thus, equitable set-off is available where the subject matter of the claim sought to be set-off impeaches the plaintiff's claim *in the sense that it makes it positively unjust that there should be recovery without deduction*. In other words, the circumstances must be such that the plaintiff's claim should be conditional upon the prior satisfaction of the defendant's claim.

Cases since Rawson v Samuel

Many cases subsequent to *Rawson v Samuel* have misunderstood the principle, or have misapplied it to the facts before them, or have done both.

Young v Kitchin,[99] a defective building case decided in 1878, was apt to confuse those who came to interpret it because although it purports to be a case of equitable set-off, in my

submission it is actually a case of common law abatement: it was a case of a claim for the cost of work and labour done, with a complaint of defects in the buildings.[100] In the particular circumstances of that case a common law abatement claim against the assignor was transformed into an equitable set-off claim against the assignee.[101] Further, no mention was made of *Rawson v Samuel*.[102] Therefore, this case can thus be placed to one side in our discussion of equitable set-off.

Newfoundland Government v Newfoundland Railway Co,[103] reported in 1888, is another problematic case. Part of the problem is that the Privy Council referred approvingly to *Young v Kitchin* and used the loose terminology of "counter-claim" in a sense which seemed to encompass set-off as well as common law abatement,[104] and yet the facts do not disclose a relationship between the claims sufficient to support either. Significantly, *Rawson v Samuel* was not cited to the court.

The early decisions of Australian courts seemed to grasp the concept of impeachment more easily.

In 1908, in *Hill v Ziymack*,[105] the High Court of Australia considered the *Rawson v Samuel* test. In that case Z had converted 3,700 head of sheep belonging to H. H recovered a verdict for £3,114 but before it could be executed Z brought a suit in equity claiming (1) a determination of unsettled accounts between Z and H (one item of which related to Z's paying off part of the stock mortgage on the sheep), (2) an injunction to restrain execution of the conversion judgment, and (3) an equitable set-off of the balance of the accounts against the conversion judgment. Griffith CJ referred to *Rawson v Samuel*, said that "[t]he rule, of course, applies with no less force to an action for tort",[106] but concluded that the facts he was presented with were not sufficient to invoke the defence of equitable set-off. I submit this was a correct application of the *Rawson v Samuel* test: Z's claim on the account did not impeach H's conversion judgment; that is, Z could show no equitable ground for being protected against her adversary's demand.

In 1912 the New South Wales Full Court in *Ralston v South Greta Colliery Co*[107] also followed the *Rawson v Samuel* test, but unlike *Hill v Ziymack*, it held that the defendant had a sufficient equity entitled to protection:

> "It seems to me that there is here not only the existence of cross demands, but a good equity in the defendant to restrain the prosecution of so much of the demand as the plaintiff has parted with and which has come back into the hands of the original debtor."[108]

In 1938 a Victorian Court in *Sun Candies Pty Ltd v Polites*[109] applied the *Newfoundland* case in holding a defendant entitled to equitable set-off: Mann CJ held that a defendant's counterclaim for damages for breach of warranty (namely, a fraudulent misstatement as to the weekly net profits of a business) could be set-off against the plaintiff's claim for the balance of the purchase money of the business. Although the *Newfoundland* case was relied upon (see the above criticism of this case), *Sun Candies* was on firm ground in establishing an equitable set-off because of the presence of the fraud;[110] if it had been an innocent misrepresentation I submit that the *Rawson v Samuel* test, to which no reference was made, would not have been satisfied.[111]

In *Re K L Tractors Ltd*,[112] in 1954, equitable set-off was refused by O'Bryan J where the plaintiff claimed a common law debt for goods supplied and work and labour done pursuant to an express contract, and the defendant's cross-claim was for common law damages for breach of terms, express or implied, in the same contract. The defendant relied upon *Morgan & Son Ltd v S Martin Johnson & Co Ltd*[113] and *Young v Kitchin*, but his Honour quoted Story's *Equity Jurisprudence*[114] with approval in stating that unless "special natural equities" exist between the parties (and he found there to be none), equity would not give a better right to set-off than that given by the common law courts.[115] This would seem to support the *Rawson v Samuel* test even though neither it nor the earlier Australian cases were either referred to the court or referred to by the court.

In the English case of *Morgan & Son Ltd v S Martin Johnson & Co Ltd*,[116] referred to unsuccessfully by the defendant in *Re K L Tractors*, the plaintiff claimed a sum due for the storage of the defendant's vehicles. The defendant admitted the claim but pleaded a defence of

equitable set-off because, through the negligence of the plaintiff, one of the defendant's vehicles either had been stolen or delivered up to a third party without the authority of the defendant. On appeal the plaintiff's counsel conceded (incorrectly) that the authorities supported an equitable set-off in the circumstances of the case. Tucker LJ referred to *Young v Kitchin*; quoted the impeachment test from *Rawson v Samuel*, highlighted the similarity of the negligence aspect in *Piggott v Williams*; and said that the defendant's claim clearly arose "out of the subject-matter of the plaintiff's claim for storage, and [was] closely *interwoven* with it."[117] Cohen LJ also referred to these three authorities. Clearly the court was purporting to apply the *Rawson v Samuel* test, but it fell into error in holding that it was satisfied on the facts of this case.

Spry contrasted the two forms of negligence in *Piggott v Williams* and *Morgan & Son* by saying that in the former "if the defendant had been upheld the claim of the plaintiff would have been completely undermined" whereas the case was "altogether different" in *Morgan & Son* where "the claim of the plaintiff was valid, and was not 'impeached' by an equity set up in the defence, but there was simply a claim by the defendant for breach of the same contract."[118] Meagher et al are more forceful in their expression; they say that *Morgan & Son* was "decided per incuriam" as "the defendant's claim consisted merely of a countervailing claim, nude of a relevant equity".[119]

Nine years later, in 1957, the English Court of Appeal made an even graver error when *Hanak v Green*[120] was decided. This case is worth discussing in some detail because of its treatment of *Mondel v Steel* and because of the purported expansion of equitable set-off to matters other than negligence or arising out of the same contract. The plaintiff, Mrs Hanak, sued the defendant builder for damages for breach of contract, alleging that a number of items had either not been completed or had not been completed properly. The builder set up his own cross-action by way of counterclaim and set-off, which fell under three headings:

(a) a claim for the value of extra work performed at the plaintiff's request (moving in the plaintiff's household goods);
(b) damages for loss caused by the plaintiff's refusing to allow the builder's workmen onto the property; and
(c) damages for trespass to tools thrown away by the plaintiff.[121]

Morris LJ (with whom Hodson LJ agreed) held that (a) and (b) were properly grounds for equitable set-off as they "in effect remained due to the defendant under the contract under which he agreed to do work for the plaintiff."[122] It was not necessary for his Lordship to address specifically claim (c) because (a) and (b) overtopped the plaintiff's claim. Sellers LJ, however, did consider claim (c) and thought that it, along with (a), was a proper subject for equitable set-off as it was "closely associated with and incidental to the [original] contract, on which the plaintiff sues for breach".[123] In the opinion of Sellers LJ, claim (b) was most easily classified as an equitable set-off because "it arises directly under and affected the contract on which the plaintiff herself relies."[124]

The defendant builder's claim did not fall under the rule in *Mondel v Steel* because Mrs Hanak had already paid the defendant builder for the original work. If she had not paid the defendant, and he had sued her for the cost of the work and labour, then the plaintiff could have relied on abatement of that price by pleading non-completion and faulty work. Accordingly, the present claim and cross-claim are outside of the ambit of common law abatement. It is clear therefore that Morris LJ's judgment rests on the basis of equitable set-off, not on the basis of common law abatement.[125]

Both Spry[126] and Meagher et al[127] concede that (b) could give rise to an equitable set-off, but the other two claims "could not conceivably do so".[128] Like the criticism of *Morgan & Son*, Meagher et al trenchantly describe *Hanak v Green* as being "decided per incuriam.[129]

Spry's criticism of English case-law since Rawson v Samuel

Spry, in an incisive article in *The Australian Law Journal* in 1969,[130] examined the relevant case law then available and concluded that the broader principles developed by the English

Court of Appeal in cases such as *Morgan & Son* and *Hanak v Green* should be discarded for the more restrictive *Rawson v Samuel* approach that, in order to establish an equitable set-off, the court must be able "to find an equity according to the principles established in the Court of Chancery before the *Judicature Act*".[131] In other words:

> "What must be established was such a relationship between the claim of the plaintiff at law and the claim of the defendant that the right of the plaintiff should be regarded in equity as dependent on satisfaction of the claim of the defendant. ... [it is] not enough to show that the various claims arose out of the same contract [or] ... merely ... that the claim of the applicant was based on the legal or equitable fraud of the other party."[132]

Spry reformulated the test in the following words in the fourth edition of his book on *Equitable Remedies*:

> "What must be established is a relationship between the respective claims of the parties which is such that the claim of the defendant has been brought about by, or has been contributed to by, or is otherwise closely bound up with, the rights that are relied on by the plaintiff and which is also such that it would be unconscionable that he should proceed without permitting a set-off."[133]

The cases subsequent to *Rawson v Samuel* in which Spry (in 1969) believed the appropriate impeachment test had been applied were: *Hill v Ziymack, Ralston v South Greta Colliery Co, Sun Candies Pty Ltd v Polites*,[134] and *Re KL Tractors Ltd*. Spry also referred approvingly to the statement by Sholl J in *Bayview Quarries Pty Ltd v Castley Development Pty Ltd*[135] that he could find in the relevant English authorities "no clear or uniform statement of the nexus which must exist before what would otherwise be a counter-claim only becomes a matter of set-off."[136]

Meagher et al support Spry's analysis of the original strict form of the impeachment test. They state:

> "One ingredient was necessary in equity but not required at law, that is, that the set-off actually go to the root of, be bound up with, 'impeach', the title of the plaintiff. No such requirement existed at law, but in equity it was indispensable. It was not sufficient that there be countervailing claims, nor that those claims were mutual, nor even that they arose out of the same transaction. The defendant, in order to make out an equitable set-off, had to establish that he possessed some equitable right to be protected from the plaintiff's claim."[137]

As already stated, the learned authors further propound that *Morgan & Son* and *Hanak v Green* were "decided per incuriam". Of these English decisions they say:

> "Either they are wholly misconceived, or they have (albeit unintentionally) abrogated the requirement that no equitable set-off of the kind under consideration can exist unless it generates an equity which impeaches the validity of the plaintiff's claim. Certainly they cannot be reconciled with prior authority."[138]

I submit that this criticism is correct. It is one thing to expand a doctrine purposefully and consciously, it is quite another to do so through misunderstanding, even if such expansion may be seen as fair and equitable. There have been many more cases considering these principles since Spry's article in 1969, some of which have addressed the above academic criticism.[139] These are now discussed.

