FEDERAL COURT OF AUSTRALIA

Norman; in the matter of Forest Enterprises Limited v FEA Plantation Limited

[2011] FCAFC 99

Citation:	Norman; in the matter of Forest Enterprises Limited v FEA Plantation Limited [2011] FCAFC 99
Appeal from:	Norman, in the matter of Forest Enterprises Australia Limited (Administrators Appointed) (Receivers & Managers Appointed) v FEA Plantations Ltd (Administrators Appointed) (Receivers Appointed) [2010] FCA 1444
Parties:	**TIMOTHY BRYCE NORMAN AND SALVATORE ALGERI IN THEIR CAPACITIES AS RECEIVERS AND MANAGERS OF FOREST ENTERPRISES AUSTRALIA LIMITED (RECEIVERS & MANAGERS APPOINTED) AND OF FEA CARBON PTY LTD (SUBJECT TO DEED OF COMPANY ARRANGEMENT) (RECEIVERS AND MANAGERS APPOINTED) AND AS CONTROLLERS OF TASMANIAN PLANTATION PTY LTD (SUBJECT TO DEED OF COMPANY ARRANGEMENT) (CONTROLLERS ACTING) AND OTHERS v FEA PLANTATIONS LTD (ADMINISTRATORS APPOINTED) (RECEIVERS APPOINTED) and FEA GROWERS GROUP INC A0054610B**
File number(s):	VID 1179 of 2010
Judges:	**JACOBSON, NICHOLAS AND YATES JJ**
Date of judgment:	9 August 2011
Catchwords:	**CONTRACT** – whether letter of commitment to provide financial support gave rise to binding agreement – whether parties had intention to create legal relations – whether requirement of consideration satisfied – whether agreement was certain **EQUITY** – equitable set-off – whether there is an entitlement to set-off against rent owing – covenant in lease to pay rent "without any deductions whatsoever" – whether covenant excluded entitlement to equitable set-off
Legislation:	*Corporations Act 2001* (Cth), ss 424, 601FA, 601FD, 913B

Australian Securities & Investment Commission, *Regulatory Guide 166: Licensing: Financial Requirements*, (May 2010)

Cases cited:

Australian Securities and Investment Commission v Lanepoint Enterprises Pty Ltd (2006) 64 ATR 524 cited
Atco Controls Pty Ltd (in liq) v Newtronics Pty Ltd (2009) 25 VR 411 distinguished
Batiste v Lenin (2002) 10 BPR 19,441 considered
Batiste v Lenin (2002) 11 BPR 20,403 cited
Branir Pty Limited v Owston Nominees (No 2) Pty Ltd (2001) 117 FCR 424 followed
British Anzani (Felixstowe) Ltd v International Management (UK) Ltd [1980] QB 137 followed
Connaught Restaurants Ltd v Indoor Leisure Ltd [1994] 1 WLR 501 discussed
D Galambos & Son Pty Ltd v McIntyre (1974) 5 ACTR 10 cited
Ermogenous v Greek Orthodox Community of SA Inc (2002) 209 CLR 95 followed
Forest Marsh Pty Ltd v Pleash (2011) 82 ACSR 164 cited
Forsyth v Gibbs [2009] 1 Qd R 403 discussed
Geldorf Metaalconstructie NV v Simon Carves Ltd [2010] 4 All ER 847 discussed
Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd [1974] AC 689 cited
Grant v NZMC Ltd [1989] 1 NZLR 8 discussed
Hamilton Ice Arena Ltd v Perry Developments Ltd [2002] 1 NZLR 309 discussed
International Air Transport Association v Ansett Australia Holdings Ltd (2008) 234 CLR 151 cited
Integrated Computer Services Pty Ltd v Digital Equipment Corp (Aust) Pty Ltd (1988) 5 BPR 11,110 cited
Investors Compensation Scheme Ltd v West Brunswick Building Society [1998] 1 WLR 896 cited
James v Commonwealth Bank of Australia (1992) 37 FCR 445 discussed
J & S Holdings Pty Ltd v NRMA Insurance Ltd (1982) 41 ALR 539 cited
Legione v Hateley (1983) 152 CLR 406 cited
Lord v Direct Acceptance Ltd (1993) 32 NSWLR 362 discussed
Maggbury Pty Ltd v Hafele Australia Pty Ltd (2001) 210 CLR 181 cited
McDonnel & East Ltd v McGregor (1936) 56 CLR 50 cited
Newfoundland v Newfoundland Railway Company (1888) 13 App Cas 199 discussed
Norman v FEA Plantation Ltd (2010) 191 FCR 39 referred to
Norman, in the matter of Forest Enterprises Australia

Limited (Administrators Appointed) (Receivers Appointed) v FEA Plantations Ltd (Administrators Appointed) (Receivers Appointed) [2010] FCA 1444 referred to
Norman, in the matter of Forest Enterprises Australia Limited (Administrators Appointed) (Receivers Appointed) v FEA Plantations Ltd (Administrators Appointed) (Receivers Appointed) (No 3) [2011] FCA 624 referred to
Pacific Carriers Ltd v BNP Paribas (2004) 218 CLR 451 followed
Popular Homes Limited v Circuit Developments Ltd [1979] 2 NZLR 642 cited
Progressive Mailing House Pty Ltd v Tabali Pty Ltd (1985) 157 CLR 17 followed
Rawson v Samuel (1841) Cr & Ph 161 cited
Re Exceel; Worthley v England (1994) 52 FCR 69 cited
Re Partnership Pacific Securities Limited [1992] 1 Qd R 410 discussed
Re Timbercorp Securities Limited (2009) 74 ACSR 626 referred to
Sandbank Holdings Pty Limited v Durkan [2010] WASCA 122 discussed
Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd (2004) 219 CLR 165 followed
Vroon Bv v Foster's Brewing Group [1994] 2 VR 32 cited
Walker v Department of Social Security (1995) 56 FCR 354 cited

A Waite, "Disrepair and Set-off of Damages against Rent: The Implication of *British Anzani*" [1983] *The Conveyancer and Property Lawyer* 373
Butterworths, *Hill and Redman's Law of Landlord and Tenant* (Issue 35, February 2001)
R P Meagher, J D Heydon & M J Leeming, *Meagher, Gummow and Lehane's Equity: Doctrines and Remedies* (Butterworths, 4th ed, 2002)
R P Meagher, W M C Gummow & J R F Lehane, *Equity: Doctrines & Remedies* (Butterworths, 3rd ed, 1992)
R S Derham, *The Law of Set-Off* (Oxford University Press, 3rd ed, 2003) [5.57]
Sweet & Maxwell, *Woodfall: Landlord & Tenant* (2000)

Date of hearing:	2 March 2011
Place:	Melbourne
Division:	GENERAL DIVISION
Category:	Catchwords

Number of paragraphs:	222
Counsel for the Appellant:	Mr P D Crutchfield SC with Dr O Bigos
Solicitor for the Appellant:	Maddocks
Counsel for the First Respondent:	Dr C L Pannam QC with Mr A P Young
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Solicitor for the Second Respondent:	Clarendon Lawyers

IN THE FEDERAL COURT OF AUSTRALIA
VICTORIA DISTRICT REGISTRY
GENERAL DIVISION **VID 1179 of 2010**

ON APPEAL FROM THE FEDERAL COURT OF AUSTRALIA

BETWEEN:	**TIMOTHY BRYCE NORMAN AND SALVATORE ALGERI IN THEIR CAPACITIES AS RECEIVERS AND MANAGERS OF FOREST ENTERPRISES AUSTRALIA LIMITED (RECEIVERS & MANAGERS APPOINTED) AND OF FEA CARBON PTY LTD (SUBJECT TO DEED OF COMPANY ARRANGEMENT) (RECEIVERS AND MANAGERS APPOINTED) AND AS CONTROLLERS OF TASMANIAN PLANTATION PTY LTD (SUBJECT TO DEED OF COMPANY ARRANGEMENT) (CONTROLLERS ACTING) AND OTHERS** **Appellant**
AND:	**FEA PLANTATIONS LTD (ADMINISTRATORS APPOINTED) (RECEIVERS APPOINTED)** **First Respondent** **FEA GROWERS GROUP INC A0054610B** **Second Respondent**
JUDGES:	**JACOBSON, NICHOLAS AND YATES JJ**
DATE OF ORDER:	**9 AUGUST 2011**
WHERE MADE:	**MELBOURNE**

THE COURT ORDERS THAT:

1. The appeal be allowed.

2. The orders of Finkelstein J made 24 December 2010 be set aside.

3. Costs be reserved.

4. The parties file short written submissions on costs within a time to be agreed or as directed.

THE COURT DECLARES THAT:

5. FEAP is not entitled to maintain an equitable set-off against the rent due to FEA under the internal leases or sub-leases for the month of August 2010 by reason of the

claims made pursuant to the letter of commitment by FEAP in letters dated 29 April 2010 and 5 May 2010.

