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DEMPSEY v BANK OF IRELAND

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1983 No. 353 Sp/Court 5

THE HIGH COURT

IN THE MATTER OF EURO TRAVEL LIMITED

AND IN THE MATTER OF THE COMPANIES ACT 1963

BETWEEN:

ROBERT DEMPSEY

Plaintiff

and

THE GOVERNOR AND COMPANY OF THE BANK OF IRELAND

Defendant

Judgment of Mr. Justice Murphy delivered the 28th day of May 1984

On the 11th day of April, 1983 a resolution was passed for the winding-up of the above named Euro Travel Limited (hereinafter called "the Company") by means of a creditor's voluntary winding-up. By that resolution the plaintiff Robert Dempsey was appointed liquidator and his appointment as such was confirmed at a meeting of creditors likewise held on the 11th April, 1983.

The present proceedings constitute an application by the liquidator of the company for the direction of the Court pursuant to Section 280 of the Companies Act 1963. The circumstances in which the directions of the Court are sought are as follows:

As might be inferred from the title of the company it had been engaged in business as Travel Agents and was in fact a member of the Irish Travel Agents' Association. The company sought to avail itself

of a bonding scheme which had been recommended to the members of the Irish Travel Agents' Association. For that purpose an agreement dated the 31st day of December, 1982 had been executed between the company of the first part, the trustees of the Irish Travel Agents' Association of the second part and the Governor and Company of the Bank of Ireland (hereinafter called "the Bank") of the third part. Under that agreement the company agreed to pay to the Trustees the sum of £75,000 if prior to the 31st day of March, 1983 certain events occurred, one of which was that the company became unable to pay its debts or ceased to carry on business as a result of being unable to pay its debts as they fell due with the result that the company should be unable to carry out or fulfil its obligation to its customers. The Bank executed the agreement aforesaid for the purpose of guaranteeing the due payment by the company of the said sum of £75,000 in the event of the same becoming payable in accordance with the terms and provisions contained in the said agreement.

At an earlier date and before any question of bonding arose the company had executed in favour of the Bank the Bank's standard form of letter of set-off. That letter is dated 26th March, 1981 and expressly authorised the Bank pending payment of any bills, notes, overdrafts, loans, guarantees or other contingencies to hold any monies which then or thereafter might stand

to the credit of the company with any of the branches of the Bank as security for all such liabilities. The letter of set-off then went on expressly to provide as follows:-

> "Furthermore you are authorised to set-off and apply such monies or any part thereof from time to time in or towards the satisfaction of such liabilities entirely at your discretion, without further notice to us and we agree that such set-off would be a good and valid discharge of such monies so applied without the necessity of any further endorsement or authorisation from us whatsoever".

In addition to that letter of set-off and contemporaneously with the bonding agreement the company entered into an agreement on the 31st December, 1982 with the Bank (sometimes referred to as "the letter of indemnity") which, after reciting the bonding agreement and in consideration of the Bank joining therein, went on to provide that the company should indemnify the Bank against all liabilities incurred by it o foot of the bonding agreement and authorising the Bank to pay any amounts demanded from it by reason of the bonding agreement on demand being made to the Bank and without requiring proof or agreement that the amounts so demanded were due or payable and indeed notwithstanding the fact that the company itself might dispute the validity of such demands.

The letter went on to provide in paragraph 3 thereof as follows:-

"You may debit any account in our names with any sums payable by us hereunder".

By March of 1983 it was clear that the company was in financial difficulties. A statement of affairs prepared as at the 23rd of that month showed an excess of liabilities over assets of £13,777 but more particularly showed creditors of approximately £130,000 where the cash and bank balances amounted to only some £35,000. It was recognised by the company and confirmed by the liquidator in the affidavit sworn by him that the company was on the 22nd March, 1983 no longer in a position to pay its debts and that it ceased to carry on business. On behalf of the liquidator the point was made - somewhat tentatively - that the inability of the company to pay its debts and to carry on its business had not necessarily resulted in the company being unable to carry out or fulfil its obligations to its customers. Whilst that point may be valid to the extent that no particular customer had been stranded abroad the former managing director, Mr. Kelly, in his evidence clearly recognised that the company would be unable to meet its commitments to its customers.

By letter dated the 24th March, 1983 the then auditors to the compar

notified the Irish Travel Agents' Association of the financial position of the company and by further letter dated the 29th March, 1983 Messrs William Fry and Sons Solicitors on behalf of the Association formally demanded payment from the Bank of the sum of £75,000 in accordance with the obligations of the Bank under the bonding agreement. It was on the 19th April, 1983 that the Bank - in pursuance of their obligation under the bonding agreement - forwarded to the Association the Bank's draft for £75,000.