Cases subsequent to Spry's criticism

In 1973, in *Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd*,[140] three members of the House of Lords[141] referred approvingly to *Hanak v Green* in relation to Morris LJ's differentiation between common law abatement and equitable set-off. In so doing, say Meagher et al, they "unfortunately" have "given at least limited approval to" the *Hanak v Green* expansion of equitable set-off.[142] In 1974 the English Court of Appeal produced *Henriksens A/S v Rolimpex*.[143] Although this case concerned the defence of common law abatement and whether it was subject to being time-barred, Lord Denning MR in obiter expressly approved *Morgan & Son* and *Hanak v Green* in relation to their statement of the "scope of equitable set off".[144] Since the focus of neither case was on equitable set-off it

is not surprising that no reference was made to Spry's criticism.[145]

Later in 1974 Woodward J in *D Galambos & Son Pty Ltd v McIntyre*[146] comprehensively reviewed the available cases relevant to set-off and abatement, and attempted to distil the relevant principles. In that case the plaintiff claimed the balance due under a building contract. The defendants did not dispute the amount of the balance, but counterclaimed an amount in excess of the balance as damages for breach of contract in respect of: (a) work not done; (b) defective work; and (c) work done not in accordance with the plans (which did not result in any loss of value to the building, but which prevented the defendants from using part of the building in the way they had intended, which thus resulted in a claim for loss of enjoyment). Woodward J held that both (a) and (b) were "matters of pure defence" which, since they overtopped the plaintiff's claim, "were sufficient to defeat the plaintiff's claim and to entitle the defendants to judgment on the counter-claim."[147] In other words, following *Allen v Cameron, Lowe v Holme,* and *Mondel v Steel* his Honour held (a) and (b) to be matters of common law abatement rather than of equitable set-off.[148] Claim (c), albeit outside the scope of abatement, was held via obiter to be an appropriate subject for equitable set-off as it was: "so closely related to the plaintiff's" claim.[149] In making this decision, his Honour was to some extent relying on the expanded operation proposed by Sellers LJ[150] in *Hanak v Green* where his Lordship held that the throwing away of the builder's tools could be set-off against what was owed by the builder under the construction contract.

Meagher et al state that the requirement of impeachment "did not escape Woodward J".[151] While this may be true to the extent that his Honour reiterated the test proposed by Lord Cottenham in *Rawson v Samuel,* I submit that Woodward J fell prey to a misunderstanding of the test, and to misapplication to the facts before him. This is demonstrated best by his Honour's statement that the conflict between the English and Australian authorities referred to by Gowans J in *Edward Ward & Co v McDougall*[152] was "more apparent than real",[153] and that *Morgan & Son* was "a clear example of an equitable set-off".[154] Nothing could be further from the truth: *Morgan & Son* is an example of the English Court of Appeal's misunderstanding of the proper operation of the impeachment test. Just as the claim in *Hanak v Green* for the throwing away of the tools was not a proper subject for equitable set-off, so, too, was the claim for loss of enjoyment in *D Galambos* not a proper subject for equitable set-off. Perhaps it is significant that Woodward J did not refer to Spry's criticism. It is unfortunate, so far as the clarification of the impeachment test is concerned, that *D Galambos* has acquired somewhat of a following, all too often in the absence of careful analysis.[155]

In 1975 in *Sidney Raper Pty Ltd v Commonwealth Trading Bank of Australia,*[156] facts amounting to a true impeachment arose for consideration. Unfortunately, in granting the equitable set-off Moffitt P referred to *Morgan & Son* and to *Hanak v Green* with apparent approval, and no reference was made to Spry's article or to the earlier Australian cases.[157] Moffitt P's comments should, however, be considered obiter as the primary basis of his decision was that of total failure of consideration.[158]

In 1977 Forbes J in *British Anzani (Felixstowe) Ltd v International Marine Management (UK) Ltd*[159] dealt with a set of facts vaguely reminiscent of those in *Beasley v D'Arcy,* and held them to be a proper subject for equitable set-off. I agree that the facts of the case warranted the application of equitable set-off, *but only if the landlord's breach of the first agreement (that is, faulty construction of the floors) inhibited or adversely affected the tenant's ability to pay the rent due under the second agreement.*[160] This is a question of fact and degree, and was not made clear in the judgment. Although the result may be correct, Forbes J unfortunately applied the newly formulated test of Lord Denning MR in *Federal Commerce and Navigation Co Ltd v Molena Alpha Inc*[161] that the court should ask itself: "What should we do now so as to ensure fair dealing between the parties?"[162] Forbes J enunciated the test as: "[I]n considering questions of this kind it is what is obviously fair or manifestly unjust that will determine the solution."[163] No Australian cases were cited, nor any reference made to the criticism of Spry or

Meagher et al.[164] This form of the test unfortunately was applied by the Full Court of the Australian Capital Territory in *Gibb Australia Pty Ltd v Cremor Pty Ltd*[165] in which, like *British Anzani*, no mention was made of *Hill v Ziymack*, *Ralston v South Greta Colliery Co*, or the academic criticism.

In New Zealand in 1978 Barker J in *Popular Homes Ltd v Circuit Developments Ltd*[166] produced the most informed judgment, to that date, of the various academic opinions on the issue: his Honour referred to Spry's article, to Spry's book, and to Meagher et al;[167] but since the facts of the case satisfied both the broader English test and the narrower Australian test, he found it unnecessary to decide which was correct.[168] Subsequent New Zealand decisions have been guided by the discussion opened up in this case. In *Parry v Grace*[169] in 1981 Thorp J referred to Barker J's discussion of the differences of judicial and academic opinion, stated his preference for the "more stringent Australian approach",[170] and then applied that narrower test to the facts before him and held that a claim to equitable set-off had not been substantiated.[171] It is noteworthy that Thorp J referred to the Australian decisions of *Ralston v South Greta Colliery Company* and *Sun Candies Pty Ltd v Polites*.[172] Similarly in 1985 in *Wilsons (NZ) Portland Cement Ltd v Gaxt-Fuller Australasia Pty Ltd (No 2)*[173] Prichard J referred to *Parry v Grace* and to Spry's text, and seemed to prefer that narrower approach to equitable set-off rather than the "more liberal view ... exemplified in *Hanak v Green*".[174] This was demonstrated by the fact that his Honour opined that a cross-claim for damages for precontractual misrepresentation (that the contractor was equipped and able to complete the work within the stipulated period), which induced the owner to enter into the contract, did not impeach the contractor's claim for payment for work done under the contract.[175]

In 1981 in Victoria Tadgell J in *Eagle Star Nominees Ltd v Merril*[176] isolated and applied the strict *Rawson v Samuel* impeachment test, of which he said: "I am not in doubt both that I should apply the principle here and that the defendant does not bring himself within it."[177] The plaintiff vendor sold a property to the defendant. When the defendant defaulted on his instalment payments the plaintiff sued to recover possession,[178] and applied for summary judgment. The defendant sought leave to defend on the basis of an equitable set-off against the plaintiff: the defendant claimed damages against the plaintiff for breach of a collateral contract to assign the benefit of an insurance policy covering the property. This was of significance to the defendant because within a week of entering into possession he alleged that he was burgled of goods to the value of $8,000. The insurer denied liability, saying that the policy had never been assigned. The plaintiff denied any representation to make such an assignment. Tadgell J emphasised the lack of evidence of inducement:

> "There is no suggestion on the defendant's part that his purchase was dependent on or induced or even influenced by the assignment of the policy which he says or infers was promised; and there is no room for an implication to that effect. The plaintiff's promise, assuming it was made and is enforceable, was collateral but subordinate to the contract of sale; and no question of fraud or any other question which might cause equity to intervene was raised. It follows that the plaintiff's claim owes nothing to any right, legal or equitable, which the defendant asserts and is not impeachable by any equity to which the defendant can refer."[179]

On these facts I agree that there was no impeachment. But if the defendant could prove the collateral contract and that he *could not*[180] (as distinct from *would not*) pay the instalments because he necessarily had to purchase new household items, then I submit that the plaintiff's claim would be impeached.

In 1987 in *Sydmar Pty Ltd v Statewise Developments Pty Ltd*[181] Smart J, to use the expression of Meagher et al, "fell victim to the English sloppiness".[182] Despite being pressed with *Hill v Ziymack's* application of *Rawson v Samuel*, and a submission that *D Galambos & Son Pty Ltd v McIntyre* was incorrectly decided (to the extent that the loss of enjoyment amounted to an equitable set-off), Smart J did not regard these cases as being "inconsistent",[183] and expressly approved of "the evolution and development that has taken place in this area of the law and

which is reflected in *Galambos*, the modern English cases and the cases in this court."[184] In *Sydmar* the claim for equitable set-off concerned negligence, but it was negligence of the *Morgan & Son* type rather than of the *Piggott v Williams* type — there simply was no impeachment of the plaintiff's claim, unless the defendant could show that it did not have the funds to pay the plaintiff *because of* the loss sustained by the plaintiff's negligence. If that were the case, then the plaintiff's claim arguably would be conditional upon the defendant's.[185]

Meagher et al cite two relatively recent English cases as demonstrating "signs of a reversion to orthodoxy";[186] they are: *Guinness Plc v Saunders*[187] and *Bank of Boston Connecticut v European Grain and Shipping Ltd (the "Dominique")*.[188] This statement should be taken with caution. The former case refers only to *Federal Commerce and Navigation Co Ltd v Molena Alpha Inc*[189] and is overwhelmed by the discussion of a director's breach of fiduciary duty and his holding the company's money as constructive trustee. In the latter case the House of Lords held that "repudiatory breach of a voyage charterparty is no more capable of giving rise to a defence by way of equitable set-off than is a non-repudiatory breach".[190] In other words, in cases of claims for payment for freight (that is, carriage of goods by sea) total failure of consideration is a defence, but common law abatement and equitable set-off, quite anomalously, are not available. Although this case referred approvingly to the impeachment test of *Rawson v Samuel* it did not disapprove of *Hanak v Green*, nor did it refer to the criticism of Spry or Meagher et al. It is submitted that, far from "reassert[ing] the primacy of the *Rawson v Samuel* test" as suggested by Meagher et al,[191] it merely paid lip service to the principle, and subsequent cases will continue to misapply it in the same manner as occurred in *Hanak v Green*.