Note: Settlement and entry of orders is dealt with in Rule 39.32 of the *Federal Court Rules 2011*. The text of entered orders can be located using Federal Law Search on the Court's website.

IN THE FEDERAL COURT OF AUSTRALIA
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AND:	**FEA PLANTATIONS LTD (ADMINISTRATORS APPOINTED) (RECEIVERS APPOINTED)** **First Respondent** **FEA GROWERS GROUP INC A0054610B** **Second Respondent**
JUDGES:	**JACOBSON, NICHOLAS AND YATES JJ**
DATE:	**9 AUGUST 2011**
PLACE:	**MELBOURNE**

REASONS FOR JUDGMENT

THE COURT

Introduction and Background

1 FEA Plantations Ltd ("FEAP") is a member of the Forest Enterprises Australia group of companies ("FEA Group") which, at all relevant times, conducted a number of managed investment schemes consisting of forestry operations in which members of the public invested.

2 FEAP was the responsible entity of each of the relevant schemes and was required, by the provisions of s 601FA of the *Corporations Act 2001* (Cth) ("the

Act"), to hold an Australian Financial Services Licence as a condition of it operating as the responsible entity of the schemes.

3 The way in which the schemes were conducted was that one or another of the companies in the FEA Group owned land on which the forestry operations were carried out. Those operations consisted of the growing of trees and the harvesting and sale of the timber. Importantly, internal leases were granted within the FEA Group which provided for FEAP as the responsible entity to obtain a lease or sub-lease of the land. FEAP then sub-leased, or sub-sub-leased, the land to the investors in each of the schemes.

4 On 14 April 2010 administrators were appointed to FEAP and other companies in the FEA Group. On the same day, banks which held a debenture charge over the assets and undertaking of the FEA Group appointed Mr Norman and Mr Algeri as Receivers and Managers of the property of Forest Enterprises Australia Ltd ("FEA").

5 FEA is the parent company of the FEA Group. It owns one of the parcels of land on which certain schemes were conducted. Two subsidiaries of FEA, namely FEA Carbon Pty Ltd ("FEA Carbon") and Tasmanian Plantation Pty Ltd ("Tasmanian Plantation") own the other relevant parcels. Mr Norman and Mr Algeri have been appointed as Receivers and Managers of FEA Carbon and Controllers of Tasmanian Plantation.

6 Prior to the insolvency of the FEA Group, on 27 August 2009, FEA gave to FEAP a letter of commitment described by counsel for the Receivers as a "letter of comfort" under which FEA agreed to provide FEAP with sufficient cash to meet its ongoing financial obligations and to satisfy FEAP's cash needs requirements from time to time.

7 The threshold issue before the primary judge was whether the letter of commitment created a legally binding and enforceable obligation upon FEA. This was because FEAP sought to set off against outstanding rent, demanded from it by the

Receivers of FEA, moneys to which it claimed to be entitled under the letter of commitment.

8 The primary judge was in no doubt that the letter of commitment was intended to, and did, create a legally binding obligation on the part of FEA to provide funds to FEAP to enable FEAP to meet its financial obligations, including rent: see *Norman, in the matter of Forest Enterprises Australia Ltd (Administrators Appointed) (Receivers Appointed) v FEA Plantations Ltd (Administrators Appointed) (Receivers Appointed)* [2010] FCA 1444 at [36].

9 His Honour was also of the view, at [42]–[45], that FEAP was entitled to assert an equitable set-off for amounts due to it under the letter of commitment against its obligation to pay rent and, at [46]–[49] that this entitlement was not excluded by FEAP's obligation under the lease to pay the rent "without any deductions whatsoever".

10 The consequence of this was that no rent was payable to FEA by FEAP for the relevant period. His Honour therefore declined to make the declaration sought by the Receivers that they would be justified in causing the relevant lessor companies to terminate the internal leases granted to FEAP.

11 The Receivers appeal against the primary judge's order. His Honour's orders were interlocutory but we granted leave to appeal in the course of the hearing.

The issues in the appeal

12 Three issues arise in the appeal. They are the same as the issues which were determined adversely to the Receivers by the primary judge. Thus, the question which arises in each instance is whether the primary judge erred in the determinations which he made.

13 The first issue is whether the letter of commitment gave rise to a legally binding obligation on the part of FEA. This issue is to be determined in the light of the express terms of the letter, its "history", as well as the statutory context in which it was made.

14 The relevant history is to be found in a memorandum from FEAP's solicitors, Blake Dawson (the "Blakes Memorandum"). The statutory context includes a consideration of the terms of the licence granted to FEAP under s 913B of the Act as well as the terms of Regulatory Guide 166 ("RG 166") published by the Australian Securities & Investments Commission ("ASIC"). RG 166 sets out the financial requirements, in particular the "cash needs requirements", that must be met by the holder of an Australian Financial Services Licence.

15 The second issue is whether FEAP was entitled to an equitable set-off for the amounts said to be due under the letter of commitment against the rent payable by FEAP to FEA under the relevant lease or sub-lease.

16 The third issue is whether FEAP's obligation to pay the rent "without any deductions whatsoever" excluded its entitlement (if any) to an equitable set-off.

17 In a sense, the second and third issues fall for consideration together because the question of the effect of the words "without any deductions whatsoever" is necessarily bound up with the issue of set-off. Nevertheless, it is convenient to approach the issues in the order in which the primary judge dealt with them, by considering the issue of equitable set-off before turning to the question of whether any entitlement to an equitable set-off was excluded by the obligation to pay without deduction.

18 The Receivers' Notice of Appeal raised two other grounds of appeal which were not pursued.

The internal leases

19 The proceeding relates to rural land on which a number of managed investment schemes were conducted. Some parcels of land are owned by FEA, with others being owned by either FEA Carbon or Tasmanian Plantation.

20 An issue arose before the primary judge as to the identity of the parties to the leases of the internal land owned by FEA Carbon and Tasmanian Plantation.

21 The determination of who the parties to the leases were and how the "leasing chains" between the companies were structured was essential to a determination of whether FEAP could raise an equitable set-off.

22 The primary judge determined the relevant leasing chains, although he was unable to reach a concluded view of whether FEA or FEAP was the lessee of the land owned by FEA Carbon. No challenge was made to his Honour's findings of fact in relation to the parties to, or structure of, the leasing chains for the land.

23 His Honour's findings about the leasing chains were to the following effect:

- The land owned by FEA was leased by FEA as lessor to FEAP as lessee, with sub-leases of the land having been granted by FEAP to the growers;

- FEA Carbon leased the land which it owned to FEAP or FEA. If FEA was the lessee, it sub-leased the land to FEAP with sub-leases or sub-sub leases then being granted by FEAP to the growers.