At the time, or shortly before the bonding agreement was entered into, the company had agreed in principle with the Bank to lodge a sum of £75,000. In fact this amount was lodged to the credit of the company with the Bank of Ireland Finance Company Limited, a separate legal entity from the Bank itself but of course associated with it. It was recognised that the reason for selecting the finance company as opposed to the Bank itself was merely to procure more favourable terms in relation to interest. The amount so lodged to the credit of the company with the Bank of Ireland Finance Company was, together with the interest accumulated thereon, transferred by the Bank to the company's account in Clones with the Bank of Ireland on the 22nd March, 1983 and on the 20th April, 1983 the sum of £75,000 was - as I was

informed by Counsel for the Bank - transferred to the Head Office of the Bank and set-off against the amount paid as already mentioned to the Trustees of the Association.

On the 18th February, 1983 the Bank took from the company an equitable mortgage by deposit of the Title Deeds relating to certain premises of the company. This security was taken in conjunction with negotiations which were then taking place for the further extension of the bonding agreement. That deposit was duly registered in the company's office but apart from that registration no other alleged charges by the company in favour of the Bank were at any time registered in pursuance of the provisions of the Companies Act 1963.

It was contended on behalf of the liquidator that the letter of indemnity dated the 31st December, 1982 was and constituted a charge falling within Section 99 of the Companies Act 1963 and accordingly was invalid for want of registration. If any such charge was created clearly it would be invalid as against the liquidator having regard to the fact that such charge was not registered as prescribed by that Section. To establish that the letter of indemnity constituted a charge it would be necessary to be satisfied first that it w

a charge to which Section 99 applies and secondly a charge created by the company. To bring the particular transaction within Section 99 it was contended on behalf of the liquidator that the letter of indemnity constituted either a charge on book debts of the company or alternatively a floating charge on the undertaking of property of the company as designated in paragraphs (e) and (f) of sub-section 2 of Section 99 aforesaid. I find it difficult to accept the proposition that the company was purporting to charge monies in the hands of the Bank itself with monies due by the company to the Bank. This argument might have been more attractive when and as long as the sum of £75,000 was lodged by the company to the credit of the Bank of Ireland Finance Company Limited, a legal entity separate from the respondents in the present proceedings. However as the monies were transferred from the accounts in that Bank to the respondents on the 22nd March, 1983 the problem can only be viewed as between the company on the one hand and its own Bankers on the other. It seems to me that the best definition of the term "book debts" as used in this context is to be found in the decision of Buckley J. in Independent Automatic Sales Limited .v. Knowles and Foster Independent Automatic Sales Limited 1962 1 W.L.R. 974 as explained by Pennycuick J. in Paul and Frank Limited .v. Discount Bank (Overseas) Limited and Another 1967 ch. 348 at 361.

The definition provided by Buckley J. as so revised would read as follows

"As far as I am aware, no more precise definition of the meaning of the term 'book debts' has ever been attempted judicially, and I shall not attempt one. Shipley .v. Marshall, I think, establishes that, if it can be said of a debt arising in the course of a business and due or growing due to the proprietor of that business that such a debt would (in practice) in the ordinary course of such a business be entered in well kept books relating to that business, that debt can properly be called a book debt whether it is in fact entered in the books of the business or not."

In principle I doubt that monies due by a Banker to its customer and whether or not recorded in books or other documents would properly be described as book debts in that sense. Such judicial authority as does exist appears to support that view. Gough on Company Charges 1978 edition cites the decision of the New Zealand Courts in Watson and _____ 1915 17 G.L.R. as authority for that proposition. The suggestion that the letter of indemnity might constitute a floating charge on the undertaking or property of the company was not urged with the same vigour and indeed I would have difficulty in seeing how the transaction which did take place could be so described.

However I have noted the arguments made on behalf of the liquidator in respect of the claim that the letter of indemnity constituted a charge which was in the circumstances invalid and have commented thereon in deference to the arguments made before me. It was clear, however, that this was not in fact the real issue between the parties. The Bank do not claim that they have a charge or lien of any description on any part of the assets of the company. Counsel on behalf of the Bank explained clearly that the Bank sought to rely upon and exercise their right of set-off or as it is otherwise described in relation to Banking, the right to combine accounts. Mr. O'Neill emphasised this was a right which was given by operation of law and not a right conferred by the parties. In that context he drew attention to the decision in the Bank of Ireland and Martin 1937 I.R. 189 where the former Supreme Court affirming Meredith J. held that the Bank was not entitled to apply monies which their clients had deposited with them in reduction of that clients liability on foot of a guarantee without first obtaining the consent of the client. Mr. O'Neill suggested that it was the decision in that case which gave rise to the practice of obtaining from clients a letter of set-off in the terms of the document executed in th present case on the 26th March, 1981. The purpose of Counsel in canvassing

this historical aspect of the Banking practice was of course to make it clear that set-off does not in general derive from the acts of the parties but by the application of settled rules of law.

It seems to me that there are two cases crucial to the resolution of the issue arising in relation to set-off. The first of these cases is in re Morris: Coneys and Morris 1922 1 I.R. 136 and the second In Re Fenton 1931 1 Ch. D. 85.

