Three things solicitors should know about CROSS-CLAIMS

ILLUSTRATION: MICHAEL MUCCI

JOHN FASHA discusses set-offs, cross-claims for or against insolvent companies or companies under administration, and restrictions on securities for costs for those who have used cross-claims.

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A CROSS-CLAIM IS AN ACTION brought by a defendant against the plaintiff, another co-party or a third party[1] to counter or set-off to reduce or extinguish the plaintiff's claim. This is common knowledge.

However, you may not know three important things about cross-claims which are not only useful practically, but which could have a substantial impact on your client's proceedings:

- ❑ you may, by way of defence, rather than a cross-claim, plead a set-off in common law or equity;
- ❑ when proceeding against a company in external administration, a cross-claim can only be used as a shield rather than a sword; and
- ❑ if the defendant (who is in substance the true plaintiff) has filed and served a cross-claim (where substantially the same facts are likely to be canvassed which arise on the plaintiff's claim), the defendant cannot seek security for costs, unless it has given the court a *Dalma Formwork* undertaking.

These three useful facts about cross-claims will be discussed in greater detail below.

Do you need to use a cross-claim?

In certain cases, a defence is sufficient to plead a set-off. According to s.21 of the *Civil Procedure Act 2005* (NSW) (the CP Act), if there are mutual debts between the parties in the proceedings, the defendant may, by way of defence rather than a cross-claim, set-off the debts against the plaintiff's claim, whether or not the debts are of a different nature. This results in costs savings and a simplification of the procedures. Under the transitional provisions, debts arising before the commencement of the CP Act may be pleaded.[2]

Accordingly, the CP Act has re-introduced the statutory right to plead a set-off in the defence. However, this set-off is limited only to mutual liquidated debts, that is, it does not extend to unliquidated damages claims.

On the question of what is a liquidated debt, Barrett J in *CGI Information Systems v APRA Consulting Pty Ltd* [2003] NSWSC 728 at [15] stated that: "a debt is a sum certain owing, as distinct from a right to recover damages for breach of contract." In a judgment handed down on 23 February 2007, *Hansmar Investments Pty Ltd v Perpetual Trustee Company Ltd* [2007] NSWSC 103, White J at [56] held

that a liquidated debt can, however, arise in a contract where: "a person promises to pay a specific or readily calculable sum which does not depend upon an assessment, albeit that the sum is payable as liquidated damages for breach of contract, the person's contractual liability is properly characterised as giving rise to a debt in that sum."

Because of the restrictions surrounding mutual liquidated debts, s.21(4) of the CP Act is expressed not to affect any other rights of set-off and does not, therefore, affect any *equitable* rights of set-off.

Set-off in equity is much broader than in the common law. In equity, a defendant is not precluded from setting off debts that are "mutual" or "liquidated". Accordingly, if the prerequisites are satisfied, in equity a defendant may set-off any unliquidated damages claims.

To plead an equitable set-off in a defence, Woodward J in *D Galambos & Son Pty Ltd v McIntyre* (1975) 5 ACTR 10 at 18 deduced from *Rawson v Samuel* (1841) 41 ER 451 that there must be "clear cross-claims for debts or damages, which were so closely related as to subject-matter that the claim sought to be set-off impeached the other in the sense that it made it positively unjust that there should be recovery without deduction".[3]

A shield rather than a sword

If you act for a plaintiff company in administration or being wound up in insolvency, the defendant cannot cross-claim for an amount exceeding your client's claim without leave of the court.

There are implications for cross-claims when you act for or against companies in administration, or companies being wound up in insolvency.

The *Corporations Act 2001* (Cth) provides a stay on proceedings against companies in administration,[4] companies subject to a deed of company arrangement[5] and companies being wound up in insolvency or where a provisional liquidator is acting.[6] Leave of the court is required before proceedings are commenced or proceeded against the company or in relation to its property.

So does a stay of proceedings mean the defendant cannot cross-claim against the plaintiff company in administration or the plaintiff company being wound up,[7] without leave of the court?