In 1988 two landlords, one in Queensland (*Pivetta v Dainty*[192]) and the other in New Zealand (*Grant v NZMC Ltd*[193]), sought summary judgment for possession for unpaid rent. In both cases the defendant sought leave to defend on the basis of having an equitable set-off against the landlord. The Queensland defendant claimed damages for deceit based on fraudulent misrepresentations concerning the takings of a business purchased from the landlord and situated on the leased premises. This case was very similar to *Sun Candies Pty Ltd v Polites*,[194] which, like the academic criticism, was not mentioned; instead Carter J in granting leave to defend seemed to adopt the broader test enunciated by Lord Denning MR in *Federal Commerce and Navigation Co Ltd v Molena Alpha Inc*.[195] Thus the result may have been correct, but it was reached by the wrong path. The New Zealand defendant claimed he had been induced to enter into the lease on the basis of a collateral contract with the landlord that panel-beating work would be referred to him. This case was of the same type as *Eagle Star Nominees Ltd v Merril*,[196] and is subject to the same comment that impeachment could only lie if the non-payment of rent was due to *lack of ability* (because of the plaintiff's breach of the collateral contract) rather than having the funds available but deciding not make the payments. The "inducement" factor was also considered important: the defendant's cross-claim for damages for breach of the collateral contract was properly a subject of equitable set-off as the landlord was "endeavouring to enforce a promise by the [tenants] to pay rent while itself in breach of its own undertaking which gave rise to the lease on which it relies."[197] Again the result may be correct, but the New Zealand Court of Appeal went terribly wrong when, after referring to Spry and Meagher et al, and stating that there is "a wider (*Hanak v Green*) and a narrower (*Rawson v Samuel*) view of what is necessary to constitute an equitable set-off", they rather fatalistically said: "But the administration of law and equity in one Court has inevitably meant that the two bodies of law have been much affected by each other ... *Hanak v Green* may evidence that trend",[198] and they formulated the following principle:

> "The principle is, we think, clear. The defendant may set-off a cross-claim which so affects the plaintiff's claim that it would be unjust to allow the plaintiff to have judgment without bringing the cross-claim to account. The link must be such that the two are in effect interdependent: judgment on one cannot fairly be given without regard to the other; the defendant's claim calls into question or impeaches the plaintiff's demand.

> It is neither necessary, nor decisive, that claim and cross-claim arise out of the same contract."[199]

In 1992 the Queensland Court of Appeal in *Hill Corcoran Constructions Pty Ltd v Navarro*[200] was asked to consider the issue of equitable set-off. The plaintiff builder had obtained leave to sign summary judgment for $50,000 (plus interest) which it had lent to the defendants "for the sole purpose of assisting [the defendants] in the construction of" a home unit building which the builder was going to build for them. The defendants appealed, arguing that they were entitled to an equitable set-off of that amount as they were claiming damages against the plaintiff for the cost (estimated to be around $1 million) of remedying defective work. The court referred to *Rawson v Samuel* as the "starting point of any discussion of the doctrine of equitable set-off' but then approved the "dicta" of the English authorities. Almost as an afterthought, the court stated:

> "It is unnecessary in the present case to consider the criticism by Spry: *Equitable Remedies* 4th ed p 176 and Meagher Gummow and Lehane: *Equity Doctrines and Remedies* 2nd ed para 3710 of the decisions in *Morgan* and *Hanak*. On either view the necessary relationship between the two claims arguably exists here."[201]

I agree that impeachment was present in this case because any breach by the builder of the construction contract "would have been likely to impede the sale [by the defendants] of the units and so *impair [their] ability" to repay the $50,000.*[202]

Gummow J, James v Commonwealth Bank of Australia, and subsequent cases

In 1992 Gummow J, while on the Federal Court, delivered his decision in *James v Commonwealth Bank of Australia*[203] (also reported sub nom *Re Just Juice Corporation Pty Ltd*[204]). This arguably is the most perceptive examination and review of this area of the law since Spry's article was published in 1969. Although the case turned upon the construction of certain deeds of indemnity, his Honour was keen to comment (albeit as obiter) on the position and direction of the law of equitable set-off because of the "importance of the matter".[205] Gummow J held that *Hill v Ziymack* (the only High Court authority of the point) and *J & S Holdings Pty Ltd v NRMA Insurance Ltd*[206] (a Full Federal Court decision), both of which rely on the strict formulation of the test expounded in *Rawson v Samuel*, were binding upon him.[207] The case concerned a claim by the plaintiff receiver for indemnity from his appointers for debts incurred by the company while he was acting as receiver and manager. On the assumption that the appointers were liable to indemnify him under the deeds of appointment and indemnity, they sought to equitably set-off any such liability on the basis that the debts were incurred as a result of the receiver's "personal default and neglect" and due to his false representations that the company was "trading profitably in receivership, that its assets were not being depleted and that its business was viable", upon which reliance was placed not to liquidate the company. Gummow J, after referring to *Eagle Star Nominees* and *Piggott v Williams*, stated that the receiver's claims to indemnity from his appointers "would not have come about or were at least contributed to by the [receiver's] own breaches of duty owed to the banks"; accordingly he believed an equitable set-off would have been established.[208]

His Honour also referred to the apparent "loosening in the requirement of impeachment" in other jurisdictions, and said that, "The actual results in these cases may not have differed if orthodox principle had been applied",[209] but the reason they attract attention is their purported reformulation of the test, as in the recent House of Lords decision of *Bank of Boston Connecticut v European Grain and Shipping Ltd.*[210] He then said: "Decisions in England, New South Wales and New Zealand have accepted a dilution of the impeachment requirement in similar but varying formulations."[211] Gummow J's attack against this dilution took the form of criticising the Privy Council's decision in the *Newfoundland* case, and its subsequent application in *Hanak v Green*, which itself was the foundation for all of the "diluted" cases either "directly or indirectly".[212] Then, after mentioning Spry's article, his Honour concluded: "It follows, in

my view, that in this court the *Newfoundland* case does not provide a good juridical root for any changed doctrine of equitable set-off."[213]

The perspicacity and significance of Gummow J's judgment has been lost to some judges in the "tangled history" of the law of equitable set-off;[214] others have perceived it, but decided to follow their own path;[215] but fortunately others, importantly some appellate judges, have discovered and applied this beacon of light.

In 1993 in *Lord v Direct Acceptance Corporation Ltd (in liq)*[216] the New South Wales Court of Appeal, in discussing the appropriate test for equitable set-off, referred approvingly to *Rawson v Samuel, Hill v Ziymack, J & S Holdings,* and *James v Commonwealth Bank of Australia,* and held that the concept was "better stated" in Meagher et al than in *Bank of Boston.*[217] This was a major advance in the reassertion of the impeachment test, coming as it did from an intermediate appellate court. It was unfortunate that the facts were not closer to an impeachment so that a strict application could be demonstrated.

In 1995 the Full Court of Western Australia in *Hazcor Pty Ltd v Kirwanon Pty Ltd*[218] referred approvingly to the impeachment test stated by Gummow J in *James v Commonwealth Bank of Australia,* and continued:

> "The right of equitable set-off clearly came to be broader in its scope than the right of set-off available under the statutes. However, one requirement of that category of equitable set-off which is relied upon in this case, *as established in the last century,* was that the set-off be essentially bound up with, or impeach, the title of the other party."[219]

His Honour then referred approvingly to Meagher et al and Spry's book, set out the test as stated in *Rawson v Samuel,* noted that there "have been a number of apparent departures from the so-called impeachment test" (citing *Henriksens v Rolimpex* and *Bank of Boston Connecticut*), and stated: "I am quite unable to accept ... that the test is no more than whether the set-off is reasonable in the interests of justice and fair dealing."[220]

Within a month of the decision in *Hazcor* being delivered, and without being referred to that decision, the Full Court of the Federal Court handed down its decision in *Walker v Secretary Department of Social Security.*[221] A majority of the judges (Cooper and Spender JJ) accepted the impeachment test described in *Rawson v Samuel, Hill v Ziymack, J & S Holding, Lord v Direct Acceptance* and *James v Commonwealth Bank of Australia,* and stated: "The respondent has not sought to point to any relevant equity of the type necessary to sustain a defence of equitable set-off."[222] Drummond J, on the other hand, produced a dissenting judgment in which he held that an equitable set-off was available because of the close connection of the claim and the cross-claim in conjunction with the fraudulent procuration of the earlier social security payments by the claimant.[223] Drummond J was critical of *James v Commonwealth Bank of Australia* as he believed it to propound a narrow fact-based test immune to discretionary considerations:

> "If the concept of impeachment involves no more than an examination of the connections between claim and cross-demand, and makes irrelevant any reference to discretionary considerations including those raised by the plaintiff's conduct which touch on his claim, it would give an equitable remedy according to whether claim and cross-demand were sufficiently connected, in a factual sense, and without reference to any of the discretionary considerations that are the hallmark of equitable intervention. Recent decisions of the High Court emphasise that the prevention of unconscionable conduct is the core justification for equitable intervention". [224]

His Honour attempted to draw support for his argument for a broader test from, inter alios, Spry's book because of the use of the words "unjust" and "inequitable".[225] I submit that Drummond J's appeal to a more equitable approach to the defence of equitable set-off ought to be rejected. With the greatest respect, I submit that his Honour was putting the "cart before the horse": impeachment is the primary, indeed the essential, criterion, from which the consequences of injustice and inequity flow as a corollary; the same cannot be said for the converse — there are many unjust situations that do not amount to impeachment. Further,

his Honour emphasised conduct as a relevant factor,[226] and seemed to believe that the narrow *Rawson v Samuel* approach disregarded conduct. That this is *not* so is demonstrated from the earliest cases from which Lord Cottenham formulated the test; but conduct, like injustice and inequity, is subject always to the overriding imperative of impeachment.

Conclusion

The development of the doctrine of equitable set-off has been twisted and warped, misunderstood and misapplied ever since the Judicature Acts brought together the administration of equity and common law.