- As from 26 June 2003, Tasmanian Plantation leased the land which it owned to FEA which sub-leased the land to FEAP, which then sub-sub leased the land to the growers.

24 The leasing arrangements between the parties were recorded in a number of documents, in particular a Master Head Lease, described as the 2000 Master Head Lease and a new Master Head Lease described as the 2003 Master Head Lease, as well as a subsequent Deed of Variation.

25 The 2000 Master Head Lease was entered into on 30 June 2000 between Tasmanian Plantation as lessor and FEAP (then known as Tasforestry Ltd) as lessee.

26 As the primary judge observed at [5], the 2000 Master Head Lease was described as the "Standard Head Lease" but it was not intended to demise any particular parcel of land to FEAP; rather it was the repository of the terms which, subject to the approval of the respective boards of Tasmanian Plantation and FEAP,

would govern the anticipated leases between those companies in respect of the land owned by Tasmanian Plantation to be used for managed investment schemes conducted by FEAP.

27 The 2000 Master Head Lease was replaced by the 2003 Master Head Lease which reflected a change that had by then taken place in the structure of the leasing arrangements within the FEA Group companies. However, brief reference may be made to the recitals to the 2000 Master Head Lease because they form part of the history against which the letter of commitment is to be construed.

28 The relevant recitals are B and C. Recital B states that FEAP was established for the purpose of holding a "Dealer's Licence" for the conduct of managed investment schemes in forestry pursuant to the provisions of the legislation then applicable to corporations and that FEAP:

> is a Single Responsible Entity of the Tasmanian Forests Trust No. 1 to 7 inclusive, and of the Tasmanian Forests Project 2000, and is expected to be the Responsible Entity of future forest projects conducted under the *Corporations Law*.

29 Recital C states that under the constitutions of these eight managed investment schemes referred to above:

- Tasmanian Plantation is to hold the land and lease it to FEAP;
- FEAP is to sub-lease the land to growers who pay fees to FEAP in order to engage in the business of forestry plantation;
- FEAP has the responsibility of engaging FEA to establish and maintain the plantations.

30 The 2003 Master Head Lease was executed on 26 June 2003 and was made between Tasmanian Plantation as lessor, FEA as lessee and FEAP. As stated above, it reflected the changed leasing structure under which Tasmanian Plantation leased the land to FEA.

31 The recitals to the 2003 Master Head Lease record that the land owned by Tasmanian Plantation and used in the schemes is to be leased to FEA and that FEA is to sub-lease the land to FEAP (which was established for the purpose stated above in

respect of the 2000 Master Head Lease) and that "FEAP as Responsible Entity will hold the sublease on behalf of Managed Investment Scheme investors and growers (the Growers Leases) who pay fees to FEAP".

32 The 2003 Master Head Lease contains the terms of the lease entered into upon the exercise of the option to renew an earlier lease made on 26 June 2002. The land which is the subject of the 2003 Master Head Lease is described in Annexure "A" to that document.

33 The land so described does not comprise all of the land which is the subject of the internal leases between the FEA Group companies. So much seems to be clear from the recital to a Deed of Rectification dated 22 December 2009 to which the primary judge referred at [11] and from his Honour's findings about the relevant leasing chains between each of FEA, FEA Carbon and the other parties referred to above.

34 Nevertheless, the argument on the question of whether FEAP was entitled to an equitable set-off proceeded on the basis that the relevant obligation to pay rent was in the same terms as are contained in the 2003 Master Head Lease.

35 We should observe that the recitals to the 2003 Master Head Lease include an acknowledgement, as required by the Australian Financial Services Licence issued to FEAP in 2003, that the land is encumbered by forestry rights in favour of FEAP held by it beneficially for the growers in accordance with its duty as responsible entity.

36 The central clause with which this appeal is concerned is cl 2(a) which provides that FEA agrees with Tasmanian Plantation to pay the rent at the time and manner stated elsewhere in the document (in effect, by equal monthly instalments) "without any deductions whatsoever".

37 Clause 2(h) contains a covenant against assignment or subletting without consent. It goes on to state that despite that prohibition, Tasmanian Plantation acknowledges that the land will be sub-let to FEAP as Responsible Entity of managed

investment schemes and that Tasmanian Plantation consents to each sub-lease to a grower.

38 Clause 4(a) entitles Tasmanian Plantation to serve a notice of default upon FEA if the rent is in arrears for 28 days. The clause also entitles Tasmanian Plantation to re-enter if the default is not remedied within a further 28 days. However this is subject to the proviso contained in clause 4(c).

39 Clause 4(c) provides that where a default in payment of rent occurs as a result of FEA or FEAP going into voluntary administration, liquidation or receivership, a moratorium of six months applies to the right of termination of the lease to allow the relevant controller of FEA or FEAP to cure the default.

The Australian financial services licence

40 FEAP held an Australian financial services licence issued under s 913B of the Act. The licence which was in evidence was effective from 20 February 2008.

41 The conditions of FEAP's licence required it, amongst other things, to meet its "cash needs requirement" by complying with one of five specified options.

42 Option 1 was the "reasonable estimate projection plus cash buffer" option. To comply with this option, the licensee was required to prepare and maintain cash flow projections for the ensuing three months and hold in "cash" 20% of the amount of the expected outgoings for that period.

43 "Cash" was defined to mean assets valued at the amount of cash for which they can be exchanged within five business days, or "a commitment to provide cash from an eligible provider that can be drawn down within 5 business days and has a maturity of at least a month". "Eligible Provider" was defined in the terms of the licence to include an ASX listed company whose net assets exceeded $50 million.

44 FEAP always satisfied the cash needs requirement specified in its licence by relying on Option 1. However, the Receivers sought to rely upon the terms of the

other four options as contextual considerations relevant to the characterisation of the letter of commitment. We will therefore refer briefly to the other options.

45 Option 2 is the "contingency based projection" option. To comply with it, the licensee was required to prepare and maintain cash flow projections based on its estimate of what would happen if its ability to meet its liabilities was affected by adverse commercial contingencies.

46 Option 3 is called the "financial commitment by an Australian ADI or comparable foreign institution" option. Under this option, an Australian deposit taking institution, or comparable foreign institution must give the licensee "an enforceable and unqualified commitment" to pay on demand an unlimited amount of money to the licensee or the amount for which the licensee is liable to creditors.

47 Option 4 is the "expectation of support from an Australian ADI or comparable foreign institution" option. This option applies where the licensee is a subsidiary of an Australian ADI or comparable foreign institution. It allows the licensee to rely upon a "reasonable expectation" of support from its parent.

48 Option 5 is entitled "parent entity prepares cash flow projections on a consolidated basis". The requirements include two alternatives. The first is that the parent entity provides an "enforceable and unqualified commitment" to pay on demand an unlimited amount of money in terms similar to those set out in Option 3. The second alternative is that the licensee reasonably expects (based on access to cash from members of the licensee group) that it will have adequate resources to meet its liabilities.

ASIC's Regulatory Guide 166

49 The Receivers also relied upon contextual considerations arising from RG 166. We will therefore refer to the salient parts.

50 RG 166 is dated May 2010. It states in its introductory remarks that:

> This guide sets out the financial requirements you will have to meet as the holder of an Australian financial services licence.

51 RG 166.22 states, relevantly, that a licensee must meet "our cash needs requirement" by complying at all times with one of Options 1 to 5.

52 There is an explanation of each of those Options commencing at RG 166.25. The explanation of Option 1 does not, for present purposes, appear to depart from the substance of what is set out in the licence. It includes the requirement that the licensee have in cash an amount equal to 20% of the greater of its projected cash outflow for the next three months, or its actual cash outflow for the most recent financial year.

53 ASIC states in RG 166.32 that Option 2 is potentially suitable for all licensees, especially small business as they do not always maintain cash or commitments of support from others.