The decision of the Court of Appeal in *Mersey Steel & Iron Co v Naylor Benzon & Co* (1882) 9 QBD 648 continues to stand as authority for the proposition that the defendant may cross-claim against a plaintiff insolvent company in liquidation without leave of the court.[8] This proposition has since been confined by the decision in *Langley Constructions (Brixham) Ltd v Wells* [1969] 2 All ER 46 in these respects:

- ❑ leave is not required for a cross-claim amount for liquidated or unliquidated damages equal to or less than the plaintiff's claim in order to set-off to reduce or extinguish the plaintiff's claim; and
- ❑ if the defendant is seeking to cross-claim an amount in excess of the plaintiff's claim, leave of the court is required.

Accordingly, in these circumstances, a cross-claim can only be used as a shield and not a sword.

In accordance with s.58AA of the *Corporations Act*, leave can only be granted in a court of competent jurisdiction such as the Supreme Court or Federal Court, meaning the Local and the District Courts do not have the power to grant leave.

In a hypothetical example of this issue, say you act for the administrators of a company in administration and you are instructed to sue a proprietary company for $100,000 to recover a debt. You com-

mence proceedings against the defendant by way of statement of liquidated claim in the District Court. The defendant subsequently files and serves a defence, and then you are surprised to be served also with a cross-claim in the amount of $150,000 for losses it suffered arising out of an alleged breach of contract.

You are then in a position to put the defendant on notice, based on the above law, that unless the excess amount of $50,000 in the cross-claim is abandoned, leave must be sought in a court of competent jurisdiction (not the District Court) to pursue the amount exceeding your client's claim of $100,000. As you can see, the effect of this is that it retains the underlying rationale of a company under external administration, as it has preserved the company's assets by staying proceedings against it.

Security for costs

When the defendant files and serves a cross-claim, is the defendant still the defendant in the proceedings, or in other words, *who is the true plaintiff in the proceedings?* The defendant becomes the cross-claimant with respect to the proceeding of the cross-claim. It follows, that in substance, the defendant has also become a plaintiff in the proceedings.[9]

When the defendant makes an application for security for costs against the plaintiff, the court, when considering granting the security, primarily considers that there is reason to believe that the plaintiff will be unable to pay the costs of the defendant if successful in its defence. The court will require sufficient security to be given for those costs and may stay all proceedings until the security is given. This rationale is used to protect the defendant from the impecunious plaintiff.

> **"There is obvious logic in a defendant not wishing to pursue cross-claims against an insolvent plaintiff, not the least of which would be the necessity to pay its own costs and, even if ultimately successful, risk receiving little or nothing."**

The three bases of power to grant security for costs are found in s.1335 of the *Corporations Act*, r.42.21 of the Uniform Civil Procedure (UCP) Rules and the inherent jurisdiction of the Supreme Court.[10]

The ordinary rule is that only the defendant is entitled to make an application for security for costs, not the plaintiff.[11] The decision of Smart J in *Sydmar Pty Ltd v Statewise Developments Pty Ltd* (1987) 73 ALR 289 is heralded as authority for the proposition that when the defendant makes a cross-claim against the plaintiff, the defendant's right to security for costs is lost, because: "the defendant is in substance, the plaintiff ... the facts ... of the defence are substantially identical with ... the cross-claim ... [t]he plaintiff is now being called upon to fund its defence to a major claim being made by the defendant. This will involve it in the expenditure of substantial sums of money and impose a heavy burden upon it. In the circumstances of this case it would be inappropriate to require security and thereby effectively reduce the moneys available to it to resist the defendant's cross-claim" (at 302 and 303).

In *Sydmar,* his Honour held (at 300) there were important factors relevant to the exercise of the court's discretion to order security:

❑ whether the defendant in question is a true plaintiff or not is one matter which may be placed on the scales in making the

decision as to which way the discretion should be exercised; and

❑ whether substantially the same facts are likely to be canvassed in determining the action and the cross-action, and that the court would be slow to allow a situation where the action is stayed because of the inability to provide security but the cross-action covering substantially the same factual areas proceeds.