The narrow, orthodox test was enunciated by Lord Cottenham in *Rawson v Samuel* in 1841. Although the facts of that case did not pass the impeachment test to give an indication of how the test was to apply, his Lordship cited four cases which demonstrated the application of the principle.[227] Since that first emphatic enunciation of the test English courts have been grappling with the concept of impeachment and how it should be applied to a given set of facts. They have confused it with common law abatement and have, without conscious or critical analysis, expanded it to include scenarios of which Lord Cottenham never would have approved. Although the modern English expansion has been welcomed by some,[228] it has been criticised by others as providing "little assistance in the determination of whether the defence is available in any particular instance".[229]

The application of equitable doctrine nowadays is every bit as constrained as common law rules. No more is the length of the Chancellor's foot the determining factor.[230] That would be unworkable, and would cause much more grief and inequity than would a firm statement, and application, of the impeachment test. In Australia there really is no room for any other view. *Rawson v Samuel* was applied by the High Court of Australia in *Hill v Ziymack* — a decision by which all subordinate courts of Australia ought to be bound. Gummow J pointed this out in *James v Commonwealth Bank of Australia*, and supported his decision to follow that case by demonstrating the erroneous development of the English law due to the unfounded reliance on *Young v Kitchin* and *Newfoundland Government v Newfoundland Railway Co* which in turn were relied on in *Morgan & Son* and in *Hanak v Green*. Thus the legacy of error began.

In searching for a reason for such a drastic departure by the modern English cases from the principle espoused by Lord Cottenham, I come to rest upon the following three possibilities: (1) the original enunciation of the test was not, in hindsight, sufficiently clear; (2) with the passing of the Judicature Acts common law judges, who were unfamiliar "with the more esoteric equitable doctrines",[231] were called on to apply the equitable principles; and (3) often the merits rested with the defendant who was trying to establish the equitable set-off.

Australian courts are not free from blame though. On many occasions, as has been demonstrated, either the modern English cases have been followed or the *Rawson v Samuel* test has been stated and then misapplied.[232] But there clearly is sufficient authority in Australia to enable any Australian judge to ignore the modern English cases and the deviating Australian cases, and to determine the matter upon the proper principles.[233] If this part of the decision-making process is adhered to, then the only question of review or appeal would relate to the correct application of the test to the facts; and since the impeachment test is quite stringent, and various common categories have surfaced,[234] it will be much easier to determine whether there has been a correct application of the test to the facts than if the modern English approach were adopted.

In 1969 Spry concluded his article by stating: "it is not at the moment likely that Australian courts will adopt departures from the former equity practices".[235] On balance this prediction has turned out to be correct, but Australian courts must guard against the "English sloppiness":[236] both in principle and on authority the *Rawson v Samuel* impeachment test is the correct test to apply in Australia today, as it always has been.

Australian courts must become familiar with the test and its application so as to avoid the sort of dilution and expansion which has occurred, for the worse, in England and in New Zealand[237] and which now has been advocated

expressly in Australia by Drummond J in *Walker v Secretary, Department of Social Security*.

Endnotes

1 *Hanak v Green* [1958] 2 QB 9 at 16 per Morris LJ.

2 See *Hazcor Pty Ltd v Kirwanon Pty Ltd* (1995) 12 WAR 62 at 69.

3 *In re A Bankruptcy Notice* [1934] Ch 431 at 437 per Lord Hanworth MR: "[Set-off] is something which provides a defence because the nature and quality of the sum so relied upon are such that it is a sum which is proper to be dealt with as diminishing the claim which is made, and against which the sum so demanded can be set off."

4 *Re K L Tractors Ltd* [1954] VLR 505 at 507.

5 Ibid at 507; *In re Hiram Maxim Lamp Co* [1903] 1 Ch 70. This is the position in relation to a legal set-off or an analogous equitable set-off. Where a classical equitable set-off is concerned the position is not so clear: see *Stewart v Latec Investments Ltd* [1968] 1 NSWR 432; *Stehar Knitting Mills Pty Ltd v Southern Textile Converters Pty Ltd* [1980] 2 NSWLR 514; and see the discussion under the heading "Set-Off in Equity".

6 *J & S Holdings Pty Ltd v NRMA Insurance Ltd* (1982) 61 FLR 108 at 126.

7 See, eg, *Walker v Secretary, Department of Social Security* (1995) 56 FCR 354 at 363 per Drummond J.

8 Derham, *Set-Off* (2nd ed, Clarendon Press, Oxford, 1996), p 2, n 7: "If the cross-demand of a defendant asserting a right of set-off is greater in value than the plaintiff's claim against him, he may employ his demand in a set-off to the extent of, and in order to defeat, the plaintiff's claim, and counter-claim for the balance" (emphasis added). See *Bankes v Jarvis* [1903] 1 KB 549 and *Baskerville v Brown* (1761) 2 Burr 1229; 97 ER 804 at 805. Since set-off is a defence only, the defendant must bring a separate action (or counterclaim, which was not available until after the *Judicature Act*) to collect the amount exceeding the plaintiff's claim.

9 See *Hanak v Green* [1958] 2 QB 9 at 17 per Morris LJ; *Grant v NZMC Ltd* [1989] 1 NZLR 8 at 11.

10 *Supreme Court of Judicature Act* 1873 (Eng), s 24(3); *Supreme Court Act* 1995 (Qld), s 244(3) — relocated from the *Judicature Act* 1876 (Qld), s 4(3) and *Rules of the Supreme Court* (Qld), O 17, r 4; O 18, r 3, O 47, r 18. Although the court could always permit it through the exercise of its inherent discretion to control its own procedure. See Parkinson (ed), *The Principles of Equity* (LBC Information Services, 1996) para 3004, n 16.

11 See also Parkinson, ibid at para 3005.

12 See *McDonnell & East Ltd v McGregor* (1936) 56 CLR 50, and *McKain v R W Miller & Co (South Australia) Pty Ltd* (1991) 174 CLR 1 at 40-45 per Brennan J (as he then was), Dawson, Toohey, and McHugh JJ; *Aries Tanker Corporation v Total Transport Ltd* [1977] 1 All ER 398 at 402 per Lord Wilberforce (with whom Viscount Dilhorne, and Lords Simon of Glaisdale, Salmon, and Edmund-Davies agreed). See also Derham, op cit n 8, at pp 64-65. Note, however, that where moratorium legislation (rather than a statute of limitations) renders the debt unenforcable, but does not extinguish the substantive right, set-off may not be available: see *R v Ray; Ex parte Chapman* [1936] SASR 241.

13 See *Judicature Act* 1873 (Eng), s 25(6); *Property Law Act* 1974 (Qld), s 199; *Smith v Parkes* (1852) 16 Beav 115; 51 ER 720 at 722; *Newfoundland Government v Newfoundland Railway Co* (1888) 13 QBD 199 at 213; *Re Partnership Pacific Securities Ltd* [1994] 1 Qd R 410 at 423 per Williams J; *Roxburghe v Cox* (1881) 17 Ch D 520 at 526 per James LJ; *Edward Nelson & Co Ltd v Faber & Co* [1903] 2 KB 367 at 375; *W Pope & Co Pty Ltd v Edward Souery & Co Pty Ltd* [1983] WAR 117; *The "Dominique"* [1987] 1 Lloyd's Rep 239. See also Derham, op cit n 8, at pp 578-580. *Sun Candies Pty Ltd v Polites* (1939) VLR 132; *West Street Properties Pty Ltd v Jamison* [1974] 2 NSWLR 435; *N W Robbie & Co Ltd v Whitney Warehouse Co Ltd* [1963] 1 WLR 1324; *Ferrier v Bottomer* (1972) 126 CLR 597.

14 See *Provincial Bill Posting Company v Low Moor Iron Company* (1909) 2 KB 344; *Sharpe v Haggith* (1912) 106 *Law Times* 13; *Hanak v Green* [1958] 2 QB 9; *Lowe v Holme* (1883) 10 QBD 286.

15 See *Stehar Knitting Mills Pty Ltd v Southern Textile Converters Pty Ltd* [1980] 2 NSWLR 514.

16 See *Hale v Victoria Plumbing Co Ltd* [1966] 2 QB 746.

17 See *Edward Ward & Co v McDougall* [1972] VR 433; *Eagle Star Nominees Limited v Merril* [1982] VR 557.

18 See *Re KL Tractors Ltd* [1954] VLR 505; *Altarama Ltd v Camp* (1980) 5 ACLR 513. Compare *Dow Securities Pty Ltd v Manufacturing Investments Ltd* (1981) 5 ACLR 501 at 504. See also Meagher, Gummow and Lehane, *Equity: Doctrines and Remedies* (3rd ed, Butterworths, 1992), para 3713.

19 See *Parry v Grace* [1981] 2 NZLR 273 at 276 per Thorp J for a nice summary of the available categories of "set-off".

20 See *Ex parte Twogood* (1805) 11 Ves 519; 32 ER 1189 and *Stooke v Taylor* (1880) 5 QBD 569 at 575 per Lord Cockburn CJ.

21 4 & 5 Anne c 4 (1705); 4 Anne c 17, s 11. Subsequent statutes were: 5 Geo II c 30 (1732), s 28; 46 Geo III c135, s 3; 6 Geo IV c 16 (1733), s 50; 46 & 47 Vict c 52, s 38. See *Ex parte Stephens* (1805) 11 Ves 24; 32 ER 996 at 997. In more modern times in England see: *Bankruptcy Act* 1914 (Eng), s 31 and *Insolvency Act* 1986 (Eng), s 323; and in Australia

see: *Bankruptcy Act* 1966 (Cth), s 86 and *Corporations Law*, s 553C. This right to set-off cannot be excluded by agreement: *National Westminster Bank Ltd v Halesowen Presswork & Assemblies Ltd* [1972] AC 785; *Watkins v Lindsay & Co* (1898) 67 LJQB 362; *Mathieson's Trustee v Burrup, Mathieson and Company* [1927] 1 Ch 562; *Re McIntyre; Ex parte Perkes and Gye* (1990) 22 FCR 260 per Gummow and von Doussa JJ.

[22] See *Insolvent Debtors Relief Act* 1729 (Eng) (2 Geo II, c 22), s 13; *Set-Off Act* 1735 (Eng) (8 Geo II, c 24), s 5. These statutes were automatically incorporated into the laws of the various Australian jurisdictions by virtue of the doctrine of reception in New South Wales: *Australian Courts Act* 1828 (Eng), s 24. See generally Castles, "The Reception and Status of English Law in Australia" (1963) 2 *Adelaide Law Review* 1.