54 ASIC also states in RG 166.33 that a licensee can take into account, in Option 2, the financial support the licensee expects a parent company or other entity would provide if needed, but only to the extent that the risk that such support would not be provided is highly unlikely.

55 As to Option 3, ASIC observes in RG 166.36 that this option is suitable for licensees able to meet the cash needs requirement in a manner that does not involve providing cash flow projections. What is required to satisfy this option is "an enforceable and unqualified commitment to meet the licensee's financial obligations" from an Australian ADI or foreign deposit-taking institution.

56 ASIC states in RG 166.38 that Option 4 is suitable for licensees who are subsidiaries of an Australian ADI or foreign deposit-taking institution. This option "allows the licensee to rely on an expectation of support, even if there is no enforceable commitment from the parent company".

57 ASIC's guide to Option 5 in RG 166.40 and RG 166.41 is not relevantly different from what we said about this option when setting out the terms of the licence.

58 ASIC's discussion in RG 166.42 of the defined terms "cash" and "eligible provider," for calculating base level financial requirements, does not depart from what we said about the licence. In particular, ASIC states at RG 16.42 in relation to the definition of "cash" that it means:

- current assets valued at the amount of cash for which they can be expected to be exchanged within 5 business days; or
- a commitment to provide cash from an eligible provider … that can be drawn down within 5 business days and has a maturity of at least a month.

59 There is discussion in RG 166 of ASIC's view of the meaning of "eligible undertaking" and its approach to the application of that criterion.

60 The definition is given at RG 166.189 in a way which repeats the substance of what is set out in the licence. RG 166.189 states that an eligible undertaking means the amount of a financial commitment payable on written demand by the licensee provided by an eligible provider in the form of an undertaking to pay the amount of the financial commitment to the licensee, and that:

- is an enforceable and unqualified obligation; and

- remains operative until [ASIC] consents in writing to the cancellation of the undertaking.

61 RG 166.191 states that ASIC will consider allowing a licensee to treat a financial commitment as an eligible undertaking in a different form if the licensee demonstrates that in exceptional circumstances, it would be impractical to comply with RG 166.189 and the commitment would be effective in meeting the objectives stated in that paragraph.

The Blakes Memorandum

62 The Blakes Memorandum is dated 27 August 2009, the same date as the letter of commitment. It states the purpose of the Memorandum by recording that FEAP has identified a "procedural breach" in relation to the "cash needs requirements" of its licence.

63 The Memorandum continues by stating that FEAP's solicitors, Blake Dawson ("Blakes"), prepared the document for the purpose of assisting the board of FEAP to assess the significance of the breach and whether it should be reported to ASIC.

64 The Memorandum goes on to state that it is a condition of FEAP's licence that FEAP satisfies the cash needs requirement in one of the five alternative ways specified in Options 1 to 5. It also states that FEA has always met its cash needs requirements by relying on Option 1, and that following discussions between Blakes and FEAP, it was FEAP's understanding that FEAP should rely on Option 1.

65 The Blakes Memorandum then sets out an explanation of the requirements which FEAP was required to meet in order to satisfy Option 1. In dealing with the requirements, Blakes state that there is no restriction on FEAP obtaining support from FEA to demonstrate that it can meet the requirements, for example:

> the cashflows may indicate inflows from FEA to satisfy some or all of the cash needs requirements for the three month period. However, if this support is relied on, then FEA must be in a position to provide this support.

66 The Memorandum also specifies the requirement that FEAP must have in cash an amount equal to 20% of the greater of either the cash outflows for the projected period of the ensuing three months or the actual cashflow for three months calculated on the basis of the profit and loss statement for the most recent financial year.

67 Importantly the Memorandum states that for the purpose of satisfying this requirement "cash" is defined as, inter alia, "a commitment to provide cash from an eligible provider that can be drawn down within 5 business days and has a maturity of at least a month".

68 The Memorandum goes on to state that based upon "our discussions", Blakes understand that FEA satisfies the requirements of an eligible provider and:

> [w]e are in the process of documenting a commitment from FEA to FEAP to satisfy this requirement. However, it is possible to infer from conduct that FEA has already provided this commitment, even though there is not a documented commitment in place.

69 Section 3 of the Memorandum addresses the question of whether FEAP was in breach of the licence conditions. It sets out the steps taken to comply with the cash needs requirements including:

> [a]t the end of each month, FEA has been transferring to [FEAP] an amount of $3 million (which is in excess of the amount … required …). This amount has been transferred into [FEAP] on one day and then immediately transferred back to FEA.

70 Section 4 of the Memorandum deals with identification and verification of the breach. It states how the breach was discovered by FEAP and refers to procedures implemented by FEAP to rectify the breach. It continues by stating that FEAP:

> is also in the process of obtaining a written commitment from FEA to provide the cash required (in support of the existing arrangement which [FEAP] has with FEA (which is undocumented)).

71 Section 5 addresses the need to report a breach to ASIC. Section 6 addresses the significance of the breach. We need not repeat what is set out in those sections of the Memorandum.

The Letter of Commitment

72 The letter of commitment is in the following terms:

> We understand that in order to comply with its cash needs requirements as set out in ASIC Regulatory Guide 166 (**RG 166**), FEA Plantations Limited (**FEA Plantations**) requires an "eligible provider" to provide a commitment to provide cash to FEA Plantations to enable it to satisfy its financial obligations.
>
> As Forest Enterprises Australia Limited (**FEA**) is an ASX listed company with net assets (excluding intangible assets) of $228 Million (as shown in the most recent audited financial statements lodged with the Australian Securities and Investments Commission), FEA qualifies as an "eligible provider".
>
> FEA hereby agrees to provide this commitment to FEA Plantations and in doing so, agrees to provide FEA Plantations with sufficient cash to meet its ongoing financial obligations and to satisfy its cash needs requirements from time to time.
>
> In accordance with RG 166, requests for provision of funds by FEA Plantations will be honoured by FEA within five business days of receipt of a request from FEA Plantations.
>
> However, the maximum amount which FEA agrees to provide FEA Plantations by way of a cash commitment in any calendar month is $5.5 Million. If FEA Plantation requires additional funds, then it can lodge a special request with FEA for these additional funds. FEA can, in its absolute discretion, provide the additional funds or deny the request.

> This commitment is ongoing. However, FEA may withdraw this commitment at any time by providing FEA Plantations with one month's written notice of termination of this commitment.

Other relevant background facts

73 On 14 April 2010 Mr Brian Silvia and two other persons were appointed as administrators of FEAP and other FEA group companies by a resolution of the directors of each company.

74 On the same day, 14 April 2010, Mr Norman and Mr Algeri were appointed by ANZ Fiduciary Services Pty Limited in its capacity as security trustee of the FEA Security Trust, as receivers and managers of the assets and undertaking of FEA and FEA Carbon and as controllers of Tasmanian Plantation.

75 On 29 April 2010, the solicitors for FEAP wrote to FEA calling upon FEA to make payment to FEAP pursuant to the letter of commitment for the sum of $5.5m for the month of April 2010.

76 The letter did not specify what particular cash needs of FEAP gave rise to the request for that sum. The letter from the solicitors simply referred to the letter of commitment, and stated that it was provided so as to enable FEAP to comply with ASIC's RG 166. It went on to refer to FEA's agreement to provide FEAP with sufficient cash to meet its ongoing financial obligations and to satisfy its cash needs from time to time, up to a maximum of $5.5 million. The letter concluded by stating:

> FEA hereby calls upon FEA to make payment to FEAP pursuant to that commitment of $5.5m for the month of April 2010. FEAP requests that payment be made within 5 business days of the date of this letter.