The statements of principle in *Sydmar* have been recognised by the courts on many occasions.[12]

So does this mean that there is a blanket prohibition on the defendant in making an application for security for costs against the plaintiff if it has filed and served a cross-claim? Save for the above two discretionary factors that the court must consider, there is one important exception to overcome the *Sydmar* principle: the defendant is still able to file and serve a cross-claim and make an application for security for costs *if the defendant undertakes not to pursue the cross-claim in the event security is ordered, but not paid*.[13]

The effect of the security being ordered, but not paid, is that the proceedings will be stayed and/or ultimately dismissed, meaning the defendant will not thereafter have to pursue its cross-claim. The rationale of this exception was stated by Rolfe J in *Dalma Formwork*: "there is obvious logic in a defendant not wishing to pursue cross-claims against an insolvent plaintiff, not the least of which would be the necessity to pay its own costs and, even if ultimately successful, risk receiving little or nothing."

Conclusion

The main benefits of cross-claims are that they play a vital role in the administration of justice, as they tend to avoid costs and multiplicity of proceedings by enabling a full account to be taken between the parties in the action.

It is worth considering, however, the three issues that form the substance of this article: that you may not need to use a cross-claim; that if you act for a plaintiff company in administration or which is being wound up in insolvency, that the defendant cannot cross-claim for an amount exceeding your client's claim without the court's leave; and that a defendant cannot seek security for costs from the plaintiff if it has filed and served a cross-claim. ❑

ENDNOTES

1. With the introduction of the Uniform Civil Procedure Rules 2005 (NSW) (the UCP Rules), Part 9 r.7, makes provision for the service of a cross-claim on new parties, thereby abolishing the need to issue a third party notice. Sub-rule 1(2) of Order 5 of the Federal Court Rules 1979 (Cth) also makes provision for the cross-claim on a third party.
2. Schedule 6, cl.6(1) of the CP Act.
3. For a recent summary of cases on equitable set-off see Harrison AJ in *CBA v G S Development P/L & 2 Ors* [2004] NSWSC 511 at [30] to [42].
4. Section 440D of the *Corporations Act*.
5. Section 444E of the *Corporations Act*.
6. Section 471B of the *Corporations Act*.
7. Where a company in being wound up, under s.553C of the *Corporations Act*, there is provision for mutual credit and set-off when lodging a proof of debt against the company.
8. *Mine & Quarry Equipment International Ltd (ARBN 079 139 683) v McIntosh (as liq of Mine & Quarry Equipment Pty Ltd (in liq) (ACN 011 012 561))* (2005) 54 ACSR 1.
9. *Neck v Taylor* [1893] 1 QB 560; *Buckley v Bennell Design & Constructions Pty Ltd* (1974) 1 ACLR 301; and *Winnote Pty Ltd (in liq) and Another v Page and Others* (2005) 56 ACSR 35 at para 18.
10. Note that in accordance with r.1.7 (Schedule 2) of the UCP Rules, Part 51 r.16 of the Supreme Court Rules 1970 (NSW) still applies and "prevails" over the UCP Rules in relation to security for costs in the Supreme Court of NSW Court of Appeal. The equivalent power to grant security for costs in the Federal Court are s.56 of the *Federal Court of Australia Act 1976* (Cth) and Order 28 r.2 of the Federal Court Rules.
11. Ibid and *Wollongong City Council v FPM Constructions Pty Limited (formerly Fyntray Project Management Pty Limited)* [2004] NSWSC 523 at para 19, sub-para 7.
12. See, for example, *Wattyl Australia Pty Ltd v GBP Enterprises Pty Ltd* [2004] NSWSC 843; *Dalma Formwork Pty Ltd (Administrator Appointed) v Concrete Constructions Group Ltd* [1998] NSWSC 472; and *Interwest Ltd v Tricontinental Corporation Ltd* (1991) 5 ACSR 621.
13. This exception is known as the '*Dalma Formwork* undertaking'. See *Dalma Formwork* (ibid) which was upheld by *Concrete Constructions v Dalma Formwork* [1999] NSWCA 16 per Sheppard AJA at [17] and [24]. In relation to a notice of cross-appeal, see *Harrington Services Pty Ltd (In Liquidation) v Harrington & Anor* [2003] NSWCA 89. ❑