[23] *Imperial Acts Application Act* 1984 (Qld); *Imperial Acts Application Act* 1969 (NSW), s 8.

[24] For England see *Civil Procedure Acts Repeal Act* 1879 (Eng), s 2 and *Hanak v Green* [1958] 2 QB 9. For Victoria see *Imperial Acts Application Act* 1922 (Vic), s 7 and Derham, "Recent Issues in Relation to Set-Off" (1994) 68 ALJ 331 at 340-344. The *Statutes of Set-Off* continue to apply in the ACT (*Gibb Australian Pty Ltd v Cremor Pty Ltd* (1992) 108 FLR 129 at 135) and in WA (*Hazcor Pty Ltd v Kirwanon Pty Ltd* (1995) 12 WAR 62 at 67).

[25] *Hong Kong and Shanghai Banking Corp v Kloeckner & Co AG* [1989] 3 All ER 513; *Grant v NZMC Ltd* [1989] 1 NZLR 8. See also *Re Partnership Pacific Securities Ltd* [1994] 1 Qd R 410 at 424-425. Cf *Citibank Pty Ltd v Simon Fredericks Pty Ltd* [1993] 2 VR 168 at 175.

[26] *National Westminster Bank Ltd v Halesowen Presswork & Assemblies Ltd* [1972] AC 785; *Re the Paddington Town Hall Centre Ltd (in liq) and the Companies Act* (1979) 41 FLR 239; *Rendell v Doors & Doors Ltd (in liq)* [1975] 2 NZLR 191.

[27] There is some doubt as to whether common law abatement is a procedural or a substantive defence (see the discussion in Derham, op cit n 8, pp 127-128). This is of importance, eg, in relation to statutes of limitation (see *Henriksens Rederi A/S v THZ Rolimpex (the "Brede")* [1974] 1 QB 233; *Sidney Raper Pty Ltd v Commonwealth Trading Bank of Australia* [1975] 2 NSWLR 227) and to the assignment of debts (see *Young v Kitchin* (1878) 3 Ex D 127; *Newfoundland Government v Newfoundland Railway Co* (1888) App Cas 199). Derham claims this is of academic interest only following the expansion of equitable set-off and the passing of the *Judicature Act* 1873 (Eng) (which made equitable defences available in the courts of common law: *Aries Tanker Corporation v Total Transport Ltd* [1977] 1 WLR 185 at 194 per Lord Salmon) because, to avoid the problem of classification as procedural or substantive, a court might simply decide the case on the principles of equitable set-off rather than those of common law abatement: see Derham, ibid, pp 128-129). Scott J in *Sim v Rotherham Metropolitan Borough Council* [1987] 1 Ch D 216 at 259 voiced the same view. He believed that the necessity to distinguish between abatement and equitable set-off "disappeared with the Judicature Acts. If the remedy of equitable set off is available, abatement is not needed. If the circumstances of the case do not warrant equitable set off, then, in my view, they would not establish an abatement." This view has a certain natural logic, but it fails to take into account the maxim that equity follows the law, and has no application when the law is applicable. Thus when an owner, in the face of a claim by a builder for payment under a building contract, cross-claims for defects in the building work, equity has no role to play as common law abatement governs the situation. Accordingly, it would be difficult for a court, as Derham suggests above, to decide the case on the principles of equitable set-off rather than those of common law abatement to avoid the problem of classification as procedural or substantive. Clearly common law abatement remains an important part of our law.

[28] See *Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd* [1973] 3 All ER 195 at 215 per Lord Diplock: "[Common law abatement] is independent of the doctrine of 'equitable set-off' developed by the Court of Chancery to afford similar relief in appropriate cases to parties to other types of contracts, of which a masterly account is to be found in the judgment of my noble and learned friend Lord Morris of Borth-y-Gest in *Hanak v Green* [1958] 2 QB 9." See also *United Dominions Corporation Ltd v Jaybe Homes Pty Ltd* [1978] Qd R 111 at 116 per Andrews J.

[29] Later codified in sale of goods legislation: *Sale of Goods Act* 1893 (Eng), s 53; *Sale of Goods Act* 1896 (Qld), s 54. For a comprehensive treatment of *Mondel v Steel* (1841) 8 M & W 858; 151 ER 1288 and the relevant sections of the *Sale of Goods Act* see the judgment of Windeyer J in *Healing (Sales) Pty Ltd v Inglis Electrix Pty Ltd* (1968) 121 CLR 584. See also *Newman v Cook* [1963] VR 659.

[30] Semble common law abatement is applicable to employment contracts unless there are any specific terms or statutory provisions disallowing it: *Sagar v H Ridehalgh and Son Ltd* [1931] Ch 310 at 326 per Lord Hanworth MR; *Sim v Rotherham Metropolitan Borough Council* [1987] 1 Ch D 216 at 259, 261 per Scott J who said at 262: "The aphorism 'no work, no pay' expresses, in my view, the equity of the situation."

[31] See Spry, "Equitable Set-Offs" (1969) 43 ALJ 265.

Scott J in *Sim v Rotherham Metropolitan Borough Council* [1987] 1 Ch D 216 at 258-259 explained: "[Common law abatement] was, however, developed ad hoc in relation to certain classes of contract: see the categories mentioned by Parke B in *Mondel v Steel* (1841) 8 M & W 858; 151 ER 1288. Equitable set-off, on the other hand, was based on principle." See also *British Anzani (Felixstowe) Ltd v International Marine Management (UK) Ltd* [1979] 2 All ER 1063 at 1070-71 in relation to another anomalous rule of the common law concerning landlord and tenant which is not a set-off, but which acts as a deduction or abatement defence: see generally Weir, "A Tenant's Right of Set-Off" (1994) 68 ALJ 857. In similar landlord and tenant circumstances equitable set-off may be allowed: *Knockholt Pty Ltd v Graff* [1975] Qd R 88 and *Tomlinson v Cut Price Deli Pty Ltd* (1992) 38 FCR 490.

[32] See also *Hanak v Green* [1958] 2 QB 9 at 17-18, 23 in which Morris LJ discusses *Mondel v Steel*, ibid, and acknowledges the common law defence of abatement. Cairns LJ in *Henriksens A/S v Rolimpex* [1974] 1 QB 233 at 252 expressly approved this aspect of Morris LJ's judgment, as did Roskill LJ at 260.

[33] *Templer v M'Lachlan* (1806) 2 Bos & PNR 136; 2 TR 136, cited in *Mondel v Steel*, ibid at 858; 1293.

[34] That is, carriage of goods by sea. *Shiels v Davies* (1814) 4 Camp 119 (sub nom *Shields v Davis* (1815) 6 Taunt 65), cited in *Mondel v Steel* ibid; *Henriksens A/S v Rolimpex* [1974] 1 QB 233; *Aries Tanker Corporation v Total Transport Ltd* [1977] 1 All ER 398.

[35] *Rigg v Commonwealth Bank* (1989) 97 FLR 261 at 267-268; *Nova (Jersey) Knit Ltd v Kammgarn Spinnerei GmbH* [1977] 1 WLR 713; *Glennie v Imri* (1839) 3 Y & C 436; 160 ER 733.

[36] For example, at law a joint debt cannot be set-off against a several debt: *Ex parte Twogood* (1805) 11 Ves 519; 32 ER 1189.

[37] See *Stooke v Taylor* (1880) 5 QBD 569 at 575 per Lord Cockburn CJ.

[38] See *Ex parte Stephens* (1805) 11 Ves Jun 24; 32 ER 996. Although this was a bankruptcy case Lord Cottenham LC's comments at 998 indicate that the set-off would have been allowable even before the bankruptcy. Also, the principle in *Ex parte Stephens* has been followed in subsequent non-bankruptcy cases without any concern for its origins in bankruptcy: see *Sidney Raper Pty Ltd v Commonwealth Trading Bank of Australia* [1975] 2 NSWLR 227 at 255 per Glass JA in obiter dictum. See also *Bank of New Zealand v Harry M Miller & Co Ltd* (1992) 26 NSWLR 48.

[39] *Lord Cawdor v Lewis* (1835) 1 Y & C Ex 427; 160 ER 451. See also *Newfoundland Government v Newfoundland Railway Co* (1888) 13 App Cas 199 at 213 where Lord Hobhouse, delivering the judgment of the Privy Council, said: "Unliquidated damages may now be set-off as between the original parties, and also against an assignee if flowing out of and inseparably connected with the dealings and transactions which also give rise to the subject of the assignment." Compare *Bank of Boston Connecticut v European Grain and Shipping Ltd (the "Dominique")* [1989] AC 1056 at 1103 per Lord Brandon of Oakbrook. See also *Bankes v Jarvis* [1903] 1 KB 549 (followed in *British Anzani (Felixstowe) Ltd v International Marine Management (UK) Ltd* [1979] 2 All ER 1063) wherein Lord Alverstone CJ, Wills and Channell JJ all agreed that since the Judicature Acts a claim for unliquidated damages could be set-off against a liquidated claim in the same way that an equitable defence might have been raised before those Acts. "Any statements in Australian cases to the contrary effect stem from *Smail v Zimmerman* [[1907] VLR 702] and *McDonnell & East Ltd v McGregor* [(1936) 56 CLR 50] ... which should not be treated as having dealt with the subject of equitable set-off": *D Galambos & Son Pty Ltd v McIntyre* (1975) 5 ACTR 10 at 25 per Woodward J. See also *Edward Ward & Co v McDougall* [1972] VR 433 at 439 per Gowans J; *United Dominions Corporation Ltd v Jaybe Homes Pty Ltd* [1978] Qd R 111 at 115 per Andrews J.

[40] See *Sim v Rotherham Metropolitan Borough Council* [1987] 1 Ch D 216 at 258 per Scott J: "Equitable set off ... was developed in the Courts of Chancery as a remedy for the injustice that the narrowness of common law set off would in many cases have caused."

[41] See Spry, *Equitable Remedies* (4th ed, The Law Book Co Ltd, 1990), p 173: "Indeed, if an otherwise sufficient equity can be found, it does not matter whether or not the material claim of the defendant is for an *unliquidated* amount, nor does it matter whether or not the opposing claims may properly be described as *mutual*" (emphasis added).

[42] Meagher et al, op cit n 18, para 3707, n 8.

[43] *Re Hiram Maxim Lamp Co* [1903] 1 Ch 70; *Re KL Tractors Ltd* [1954] VLR 505 at 507.

[44] See *Stewart v Latec Investments Ltd* [1968] 1 NSWR 432.