77 On the following day, 30 April 2010, the solicitors for FEA wrote to the administrators of FEAP. The letter asserted that the letter of commitment did not constitute a binding or enforceable obligation upon FEA. The letter went on to state that, without prejudice to the assertion that the letter of commitment was not binding, and out of "an abundance of caution":

> FEA hereby gives one month's written notice of termination of any commitment contained within that letter.

78 On 5 May 2010 the solicitors for FEAP wrote again to FEA making a further request for funds under the letter of commitment. Once again, the request was stated in general terms, as follows:

> In respect of the month of May, FEAP requires FEA to make available to FEAP, $5,500,000 to enable FEAP to meet its obligations as responsible entity of the various managed investment schemes for which it is responsible.

79 In an affidavit sworn by Mr Silvia on 21 September 2010, he states that prior to the appointment of administrators to FEAP, rent was not paid by FEAP to FEA in cash, but rather, through entries in an inter company loan account. Details of the loan account were supplied in an annexure to the affidavit, but it recorded the position only for the period from 1 July 2009 to 28 February 2010.

80 Mr Silvia went on to state that the loan account showed that for the period referred to above, FEAP was a creditor of FEA. However, the affidavit does not address the state of the loan account after 28 February 2010 and it does not address the question of what financial obligations FEAP had to FEA or other persons after that period. Nor does the affidavit state what particular cash needs requirements FEAP had from the time of Mr Silvia's appointment.

81 Rather, Mr Silvia's affidavit goes on to refer to the request for funds of $11 million contained in the solicitors' letters of 29 April 2010 and 5 May 2010 (as well as to further requests made after FEA's withdrawal of the commitment). Mr Silvia states his belief that the obligations owed by FEA to FEAP "consequent upon the two requests of April and May" and the further requests would provide "more than sufficient funds to set off any obligation which FEAP may owe to FEA".

82 On 7 September 2010, Mr Norman caused to be served on FEAP notices of default in respect of rent payable by FEAP to FEA and other FEA group companies. The default notice in respect of rent payable by FEAP to FEA is for the month of August 2010.

83 On 17 August 2010, that is to say, prior to service of the notices of default, the Receivers filed their originating process seeking declaratory relief. The originating

process was amended on 17 September 2010. No point was taken that the notices of default were served after the date on which the proceeding was commenced.

Was the letter of commitment a legally binding contract

84 The Receivers submitted that there were three reasons why the primary judge erred in finding that the letter of commitment created a legally binding obligation on the part of FEA.

85 The first was that the letter was not intended to create legal relations between the parties. The second reason was that the letter of commitment was not supported by consideration. The third reason was that the terms of the letter of commitment were too uncertain and incomplete to constitute a contract.

86 The Receivers' submissions were based in large measure on the decision of the Victorian Court of Appeal in *Atco Controls Pty Ltd (in liq) v Newtronics Pty Ltd* (2009) 25 VR 411 ("*Atco Controls*"). There, the Court of Appeal (Warren CJ, Nettle and Mandie JJA), held that a letter of support provided by a parent company to its subsidiary was not a legally binding agreement.

87 The principles stated and applied in *Atco Controls* are not in doubt but the question which arises in the present case turns on the application of those principles to the facts of the case.

Intention to create legal relations

88 It is customary to treat intention to create legal relations as a contractual requirement separate and distinct from the requirement of consideration: cf *Atco Controls* at [60].

89 We will deal first with the question of intention to create legal relations. The essential question which arises in such cases, as stated by Allsop J in *Branir Pty Ltd v Owston Nominees (No 2) Pty Ltd* (2001) 117 FCR 424 at [369],

> is whether the parties' conduct, including what was said and not said and including the evident commercial aims and expectations of the parties, reveals an understanding or agreement … which bespeaks an intention to be legally bound to

the essential elements of a contract.

90 What is required is an objective assessment of the state of affairs between the parties; that is an assessment of what was conveyed objectively by what was said or done: *Ermogenous v Greek Orthodox Community of SA Inc* (2002) 209 CLR 95 at [25] ("*Ermogenous*").

91 Here, the terms of the letter of commitment and the circumstances in which it was made make it clear in our view that the aims and expectations of FEA and FEAP revealed an intention on their part to impose a legally binding obligation upon FEA.

92 The evident commercial purpose of the letter of commitment is revealed, in particular, in the opening paragraph of the letter, when read in light of the observations made in the Blakes Memorandum.

93 It is plain from the Blakes Memorandum that the solicitors were then in the process of documenting a "commitment" from FEA to FEAP to satisfy the cash needs requirements of FEAP's licence in a way which would satisfy Option 1.

94 Option 1 required FEAP, *inter alia*, to hold in "cash" 20% of the amount of its expected outgoings for the ensuing three month period. "Cash" was defined in the licence as a "commitment" to provide cash from an eligible provider that could be drawn within five days and had a maturity of at least a month.

95 The first two paragraphs of the letter of commitment, and the terms of the Blakes Memorandum, make it clear that FEA was to be the eligible provider and that it was to, and did, provide the "commitment".

96 The third paragraph of the letter of commitment states in plain terms that FEA agrees to provide "this commitment". Those words can only be construed as the commitment contemplated by Option 1, as stated in the terms of the licence, and as explained in RG 166.25.

97 What must be borne in mind is that the commitment was to provide cash. Yet the effect of the Receivers' submissions was that the commitment was one which was

not intended to be legally binding. That submission, if correct, would mean that the commitment to provide cash contemplated by Option 1 should be read as meaning a legally unenforceable commitment to provide cash.

98 The Receivers' submission would therefore seem to us to lead to a result that is contrary to the plain meaning of the word "commitment" in the letter, particularly when read in light of the intended regulatory purpose revealed in RG 166 and the terms of the licence.

99 In short, the cash needs requirements of Option 1 are to have cash or assets which are the equivalent of cash. To satisfy those requirements, the commitment from the eligible provider must be a legally binding one. Thus, when FEA agreed "to provide this commitment", it manifested an intention to provide a legally binding commitment in the terms stated in the third paragraph of the letter.

100 Indeed, the proposition that FEA did not intend to give a legally binding commitment is contrary to the terms of the penultimate paragraph of the letter. That paragraph draws a distinction between the amount which FEA agreed to provide by way of a cash commitment in any calendar month, namely $5.5 million, and the amount which FEA may provide by way of additional funds over and above the sum of $5.5 million.

101 What was required for FEA to consider the provision of additional funds was for FEAP to lodge a special request with FEA for those funds. Importantly, FEA could then "in its absolute discretion" provide FEAP with the additional funds or deny the request.

102 The distinction thereby drawn between the maximum amount which FEA agreed to provide and the "absolute discretion" to provide any additional funds is a critical one. It manifests an intention on FEA's part to give a legally binding commitment to provide up to $5.5 million with an absolute discretion whether to provide a "top-up" over and above that amount.

103 Senior counsel for the Receivers pointed to a number of contextual considerations which, in his submission, suggest that the letter of commitment was intended to provide a non-contractual statement of support from FEA.

104 The first was that the letter of commitment from FEA was not an "eligible undertaking" within the terms of the licence, or as explained by ASIC in RG 166.189.

105 It is true that the letter of commitment was not an eligible undertaking because, to satisfy that definition, it was required to remain operative until ASIC consented in writing to its cancellation. But the primary judge recognised this at [32] of his reasons and was of the view at [36] that the letter of commitment showed that, until it was withdrawn by one month's notice, it was intended to, and did, create a binding obligation on the part of FEA.

106 We agree with this analysis for the reasons which we have set out above in relation to the wording of the letter and its history as appearing from the Blakes Memorandum, as well as the statutory context.

107 All of those considerations show, quite plainly, that the letter was intended to be a legally binding commitment by FEA, albeit that it was not an eligible undertaking in the terms stated in the licence or in RG 166.189.

108 The second contextual matter to which Mr Crutchfield SC pointed was that of the differences in language employed in the description of the different types of support referred to in Options 1 to 5 of the licence and in RG 166.