In the Irish case the then High Court of Appeal rejected the contention that a Bank has a lien in respect of a balance to the credit of a client and held that the only right of the Bank was to set-off. In his judgment Sir John Ross C. at page 137 quoted from Harte's Law of Banking, third edition, page 810, as follows:-

"It is often stated that the lien attaches to the money; but inasmuch as, quite apart from any question of lien, a Banker is only bound to pay to, or to the order of, his customer the amount of the balance due to the latter after deducting what is due to the Banker himself from the customer, the lien will not normally have any effective application to the monies; "

The learned Chancellor then went on to comment as follows:

"The lien suggested in this case is not like any other kind of lien

"with which we are familiar. In the ordinary case there must be some specific thing to which the lien can attach, but in this case where is the specific entity to which it attached? In this case there are two accounts - a current account and a deposit account. The lien could not be on the current account, because it was not in funds. How can it be on the deposit account? That account consisted of money paid in by the customer on deposit, and which became the money of the Bank. There are no indicia of ownership in the hands of the Bankers which could be applied by them. The indicia of ownership, the deposit receipt, are in the hands of the creditor, the depositor; and that being so, the right of the Bankers is a right of set-off, but that right can be exercised only where there are in existence legal enforceable debts. A Banker's right is the right of adjustment of credits and debits and it is involved in this that the debts must be enforceable."

Again in his judgment O'Connor M.R. at page 138 commented as follows:-

"But a lien requires for its existence some specific thing on which it operates either by possession of the specific property itself, such as plate or jewels, or by possession of the indicia of ownership, such as

"Title Deeds, a policy of assurance or a bond. The extension of the term "lien" to a right of set-off against a balance in the Bank to the credit of the client is not strictly proper, because there is no specific thing which represents the balance. The balance does not earmark any particular asset in the hands of the Bank. It merely indicates a debt by the Bankers to the client of a certain amount. It only raises the relationship of debtor and creditor which gives the client a right of action. If when the action is brought the Bank has a claim against the client it has a right of set-off which is just as effectual as a lien; but it is only in this sense a lien and not a lien properly so called."

In my view that decision fully supports the approach adopted by the Bank in the present case, that is to say, the assertion made on behalf of the Bank that they are not claiming a lien (or indeed a charge of any form) but merely the ordinary traditional right granted by law (subject to any special contract between the parties and any special factors affecting the accounts) to set-off what is due by the client to the Bank against any sum which may be due by the Bank to its client. This particular right of set-off is sometimes described as the right

to combine accounts or as in the Irish case aforesaid, the right to adjust accounts.

It is ironic that in relation to the set-off issue both parties rely on the decision in the Fenton Case in support of their conflicting arguments.

On the particular, and somewhat complex, facts of that case it was held that a party with a contingent but undischarged liability on foot of a guarantee was not entitled to operate a right of set-off against the estate of a bankrupt debtor. Indeed there are dicta within the judgments which do give comfort to both parties. At page 113 Lawrence L.J. stated the position as follows:

"It has also been decided that, although the date for ascertaining the existence of any mutual debts, credits or dealings which may b made the subject matter of set-off under the section is the date o the receiving order, yet it is sufficient if the account prescribe by the Section can be taken when the set-off arises: see In Re Daintrey 1900 1 Q.B.546 where the Court of Appeal allowed a set-o in respect of a debt whose existence and amount were alike unascertained at the date of the receiving order;"

However the same distinguished Judge dealing expressly with the

case where the principal debtor was insolvent went on to express his conclusion - and indeed his reasons for it - at page 114 in the following terms:-

"When, however, as in the present case, the principal debtor is bankrupt, the case assumes a different aspect. In such a case the claim of a surety, who has been called upon to pay but has not yet paid anything to the principal creditor, is in effect a claim for damages for the breach by the principal debtor of his obligation to indemnify his surety on the ground that his bankruptcy has rendered it impossible for him to perform his obligation and has made it possible to estimate the amount which the surety can properly claim by way of damages. The reason why, in my opinion, such a claim (although it apparently has the requisite attributes for a set-off under the section and although it is one from which the principal debtor would be released by the order of discharge) cannot be set-off is because so long as the estate of the principal debtor remains liable to the principal creditor the surety will not be permitted to prove against the estate of the principal debtor, as such a proof would be a double proof for the same debt, and would therefore be

inadmissible as being concrete to the established rule in Bankruptcy;"

Indeed it is noticeable that Romer L.J. gave the same reason for hi conclusion at the foot of page 118 of the report.

Having regard to the decision in the Fenton Case it seems to me that it is fatal to the Banks the case that no part of the monies due on foot of the guarantee were paid until after the commencement of the liquidation. I may add that apart from the reasoning given by the Judges in the Court of Appeal in the Fenton Case it does seem to me that it would be wrong both in law and in logic to allow the form of set-off on which the Bank rely, that is to say, a combining or adjustment of accounts in such a way as to enable the Bank to set-off it contractual obligation under the Bond even allowing that it had crystallised to the extent of constituting an enforceable legal obligation against it before that obligation had been discharged in such a way as to result in the actual accounts between the parties showing the mutual debits and credits which the Bank now seek to combine.

Subject to any arguments which the parties may wish to make it seems to me that in the light of the foregoing that Question 5 in the Special Summons herein should be answered in the negative. None

of the other questions arises.

James D Murphy

6/6/84