[45] Ibid.

[46] Derham agrees with this conclusion, and states that *Stewart v Latec Investments Ltd* "is not a satisfactory decision": Derham, op cit n 24, at 337, n 58.

[47] [1903] 1 Ch 70.

[48] [1954] VLR 505 at 507.

[49] [1980] 2 NSWLR 514 at 518. See also *Tomlinson v Cut Price Deli Pty Ltd* (1992) 38 FCR 490 at 494-495 per Drummond J.

[50] *Clark v Cort* (1840) Cr & Ph 154; 41 ER 449. See also *Tony Lee Motors Ltd v MS MacDonald Son* (1974) Ltd [1981] 2 NZLR 281 per Bisson J where, however, his Honour at 288 unnecessarily used the terminology of "impeachment" in allowing an analogous equitable set-off. Further, in the paragraph at 288, lines 23-28, Bisson J must be taken as referring only to analogous equitable set-off, and not to classical equitable set-off. See also *Halsbury's Laws of England* (4th ed), Vol 16, p 990, para 1466; and *Story on Equity* (3rd English ed, 1920), p 604, para 1436a.

[51] See *Mathieson's Trustee v Burrup, Mathieson and Company* [1927] 1 Ch 562.

[52] *Thornton v Maynard* (1875) LR 10 CP 695 at 699 per the court (Lord Coleridge CJ, Brett and Archibald JJ). See also *Bankes v Jarvis* [1903] 1 KB 549.

[53] This was the situation in *Smith v Parkes* (1852) 16 Beav 115; 51 ER 720 where it appears that the defendant debtor, instead of raising a legal set-off under the *Statutes of Set-Off* in the action at law, went to the Court of Chancery and obtained a set-off in equity, presumably along the lines of an analogous equitable set-off.

[54] *Re Whitehouse & Co* (1878) 9 Ch D 595 at 597 per Jessel MR in obiter dictum: "Courts of Equity allowed set-off, but the Court of Equity, following the spirit of the statutes, would not allow a man to set off, even at law, where there was an equity to prevent his doing so; that is to say, where the rights, although legally mutual, were not equitably mutual." See also *Ex parte Morier* (1879) 12 Ch D 491 at 502 per Cotton LJ in discussing *Bailey v Finch* (1871) LR 7 QB 34: "There was a legal right to set off, and the question was whether there was a sufficient equitable ground for preventing the legal right from taking effect." In *Ralston v South Greta Colliery Co* (1912) 13 SR (NSW) 6 the debts were mutual in equity, but, since they were unliquidated, classical equitable set-off had to be invoked.

[55] Debts in autre droit (that is, in another's right, or due in different rights, or lacking mutuality) can be set-off only by virtue of classical equitable set-off which requires impeachment of the plaintiff's claim: *Rawson v Samuel* (1841) Cr & Ph; 41 ER 451 at 458-459 per Lord Cottenham LC. Examples of debts in autre droit can be found in *Bishop v Church* (1748) 3 Atk 691; 26 ER 1197 (Bishop held unable to set-off the benefit she would receive as a residuary legatee in an estate owed money by Church against a debt she owed to Church because the debts were due in different rights, and there was no additional or connecting factor to impeach the plaintiff's claim); and in *Ex parte Morier* (1879) 12 Ch D 491 (where a residuary legatee *would have* been able to set-off a debt against the residuary estate if the administration of the estate had been finalised and the joint executorship account he held with his sister had been a *simple trust* such that he "was so much the person beneficially interested that a Court of Equity, without any terms or any further inquiry, would have obliged the sister to transfer the account into her brother's name alone" (at 502 per Brett LJ).

[56] *Imperial Acts Application Act* 1969 (NSW), s 8; and see *Stehar Knitting Mills Pty Ltd v Southern Textile Converters Pty Ltd* [1980] 2 NSWLR 514.

[57] *Imperial Acts Application Act* 1984 (Qld), s 7.

[58] *Southern Textile Converters Pty Ltd v Stehar Knitting Mills Pty Ltd* [1979] 1 NSWLR 692 at 699; affd on this point in *Stehar Knitting Mills Pty Ltd v Southern Textile Converters Pty Ltd* [1980] 2 NSWLR 514.

[59] *Stehar Knitting Mills Pty Ltd v Southern Textile Converters Pty Ltd*, ibid at 523 per Glass JA and at 517 per Hutley JA.

[60] Derham, op cit n 24, at 332. There is a short but instructive discussion of *Stehar* in *Hazcor Pty Ltd v Kirwanon Pty Ltd* (1995) 12 WAR 62 at 69 per Kennedy J (with whom Malcolm CJ and Murray J agreed).

[61] *Rawson v Samuel* (1841) Cr & Ph; 41 ER 451 at 458-459 per Lord Cottenham LC.

[62] More properly termed an "equitable defence" than a set-off: see *Henriksens A/S v Rolimpex* [1974] 1 QB 233 at 248 per Lord Denning MR and at 251 per Cairns LJ. See also *Sanders Bros v Marshall* (unreported, Court of Appeal, Qld, No 225 of 1994, 27 October 1995) in which McPherson JA (with whom Williams and MacKenzie JJ concurred) applied the reasoning in *Henriksens* to the *Limitation of Actions Act* 1974 (Qld), s 42 in holding that an opposing claim on a running account is a pure defence, and not a matter of set-off, and therefore it was not time-barred. McPherson JA also stated that such matters of defence ought to be "affirmatively pleaded in the defence", and not just in the counterclaim, so that the plaintiff is not likely to be taken by surprise. Compare *Bright v Rogers* [1917] 1 KB 917.

[63] Spry, op cit n 31, at 265.

[64] See *Rawson v Samuel* (1841) Cr & Ph 161; 41 ER 451 at 458-459 per Lord Cottenham LC.

[65] (1805) 11 Ves 24; 32 ER 996.

[66] (1815) 19 Ves 465; 34 ER 589. Hearn owed Mrs Blagden (before her marriage) £525. Mr Blagden owed Hearn about £588. Hearn went bankrupt. Mr Blagden sought to set-off the £588 to the extent of the £525 Hearn owed his wife, and to pay the balance to the assignees in bankruptcy. Since there was no mutuality, an equity was required; and since Lord Eldon LC could find no

equity (such as the fraud in *Ex parte Stephens*), set-off was not permitted.

[67] (1796) 3 Ves 248; 30 ER 994.

[68] (1799) 5 Ves 108; 31 ER 496.

[69] (1841) Cr & Ph 161; 41 ER 451. Indeed, that the true rationale for equity's action was unclear was demonstrated by the fact that counsel opposing the grant of the injunction (which would lead to an equitable set-off) argued that the cases relied on by the applicant were cases of *security* or *lien* rather than cases of set-off: ibid at 457.

[70] (1841) Cr & Ph 161 at 178-179; 41 ER 451 at 458. Counsel supporting the application must not have been aware of *Ex parte Quintin* (1796) 3 Ves 248; 30 ER 994 and *James v Kynnier* (1799) 5 Ves 108; 31 ER 496.

[71] (1800) 2 Sch & Lef 403, n (Irish).

[72] (1804) 1 Sch & Lef 305 (Irish).

[73] (1805) 11 Ves Jun 24; 32 ER 996.

[74] (1821) 6 Madd 95; 56 ER 1027.

[75] (1835) 1 Y & C Ex 427; 150 ER 174.

[76] (1800) 2 Sch & Lef 403, n (Irish).

[77] Spry, op cit n 31.

[78] (1805) 2 Sch & Lef 400 at 413.

[79] See Spry, op cit n 31 at 267.

[80] (1804) 1 Sch & Lef 305 (Irish).

[81] Ibid at 309.

[82] Meagher et al, op cit n 18, para 3707, n 8.

[83] (1805) 11 Ves Jun 24; 32 ER 996 per Lord Eldon LC.

[84] Ibid at 24; 998 per Lord Eldon LC.

[85] Ann effectively was a surety because the loan was for her brother's benefit solely.

[86] See the discussion of this case by Jessel MR in *Middleton v Pollock* (1875) 20 LR Eq 515 at 520-521.

[87] Spry, op cit n 31.

[88] Ibid at 268 (emphasis added).

[89] See also *Sun Candies Pty Ltd v Polites* [1939] VLR 132 where, in Spry's opinion, ibid at 271, the fraudulent aspect of the case was sufficient to bring it within the impeachment principle.

[90] (1821) 6 Madd 95; 56 ER 1027 per Sir John Leach V-C.

[91] Ibid at 95; 1027.

[92] Woodward J in *D Galambos & Son Pty Ltd v McIntyre* (1974) 5 ACTR 10 at 16 observed, in referring to *Piggott v Williams*: "The defence was held to amount to an equitable set-off; but since the allegation was that the solicitor's work had only been made necessary by his own negligence, it may be that the defence would have been regarded as a simple denial of indebtedness *had the solicitor merely been suing for the value of his work*" as opposed to suing for the foreclosure of an estate pledged by the client as security for the solicitor's costs (emphasis added).

[93] Spry, op cit n 31, at 268. Cf the analysis below of another negligence case: *Morgan & Son Ltd v S Martin Johnson & Co Ltd* [1949] 1 KB 107.

[94] See *Re Kostezky, Ex parte Midler Elfman Szmerling Krycer Pty Ltd* (unreported, Federal Court, Sundberg J, VP 570 of 1995, 12 June 1996) and *Morgan & Son Ltd v S Martin Johnson & Co Ltd* [1949] 1 KB 107 which I submit were decided erroneously.

[95] (1835) 1 Y & C Ex 427; 160 ER 174.

[96] Spry, op cit n 31 at 268.

[97] *Rawson v Samuel* (1841) Cr & Ph 161; 41 ER 451.

[98] (1815) 19 Ves 465; 34 ER 589.

[99] (1878) 3 Ex D 127.

[100] See also *Lowe v Holme* (1883) 10 QBD 286 at 289 where Baron Huddleston said that the plaintiff's defective construction work, some of which had to be redone at the expense of the defendants, gave rise to "a defence to the claim on the ground of the defective performance of the work contracted for". No mention was made of *Rawson v Samuel*.

[101] See Spry, op cit n 31, at 269.

[102] The only case cited in support of this conclusion was *Tooth v Hallett* (1868-69) 4 LR Ch App 242 which itself made no mention of *Rawson v Samuel*. *Tooth v Hallett* concerned an assignment in circumstances similar to those in *Young v Kitchin*, but of a conditional debt which, since the conditions were not later fulfilled by the assignor, was an assignment of nothing.