109 In particular, Mr Crutchfield drew attention to the words "enforceable and unqualified commitment" in Option 3 and Option 5 as well as to the words "enforceable and unqualified obligation" in the definition of eligible undertaking.

110 However, when regard is had to the terms of the definitions of each of Options 1 to 5, considered as a whole, the distinction which is drawn in the various options is between a "commitment" and a reasonable expectation of access to cash from a related body corporate; see in particular Option 4 and Option 5, alternative B.

111 The question of whether there is such a reasonable expectation is a question of fact, as is the requirement stated in Option 2 that the licensee demonstrate that it will have access, when needed, to sufficient financial resources.

112 We do not see that anything turns on the omission of the words "enforceable and unqualified" from the description of the commitment required to satisfy Option 1.

113 What is plain is that the commitment required to satisfy Option 1 is a commitment that is equivalent to cash. To treat such a commitment as embracing a non-binding, legally unenforceable commitment to provide cash would defeat the objectives which underlie the licensing requirement stated in s 601FA of the Act.

114 The licence, and the conditions stated in it, are a matter of statutory protection of investors in managed investment schemes. The cash needs requirements are an essential condition which the licensee must meet in the interests of investors. It is true that some of the options contemplate that the condition may be met by a "letter of comfort" but there is nothing to suggest that when the relevant option in the present case, Option 1, refers to a commitment, it is to be read in the sense for which the Receivers contend.

115 Nor, in our view, is the Receivers' argument supported by the decision in *Atco Controls*. That case is to be understood in light of its own facts. In particular, to construe the letter of support as providing a binding legal commitment was inconsistent with the terms of a debenture provided by the subsidiary for the purpose of securing financial support already extended by the parent company: see *Atco Controls* at [50].

116 Moreover, the Court of Appeal in *Atco Controls* approached the letter of support as a matter of "commercial reality", in light of what their Honours described as the legal significance of non-binding undertakings and assurances, in the context of the law of directors' obligations to ensure that a company has reasonable or probable grounds to expect that the company will be able to pay its debts as and when they fall due: see *Atco Controls* at [54]–[57].

117 The context in the present case is quite different from that which arose in *Atco Controls*, as is the language of the letter of commitment: see *Atco Controls* at [5].

118 Here, as we have said, the context and the language of the letter point strongly to the inference that the parties intended FEA to be legally bound to a commitment to provide cash in the terms stated. By contrast, in *Atco Controls*, the relevant context was the provision in certain financial years, of letters of support from the parent to its subsidiary provided by the parent to the subsidiary's auditors in connection with the preparation of the subsidiary's accounts.

119 That context in *Atco Controls*, and the other matters referred to above, readily explain why the Court of Appeal came to the view that the letter of support was not intended to give rise to a binding legal commitment.

120 Finally, in our view, nothing turns upon the fact that the Blakes Memorandum might suggest that what was documented in the letter of commitment was merely the confirmation of an earlier undocumented and non-binding commitment which was in place between the parties before 27 August 2009. Indeed, that undocumented commitment appears to be so unorthodox that it involved the transfer of funds from FEA on one day and the immediate re-transfer from FEAP to FEA on the same or following day.

121 The short answer to this is that there is no suggestion in the terms of the letter of commitment that such unorthodox arrangements were intended to apply. The clear terms of the letter, including the statement of FEA's understanding that the "commitment" was required by FEAP from FEA to comply with FEAP's cash needs requirements stated in ASIC's RG 166, point strongly against such informality and against a departure from the ordinary norms of commercial behaviour.

The requirement of consideration

122 The Receivers emphasised the statements of principle made as to the law of consideration by the Court of Appeal in *Atco Controls*. Once again, we do not depart from those principles, but the question which arises turns on the facts of the case.

123 In *Atco Controls*, their Honours said at [62] that in order to establish the existence of good consideration it must be made to appear that the promise made by the promisor was really offered as the price or *quid pro quo* for the action taken. In that case, what was required was that the promisee show that the parent requested the subsidiary to continue to trade in return for the undertaking of continued support and that the subsidiary was moved by that request.

124 Their Honours were conscious in *Atco Controls* at [64], that a request need not be express and that one may be implied. But their Honours were of the view that the factual findings pointed against the existence of any implied request by the parent for the subsidiary to continue to trade.

125 In the present case, the primary judge was of the view at [38] that it was possible to infer that the request for the letter of commitment was premised on the proposition that, without it, FEAP would no longer act as the responsible entity. He said that the inference may be made because, without the letter, FEAP could not, consistent with the conditions of the licence, act in that capacity.

126 The Receivers submitted that the inferences drawn by the primary judge were not open. They relied on the principle that the onus of demonstrating the existence of a legally binding contract rested on the party asserting the existence of a contract (ie FEAP): *Ermogenous* at [26]. The Receivers also pointed to the fact that FEAP led evidence from a director and an officer of FEA and FEAP but neither said anything about a request for the letter or reliance upon it.

127 However, we do not consider that the absence of evidence from the officers of the companies precluded the primary judge from drawing the inference that consideration moved from FEAP.

128 The question of the inference or inferences to be drawn must be considered in light of all the circumstances. These include the purpose for which FEAP was established as a member of the FEA Group. That is stated in the recitals to the 2000 Master Head Lease and the 2003 Master Head Lease. FEAP was established for the

purpose of holding the necessary licence for the conduct of the managed investment schemes carried on by the FEA Group.

129 The Blakes Memorandum reveals that by August 2009 FEAP had fallen into breach of the cash needs requirements of its licence and that it proposed to obtain a letter of commitment from FEA in order to cure the breach.

130 It may be true, as was submitted by the Receivers, that FEAP sought, and relied upon, the letter of commitment in order to comply with the terms of its licence. It may also be true that FEAP made the initial request to FEA. But it is open to infer that FEA knew that, without the letter of commitment, FEAP could not continue to act as the responsible entity and that it was FEA's desire to avoid that result which prompted it to provide the letter of commitment. In those circumstances, it is open to infer that FEA impliedly requested FEAP to continue to act as responsible entity and that FEAP agreed to do so.

131 This is sufficient to distinguish the present matter from the facts in *Atco Controls*. Here the circumstances demonstrate a sufficient nexus between the offer of support from FEA and its acceptance by FEAP. The onus of demonstrating the existence of a contract was discharged by FEAP.

Uncertainty

132 There was nothing uncertain about the terms of the obligation undertaken by FEA.

133 FEA was aware of what constituted the financial obligations of its subsidiary, FEAP. Moreover, FEA set a maximum figure of $5.5 million per month as the amount which it was bound to provide. Thus, the commitment was not open-ended and any possible uncertainty as to whether FEA's commitment continued indefinitely, including for any time when FEAP may be hopelessly insolvent, was overcome by the entitlement of FEA to withdraw its commitment by giving one month's written notice of termination.

134 Finally, we have taken into account the well established principle that the courts should endeavour to give effect to the stated arrangements and expectations of those engaged in business: *Atco Controls* at [68], and the authorities there cited. Of course, there can be no binding and enforceable obligation unless the terms of the bargain, or at least the essential terms, have been agreed upon, but this is a case where that requirement is satisfied: cf *Vroon Bv v Foster's Brewing Group* [1994] 2 VR 32 at 67 per Ormiston J; see also *Integrated Computer Services Pty Ltd v Digital Equipment Corp (Aust) Pty Ltd* (1988) 5 BPR 11,110 at 11,117–11,118 per McHugh JA (Hope and Mahoney JJA concurring).

Equitable set-off: the legal principles

135 The essential question which arises in the appeal is, of course, whether FEAP was entitled to claim an equitable set-off for the amount of $11 million, demanded by it under the letter of commitment, against FEA's demand for payment of rent.

136 Special considerations are relevant to the principles to be applied in determining whether a tenant is entitled to maintain a set-off against rent: see *D Galambos & Son Pty Ltd v McIntyre* (1974) 5 ACTR 10 at 26 ("*Galambos*").

137 At common law, no set-off will be allowed against a landlord's claim for rent: see Meagher, Heydon and Leeming, *Meagher, Gummow & Lehane's Equity Doctrines and Remedies* (Butterworths, 4th ed, 2002) at 1056 [37-045]. However, the decision of Forbes J in *British Anzani (Felixstowe) Ltd v International Management (UK) Ltd* [1980] QB 137 ("*British Anzani*"), is authority for the proposition that a tenant may claim an equitable set-off against rent provided that the tenant's equity "impeaches" the landlord's title to the demand for rent.

138 That formulation of the principle of equitable set-off is in accordance with the statement made by Lord Cottenham LC in the seminal authority on the subject, *Rawson v Samuel* (1841) Cr & Ph 161, 178–179 ("*Rawson v Samuel*") to which Forbes J referred in *British Anzani* at 145.

139 The test stated in *Rawson v Samuel* at 178 was that the party seeking the benefit of the equitable set-off must demonstrate:

> some equitable ground for being protected against his adversary's demand. The mere existence of cross-demands is not sufficient.

140 Lord Cottenham LC went on at 179 to identify the feature which has been taken by most of the authorities to be the essential attribute of the equity, namely that it "impeach" the title to the legal demand.

141 The "impeachment" test has been adopted by Full Courts of the Federal Court as an accurate statement of the requirements for equitable set-off: *Walker v Department of Social Security* (1995) 56 FCR 354 at 363 per Drummond J; at 375 per Cooper J (with whom Spender J agreed); see also *J & S Holdings Pty Ltd v NRMA Insurance Ltd* (1982) 41 ALR 539 at 554 per Blackburn, Deane & Ellicott JJ.

142 The impeachment test was also adopted by Gummow J in *James v Commonwealth Bank of Australia* (1992) 37 FCR 445 at 458 ("*James v CBA*") as a correct statement of the principle.

143 It was also accepted and applied by the Queensland Court of Appeal in *Forsyth v Gibbs* [2009] 1 Qd R 403. In that case Keane JA (with whom McMurdo P and Fraser JA agreed) said at [10] that equitable set-off does not depend upon an unfettered discretionary assessment of what is fair. Rather, it is essential that there be such a connection between the claim and cross-claim that the cross-claim can be said to impeach the claim.

144 In other jurisdictions, the language used by the Lord Chancellor in *Rawson v Samuel* has been "explained or diluted often in ways that are not entirely satisfactory": *Lord v Direct Acceptance Ltd* (1993) 32 NSWLR 362 at 367 per Sheller JA citing Gummow J in *James v CBA* at 349–352.

145 Sheller JA went on to accept the "impeachment" test as explained by the learned authors of Meagher, Gummow & Lehane's *Equity Doctrines & Remedies* (Butterworths, 3rd ed, 1992) at [3709(h)], namely that it is an indispensable requirement of equitable set-off "that the set-off actually go to the root of, be essentially bound up with, impeach the title of the plaintiff". The same test is stated in the 4th edition of that work at [37-045] on page 1057.

146 In *James v CBA* at 460, Gummow J referred to a "reinterpretation" of the impeachment test which seems to find its source in the speech of Lord Hobhouse in the Privy Council decision in *Newfoundland v Newfoundland Railway Co* (1888) 13 App Cas 199 at 213 ("*Newfoundland* case"). The test stated there was that equitable set-off may be maintained:

> if flowing out of and inseparably connected with the dealings and transactions which also give rise [to the plaintiff's claims].

147 In more recent times the courts in England and Wales, based on a line of cases of which the *Newfoundland* case forms part, have moved from a "reinterpretation" of the impeachment test to its complete abandonment: *Geldorf Metaalconstructie NV v Simon Carves Ltd* [2010] 4 All ER 847 at [43]. However, in *James v CBA* at 462, Gummow J expressed the view that in this Court the *Newfoundland* case does not provide a good juridical basis for any changed doctrine of equitable set-off. He illustrated this by reference to the remarks of Dixon J in *McDonnel & East Ltd v McGregor* (1936) 56 CLR 50 at 59–60 which point to the distinction between equitable set-off, in the strict sense, and counterclaim and to the apparent deviation from that position in *Newfoundland*.

148 In the present appeal the parties did not suggest that the impeachment test should not be applied. Indeed, all parties advocated that the relevant principles were those explained in *Rawson v Samuel* and *British Anzani.*

149 In *James v CBA*, Gummow J was critical of the language employed by the New Zealand Court of Appeal in *Grant v NZMC Ltd* [1989] 1 NZLR 8 ("*Grant v NZMC*") insofar as it may be seen as re-interpreting the impeachment test. But he made no comment about the proposition that equitable set-off may arise where the cross-claim arises out of a different contract.

150 The principle stated in *Grant v NZMC* at 12–13 was as follows:

> 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.

151 This formulation of the principle permits a set-off to be maintained even if the "cross-claim" does not arise out of the same contract as that which gives rise to the plaintiff's claim.

152 *Hamilton Ice Arena Ltd v Perry Developments Ltd* [2002] 1 NZLR 309 ("*Hamilton*") was another New Zealand authority in which a claim for set-off was made against arrears of rent.

153 In *Hamilton*, Tipping J, who delivered the judgment of the Court, drew attention to a distinction drawn by the leading texts on the law of Landlord and Tenant. His Honour cited, at [36], the statement in *Woodfall: Landlord & Tenant* (2000) which states at para 7.114 that:

> A cross-claim may be set off against a claim for rent…provided that it arises under the lease itself, or directly from the relation of landlord and tenant, or out of an agreement for lease.

154 His Honour went on to point out, at [37]–[38], that the formulation stated in Issue 35 of *Hill and Redman's Law of Landlord and Tenant* at [3384] is wider than that which appears in Woodfall because it extends to cross-claims:

> which arise not only out of the same contract as the claim (ie the lease), but …where there is a sufficiently close connection between the transaction giving rise to the cross-claim for the equitable doctrine of set-off to apply.

155 Tipping J went on at [39] to say that *Hill and Redman's* formulation is consistent with what was said in *Grant v NZMC* and it was therefore appropriate to adopt that approach:

> which allows a set-off even if the cross-claim does not arise out of the relationship of landlord and tenant, provided there is a 'sufficiently close connection' between the two claims.

156 The judgment of Forbes J in *British Anzani* also supports the proposition that the tenant's cross-claim may give rise to an equitable set-off even if the cross-claim does not arise from the lease itself, or directly from the relationship of landlord and tenant, provided that the claim for rent and the cross-claim arising from another

contract are so closely connected that the principles affecting equitable set-off can be said to apply: see *British Anzani* at 154–155.

157 Although some of the authorities to which Forbes J referred in support of that proposition employed language which departed from the orthodox principle stated in *Rawson v Samuel*, it seems to us that the proposition which Forbes J distilled from the authorities is correct.

158 This may be seen from the emphasis which Forbes J put upon the essential attribute that the equity must "go to the root" of the plaintiff's claim and that it must impeach the title to the legal demand: see *British Anzani* at 145, 152 and 156.

159 His Lordship's approach is consistent with the formulation of the principle stated in *Hill and Redman's Law of Landlord and Tenant* and with the approach adopted by the New Zealand Court of Appeal in *Grant v NZMC* and *Hamilton*; see also *Popular Homes Ltd v Circuit Developments Ltd* [1979] 2 NZLR 642 at 658–659.

160 The cross-claim in *British Anzani* arose out of an agreement which Forbes J held to be sufficiently connected with the lease of a warehouse as to impeach the title to the demand for rent.