[103] (1888) 13 App Cas 199.

[104] Dixon J in *McDonnell & East Ltd v McGregor* (1936) 56 CLR 50 at 60 believed that the Privy Council was referring to a counterclaim rather than to set-off.

[105] (1908) 7 CLR 352.

[106] Ibid at 361.

[107] (1912) 13 SR (NSW) 6.

[108] Ibid at 16 per Cullen CJ (with whom Pring and Sly JJ concurred).

[109] [1939] VLR 132.

[110] Spry, op cit n 31, at 271 comments that although this case "apparently involved a liberal application of the doctrine ... the contract had, however, been induced by the fraud of the plaintiffs, so that an equity may have arisen on this basis". Cf *Altarama Ltd v Camp* (1980) 5 ACLR 513 at 519-520 per McLelland J.

[111] Mann CJ did not go on to consider whether equitable set-off would lie if, absent the breach of warranty, the defendant only had a tortious action in deceit. In light of the dictum of Griffith CJ in *Hill v Ziymack* (1908) 7 CLR 352 at 361 mentioned above, I submit that the tortious claim could have been equitably set-off.

[112] [1954] VLR 505.

[113] [1949] 1 KB 107.

[114] Story, *Equity Jurisprudence* (13th ed), Vol 2, Ch 38, pp 765ff.
[115] [1954] VLR 505 at 508.
[116] [1949] 1 KB 107.
[117] Ibid at 108 (emphasis added).
[118] Spry, op cit n 31, at 270.
[119] Meagher et al, op cit n 18, para 3710.
[120] [1958] 2 QB 9.
[121] "[T]he plaintiff, who was of an excitable nature, so conducted herself in the course of the trial that she had to be committed to prison for contempt of court" (ibid at 27 per Sellers LJ).
[122] Ibid at 26.
[123] Ibid at 31.
[124] Ibid.
[125] Ibid at 23-26.
[126] Spry, op cit n 31, at 270.
[127] Meagher et al, op cit n 18, para 3710.
[128] Ibid at para 3710.
[129] Ibid at para 3710. *Hale v Victoria Plumbing Co Ltd* [1966] 2 QB 746 falls into the same category. It was decided by a Court of Appeal comprising Danckwerts and Winn LJJ in 1966. It clearly was a case of common law abatement and yet the court relied on *Morgan & Son*. Although I agree with the result, the decision should have stemmed from *Mondel v Steel* and from reasoning analogous to *Young v Kitchin*. Another error in direction occurred, this time in Australia, when Hudson J in *Newman v Cook* [1963] VR 659 at 673-674 followed *Morgan & Son* and *Hanak v Green* without being referred to the earlier Australian decisions of *Hill v Ziymack* and *Ralston v South Greta Colliery Co — Newman v Cook* was in fact a case of common law abatement, and no discussion of equitable set-off was necessary.
[130] Spry, op cit n 31.
[131] Ibid at 271.
[132] Ibid at 268. Applied in *Griffiths v Commonwealth Bank of Australia* (1994) 123 ALR 111 at 124 per Lee J.
[133] Spry, op cit n 41, p 174. Quoted with approval in *Westwind Air Charter Pty Ltd & Mullins Investments Pty Ltd v Hawker de Havilland Ltd* (1990) 3 WAR 71 at 85 per Murray J, and in *W Pope & Co Pty Ltd v Edward Souery & Co Pty Ltd* [1983] WAR 117 at 120-121 per Olney J.
[134] Although the *Newfoundland Government* case was followed, and *Rawson v Samuel* was not referred to, the result of *Sun Candies* was correct on its facts.
[135] [1963] VR 445.
[136] Ibid at 448-449. Note that this case followed the erroneous approach of *Smail v Zimmerman* [1907] VLR 702 and *McDonnell & East Ltd v McGregor* (1936) 56 CLR 50 in holding that only liquidated demands may be set off, even in equity: see *D Galambos & Son Pty Ltd v McIntyre* (1975) 5 ACTR 10 at 19-20, 24 per Woodward J.
[137] Meagher et al, op cit n 31, para 3709. Quoted with approval in *Lord v Direct Acceptance Corporation Ltd (in liq)* (1993) 32 NSWLR 362 at 367 per Sheller JA (with whom Kirby P and Meagher JA agreed); *Griffiths v Commonwealth Bank of Australia* (1994) 123 ALR 111 at 124 per Lee J; *Westwind Air Charter Pty Ltd & Mullins Investments Pty Ltd v Hawker de Havilland Ltd* (1990) 3 WAR 71 at 85 per Murray J (a reference to the 1984 edition) and in *Covino v Bandag Manufacturing Pty Ltd* [1983] 1 NSWLR 237 at 238 per Hutley JA (a reference to the 1975 edition). See also *Geraldton Building Co Pty Ltd v Christmas Island Resort Pty Ltd* (1992) 11 WAR 71.
[138] Meagher et al, ibid, para 3710.
[139] Note that the first edition of Meagher et al (which contained the quoted criticism in para 3709) was published in 1975.
[140] [1973] 3 All ER 195.
[141] Ibid at 210 per Viscount Dilhorne, at 215 per Lord Diplock, and at 219 per Lord Salmon. Note that Morris LJ (now Lord Morris of Borth-y-Gest) sat on the same appeal but did not refer directly to *Hanack v Green*.
[142] Meagher et al, op cit n 18, para 3710.
[143] [1974] 1 QB 233.
[144] Ibid at 248. Cairns and Roskill LJJ also referred to *Hanak v Green*, but not in relation to the scope of the test for equitable set-off.
[145] See also *Aries Tanker Corporation v Total Transport Ltd* [1977] 1 All ER 398 whose facts were on "all fours" with *Henriksens*. In *Aries* the House of Lords, as an aside, seemed to adopt the test proposed in *Rawson v Samuel*; but at the same time they approved *Morgan & Son* and *Hanak v Green* thus demonstrating their unfamiliarity with Spry's and with Meagher et al's criticism.
[146] (1975) 5 ACTR 10.
[147] Ibid at 26.
[148] Smart J recognised this in *Sydmar Pty Ltd v Statewise Developments Pty Ltd* (1987) 73 ALR 289 at 293, but then "fell victim to the English sloppiness": see Meagher et al, op cit n 18, para 3710.
[149] (1975) 5 ACTR 10 at 26.
[150] Hodson and Morris LJJ did not address this particular issue.
[151] Meagher et al, op cit n 18, para 3709, n 19.
[152] [1972] VR 433. An article by Granat was mentioned in this case: "The Doctrine of Equitable Set-Off" (1965) 5 MULR 76. The thesis of this article, however, is that an unliquidated claim can be an appropriate subject of set-off. The author does not really enter into the debate relating to "impeachment". Of this article Meagher et al, ibid, at para 3709, n 19, state that: "The necessity for the

equitable set-off to impeach the title of the plaintiff escaped Mr Granat and so detracts from the value of his article."

[153](1975) 5 ACTR 10 at 15.

[154]Ibid at 20.

[155]See, eg, *Freiberg International Pty Ltd v Iken Commercial Interiors Pty Ltd* (unreported, Supreme Court, ACT, Master A Hogan, SC 209 of 1995, 5 May 1995) where damages for delay in completion of building work *for that reason alone* were held to amount to an equitable set-off against a claim for payment for the work. See also *Argento v Cooba Developments Pty Ltd* (1987) 71 ALR 253, and *Hivari Pty Ltd v QH & M Birt Pty Ltd* (unreported, Supreme Court, ACT, Miles CJ, No 462 of 1988, 1 February 1989).

[156][1975] 2 NSWLR 227.

[157]Ibid at 236, 238.

[158]Ibid at 231, 235. See also *General Credits (Finance) Pty Ltd v Stoyakovich* [1975] Qd R 352, another case of true impeachment, where Dunn J, almost by chance, correctly applied the *Rawson v Samuel* impeachment test; and see *United Dominions Corporation Ltd v Jaybe Homes Pty Ltd* [1978] Qd R 111, where Andrews J adopted the narrower approach: referring to cases such as *Re KL Tractors Ltd, Hill v Ziymack* and *Rawson v Samuel*, and *Ralston v South Greta Colliery Co* (but not to Spry). Unfortunately, Andrews J at 115 seems to have believed that since the cross-claim arose out of a "quite separate" agreement equitable set-off was not available. Compare the facts of this case with those in *Grant v NZMC Ltd* [1989] 1 NZLR 8. See also *British Anzani (Felixstowe) Ltd v International Marine Management (UK) Ltd* [1980] QB 137 at 155-156 and *Tomlinson v Cut Price Deli Pty Ltd* (1992) 38 FCR 490.

[159][1979] 2 All ER 1063.

[160]See *Knockholt Pty Ltd v Graff* [1975] Qd R 88 which was actually a case of common law abatement of rent: see the analysis, with which I agree, in Weir, "A Tenant's Right of Set-off" (1994) 68 ALJ 857 at 863-865. See also *Tomlinson v Cut Price Deli Pty Ltd* (1992) 38 FCR 490 which I submit was decided incorrectly because of a lack of understanding of the nature of impeachment required — *Beasley v D'Arcy* was relied on without referring to its true position as stated in *O'Mahoney v Dickson* (see the discussion above under the heading "Lord Cottenham and *Rawson v Samuel*"). It is only if the landlord's conduct has contributed to the incurring of expenditure by the tenant such that the tenant *cannot* (ie, he does not have the funds) make his rental payments that the landlord's claim is impeached.

[161][1978] QB 927.

[162]Ibid at 974. With respect, this is a test which is impossible to apply — it intimates a return to the deciding of cases according to the length of the Chancellor's foot.

[163][1979] 2 All ER 1063 at 1076.

[164]Care must also be taken when reading the 1986 English case of *Sim v Rotherham Metropolitan Borough Council* [1987] 1 Ch D 216 because of Scott J's transformation of what clearly was a common law abatement case into a discussion of equitable set-off: his Honour incorrectly believing that equitable set-off now subsumed the doctrine of abatement: ibid at 259; see the discussion above of common law abatement under the heading "Legal Set-off".

[165](1992) 108 FLR 129 at 138.

[166][1979] 2 NZLR 643.

[167]Spry, op cit nn 31 and 41, Meagher et al n 18.

[168][1979] 2 NZLR 643 at 658-659.

[169][1981] 2 NZLR 273.

[170]Ibid at 277.

[171]Ibid at 278, 280.

[172]Ibid at 279.

[173][1985] 2 NZLR 33.

[174]Ibid at 38. Note that Prichard J's comment at 38, lines 42-44, that *Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd* [1973] 3 All ER 195 extended common law abatement to damages for delay is unfounded as that case turned on the particular terms of the contract involved.

[175]Perhaps, if the misrepresentation could be proved to be fraudulent (as opposed to innocent), an equitable set-off might arise: see *Sun Candies Pty Ltd v Polites* [1939] VLR 132, discussed above.

[176][1982] VR 557.

[177]Ibid at 560-561: Tadgell J stated that *Piggott v Williams* "exemplified" the test, and he referred approvingly to *Edward Ward & Co v McDougall* and *Re KL Tractors Ltd*, and to Spry and Meagher et al.

[178]Tadgell J was prepared to assume that the plaintiff's claim might be characterised as a claim for payment of the balance of the purchase price and not merely as a claim for possession. However, whether the claim is for possession or for the balance of purchase moneys or for unpaid arrears of rent, equitable set-off is available as a defence: see *MEK Nominees Pty Ltd v Billboard Entertainments Pty Ltd* (unreported, Supreme Court, Vic, Tadgell J, 14 May 1993) and Derham, op cit n 24, at 343-344.

[179][1982] VR 557 at 561. This case was followed by the Victorian Full Court in *Indrisie v General Credits Ltd* [1985] VR 251 and the above quotation was set out with express approval by Gummow J in *James v Commonwealth Bank of Australia* (1992) 37 FCR 445.

[180]See, eg, *Beansley v D'Arcy* and *Grant v NZMC Ltd* [1989] 1 NZLR 8.

[181](1987) 73 ALR 289.

[182]Meagher et al, op cit n 18, para 3710.

[183] (1987) 73 ALR 289 at 295.
[184] Ibid at 296. Smart J was referring to the two unreported decisions of the Supreme Court of New South Wales of *Tooth & Co v Smith* (unreported, Supreme Court, NSW, Clarke J, 5 September 1984) and *Tooth & Co v Rosier* (unreported, Supreme Court, NSW, Wood J, 7 June 1985). Meagher et al also condemn these two cases: op cit n 18, para 3710.
[185] See the above discussion of *Sun Candies Pty Ltd v Polites* [1939] VLR 132; *British Anzani* [1979] 2 All ER 1063 and *Eagle Star Nominees Ltd v Merril* [1982] VR 557, and the discussion below of *Hill Corcoran Constructions Pty Ltd v Navarro* (unreported, Court of Appeal, Qld, Davies, Pincus JJA, Thomas J, 6 March 1992), and cf *James v Commonwealth Bank of Australia* (1992) 37 FCR 445.
[186] Meagher et al, op cit n 18, para 3710.
[187] [1988] 2 All ER 940.
[188] [1989] AC 1056.
[189] [1978] QB 927 at 974.
[190] [1989] AC 1056 at 1107 per Lord Brandon of Oakbrook, relying on *Aries Tanker Corporation v Total Transport Ltd* [1977] 1 All ER 398 for the proposition that a non-repudiatory breach of a voyage charterparty could not give rise to a defence of equitable set-off.
[191] Meagher et al, op cit n 18, para 3710.
[192] Unreported, Supreme Court, Qld, Carter J, No 140 of 1988, 15 March 1988.
[193] [1989] 1 NZLR 8.
[194] [1939] VLR 132, discussed above. See also *AWA Ltd v Exicom Australia Pty Ltd* (1990) 19 NSWLR 705 per Giles J and *Australian Mutual Provident Society v Specialist Funding Consultants Pty Ltd* (1991) 24 NSWLR 326 per Rogers CJ Comm D both of which were factually similar but in both the judges fell prey to the enticements of the broader English approach without referring directly to the academic criticism.
[195] [1978] QB 927 at 974-975.
[196] [1982] VR 557.
[197] [1989] 1 NZLR 8 at 13.
[198] Ibid at 12.
[199] Ibid at 12-13.
[200] Unreported, Court of Appeal, Qld, Davies and Pincus JJA, Thomas J, 6 March 1992.
[201] The court referred to the close factual similarity of *Popular Homes Ltd v Circuit Developments Ltd* [1979] 2 NZLR 642 in which Barker J also avoided choosing between the two tests because on the facts both were satisfied. See also *Murphy v Zamonex Pty Ltd* (1993) 31 NSWLR 439 at 465 where Giles J chose not to enter into the debate, but seemed to prefer the broader test.
[202] See n 185.
[203] (1992) 37 FCR 445.
[204] (1992) 109 ALR 334.
[205] (1992) 37 FCR 445 at 457.
[206] (1982) 61 FLR 108 at 127 per Blackburn, Deane and Ellicott JJ where, however, the only discussion involved the court citing *Rawson v Samuel* and *Welton v Harnett* (1886) 7 LR (NSW) 74 at 76 as establishing the principles of equitable set-off.
[207] (1992) 37 FCR 445 at 457-458.
[208] Ibid at 459.
[209] Ibid at 460.
[210] [1989] AC 1056 at 1103, 1106.
[211] (1992) 37 FCR 445 at 460. Gummow J was alluding to those cases beginning with *Morgan & Son* and *Hanak v Green* in England; those beginning with *Tooth & Co v Smith* (unreported, Supreme Court, NSW, Clarke J, 6 September 1984) and *AWA Ltd v Exicom Australia Pty Ltd* in New South Wales and *Grant v NZMC Ltd* in New Zealand.
[212] (1992) 37 FCR 445 at 460.
[213] Ibid at 462.
[214] See, eg, *Murphy v Zamonex Pty Ltd* (1993) 31 NSWLR 439 at 465 per Giles J and *Signature Resorts Pty Ltd v DHD Constructions Pty Ltd* (1995) 18 ACSR 627 at 634 per Bryson J.
[215] See, eg, *Re Queensland Nickel Staff Superannuation Plan* (unreported, Supreme Court, Qld, Kiefel J, No 93 of 1993, 9 September 1994) and *Walker v Secretary, Department of Social Security* (1995) 56 FCR 354 per Drummond J (dissenting).
[216] (1993) 32 NSWLR 362. In this case the Court essentially held that *Bank of New Zealand v Harry M Miller & Co Ltd* (1992) 26 NSWLR 48 per Brownie J was decided per incuriam. See also Derham, op cit n 24, at 344-349 for further discussion of Brownie J's judgment.
[217] Ibid at 367 per Sheller JA (with whom Kirby P and Meagher JA agreed).
[218] (1995) 12 WAR 62 at 67 per Kennedy J (with whom Malcolm CJ and Murray J agreed).
[219] Ibid at 67 (emphasis added).
[220] Ibid at 68.
[221] (1995) 56 FCR 354 (Spender, Drummond, and Cooper JJ).
[222] Ibid at 375 per Cooper J (with whom Spender J agreed).
[223] Ibid at 370 per Drummond J.
[224] Ibid at 365.
[225] Ibid at 366.
[226] Ibid.
[227] *O'Connor v Spaight*, as already mentioned, ought probably to be seen as a case of set-off by agreement.
[228] See, eg, Dal Pont and Chalmers, *Equity & Trusts in Australia & New Zealand* (LBC Information Services, 1996) p 565: "The modern interpretation is to be welcomed because it de-emphasises the oft-troublesome test of 'impeachment' in favour of

the emphasis upon notions traditionally associated with equity, namely justice and conscionability." Quite extraordinarily the authors then go on to say: "Beyond the foregoing [statements of the modern broader test], it is difficult to formulate general principles governing the availability of equitable set-off." See also *Walker v Secretary, Department of Social Security* (1995) 56 FCR 354 at 363-367 per Drummond J (dissenting).

[229] Derham, op cit n 24, at 333.

[230] See the *Leon* [1985] 2 Lloyd's Rep 470 at 474 per Hobhouse J; *Hazcor Pty Ltd v Kirwanon Pty Ltd* (1995) 12 WAR 62 at 68 per Kennedy J (with whom Malcolm CJ and Murray J agreed).

[231] Spry, op cit n 31, at 270.

[232] See, eg, *Re Kostezky, Ex parte Midler Elfman Szmerling Krycer Pty Ltd* (unreported, Federal Court, Sundberg J, VP 570 of 1995, 12 June 1996) in which after asserting the authority of the impeachment test (citing *James v Commonwealth Bank of Australia*, but then also citing *D Galambos*, which does not approve the impeachment test), Sundberg J, in purported application of that test, applied it to a negligence situation similar to *Morgan & Son*, and erroneously held that the impeachment test had been satisfied.

[233] Full Court of the Federal Court: *Walker v Secretary, Department of Social Security* (1995) 56 FCR 354 at 375 per Cooper J with whom Spender J agreed and *J & S Holdings Pty Ltd v NRMA Insurance Ltd* (1982) 61 FLR 108 at 127. New South Wales Court of Appeal: *Lord v Direct Acceptance Corporation Ltd* (1993) 32 NSWLR 362 at 367 and *Covino v Bandag Manufacturing Pty Ltd* [1983] 1 NSWLR 237 at 238. Full Court of Western Australia: *Hazcor Pty Ltd v Kirwanon Pty Ltd* (1995) 12 WAR 62 at 67 and *Geraldton Building Co Pty Ltd v Christmas Island Resort Pty Ltd* (1992) 11 WAR 40 at 52. Full Court of the ACT: *Gibb Australia Pty Ltd v Cremor Pty Ltd* (1992) 108 FLR 129 at 135. Full Court of Victoria: *Indrisie v General Credits Ltd* [1985] VR 251 at 254 but the adoption of the test in this case is not so clear because it also refers approvingly to *British Anzani* which does not support the impeachment test.

[234] See, eg, Parkinson (ed), op cit n 10, para 3015, p 993.

[235] Spry, op cit n 31, at 272.

[236] Meagher et al, op cit n 18, para 3710.

[237] See *Grant v NZMC Ltd* [1989] 1 NZLR 8 a decision by the Court of Appeal of New Zealand which has broadened the test even though some first instance decisions adopted the *Rawson v Samuel* approach: see *Parry v Grace* [1981] 2 NZLR 273 and *Wilsons (NZ) Portland Cement Ltd v Gaxt-Fuller Australasia Pty Ltd (No 2)* [1985] 2 NZLR 33.