161 By contrast, in *Hamilton*, the cross-claim arose out of a separate contract under which the tenant agreed to refurbish other premises. There was no "practical or conceptual linkage" between the claim for rent and the claim for damages for breach of the contract for refurbishment. That was why the title to the demand for rent was not impeached and the distinction between equitable set-off and counterclaim would have been "blurred almost to the point of extinction" if the tenant were permitted to maintain a set-off.

162 The discussion in Derham's *The Law of Set-Off* (Oxford University Press, 3rd ed, 2003) at [5.57] of the cases in which equitable set-off against rent has been permitted also support the proposition that the doctrine is not limited to cross-claims arising under the lease.

163 Similarly, the extensive discussion of the authorities by Woodward J in *Galambos* suggests that the cross-claim need not arise under the original contract so long as there is a "direct connection" between the claims. That approach appears to be accepted by the authors of the 4th edition of *Meagher, Gummow and Lehane's Equity: Doctrines and Remedies* at 1054 [37-040].

Whether FEAP was entitled to maintain an equitable set-off

164 In coming to the view that equitable set-off could be maintained in the present case, the learned primary judge correctly described the relevant test in accordance with the principles stated above.

165 His Honour was of the view that the "relevant impeachment" exists in this case notwithstanding that the claim for rent and the cross-claim under the letter of commitment do not arise out of the same transaction. This was because, as he said at [45], the stated purpose of the letter of commitment was to enable FEAP to meet its ongoing financial obligations, of which, no doubt, FEAP's largest recurring obligation was to pay rent.

166 We agree that, as a matter of principle, a claim made by FEAP under the letter of commitment could be capable of impeaching a demand made by FEA against FEAP for the payment of rent.

167 This is because, even though the claim under the letter of commitment does not arise under the lease, or out of the relationship of landlord and tenant, the evident purpose of the letter of commitment was to enable FEAP to meet financial obligations such as the demand for rent made by FEA.

168 It would follow from this that, depending upon all the circumstances relating to the claim by FEA for rent, and the cross-demand by FEAP for funds to meet its financial obligations, the cross-demand could impeach the claim for rent.

169 However, the difficulty which arises in the present matter is that the facts that were in evidence before the primary judge did not enable his Honour to draw the

conclusion that the necessary impeachment of the title to the legal demand for rent was made out.

170 The title to the legal demand was to be found in the claim by FEA for payment of rent for the month of August 2010. Notice of Default was served for the outstanding rent for that month. In addition, there was evidence in Mr Norman's affidavit that rent was owing by FEAP to FEA for the months of May, June and July 2010, although the affidavit is silent as to whether default notices were issued for those months.

171 As a minimum, what was required for FEAP to impeach the title to FEA's demand for the month of August was a claim by FEAP on FEA for sufficient funds to meet such of its ongoing financial obligations, or to satisfy such of its cash needs requirements, as consisted of its obligation to pay rent to FEA for that month.

172 But the only evidence relied upon by FEAP as giving rise to such an obligation on the part of FEA was the claim made in general terms for $5.5 million for each of the months of April and May 2010 made in the solicitors' letters of 29 April 2010 and 5 May 2010.

173 It seems to us to be clear that these claims made by FEAP under the letter of commitment did not go to the root of, were not essentially bound up with, and did not impeach the title of FEA to make its legal demand for rent for the month of August 2010.

174 This is because the evidence before the primary judge did not show what financial obligations or cash needs were encompassed within the request for $5.5 million for each of the months of April and May 2010.

175 It is true that the primary judge considered that the payment of rent was FEAP's largest obligation, or at least its largest recurring obligation. It is also true that the evidence in the table in Mr Norman's affidavit suggests that the rent payable by FEAP to FEA, FEA Carbon and Tasmanian Plantations amounted to less than $1

million so that, if FEA had paid FEAP the full amount of $5.5 million as requested, there would have been more than sufficient funds to meet other creditors.

176 The difficulty in drawing that conclusion is that the evidence does not establish what other creditors FEAP needed to pay by way of recurring obligations or to otherwise satisfy its cash needs requirements for April and May 2010, those months being the particular months for which the request for funds was made.

177 We doubt whether, upon its proper construction, the letter of commitment extended to a request by FEAP to FEA to meet all of its ongoing financial commitments or future cash needs without any limit as to the point of time at which those obligations or cash needs arose.

178 More particularly, we doubt whether FEAP was permitted to claim $5.5 million in April or May to meet obligations due to arise in August. Whether or not this was so was not the subject of argument in the appeal and we do not decide the matter by reference to it. Be that as it may, Senior Counsel for FEAP, Dr Pannam QC, accepted that there was no direct evidence that even if the $5.5 million were paid by FEA, then FEAP would have paid the rent commitment to FEA.

179 In our view, it was for FEAP to establish facts and matters which impeached the title to the demand for rent for the month of August. For the reasons set out above, it did not do so.

"Without any deductions whatsoever"

180 It is not necessary for us to decide the question of the meaning and effect of the words "without any deductions whatsoever" because of the view we have reached as to the unavailability of equitable set-off in the present case. However, we will deal briefly with the issue of construction of this phrase.

181 The primary judge followed the approach taken by the Court of Appeal of England and Wales and the New Zealand Court of Appeal rather than the contrary approach adopted in a number of first instance Australian authorities. His Honour did so because he thought it preferable to follow the appellate authorities, although he

said at [48] that if the issue were not covered by authority, it was likely that he would have reached a contrary conclusion.

182 The appellate authorities are *Connaught Restaurants Ltd v Indoor Leisure Ltd* [1994] 1 WLR 501 ("*Connaught Restaurants*") and *Grant v NZMC*. We referred to *Grant v NZMC* in our discussion of the principles underlying equitable set-off.

183 The reasons given by Somers J, who delivered the reasons of the Court, in *Grant v NZMC* at 13 and the reasons of Waite LJ at 509–510 and Neill LJ at 511 (Simon Brown LJ agreeing with both) in *Connaught Restaurants* are stated in slightly different terms but four propositions may be extracted from those authorities.

184 First, a tenant's right of equitable set-off against rent may be excluded by the terms of the lease but clear words are needed to do so: see also *Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd* [1974] AC 689 at 717–718, 723.

185 Second, the word "deduction" is a flexible term, the meaning of which is heavily dependent upon its context.

186 Third, in the absence of contextual considerations to the contrary, the words "without deduction" are not sufficiently clear to exclude a tenant's equitable right of set-off against rent.

187 Fourth, added words of exception or qualification are relevant to the construction of the phrase in question, but they are also subject to the general requirement of clarity.

188 The reasons of Williams J in *Re Partnership Pacific Securities Ltd* [1994] 1 Qd R 410 at 424–425 ("*Partnership Pacific*") are to the same effect as the decisions in *Connaught Restaurants* and *Grant v NZMC*. His Honour found the observations of Mr Andrew Waite in an article, "Disrepair and Set-off of Damages against Rent: The Implication of *British Anzani*" [1983] *The Conveyancer and Property Lawyer* 373 to be compelling. There, the author stated that a phrase such as "without any deduction"

is inapt to cover equitable set-off, which is a true defence that requires impeachment of title so that rent is no longer due.

189 The authorities pointing against that approach are collected by Murphy J in *Sandbank Holdings Pty Ltd v Durkan* [2010] WASCA 122 at [35] ("*Sandbank*"). His Honour there set out the line of authority for the proposition that the words "clear of all deductions" and cognate phrases such as "without deductions" are to be given their literal and ordinary meaning, and that they exclude any right of set-off or recompense.

190 His Honour went on to refer to the other line of authorities, namely *Connaught Restaurants, Grant v NZMC* and *Partnership Pacific* which stand for the proposition that the word "deduction" does not, on its own, embrace equitable set-off.

191 In *Sandbank* it was not necessary for the Western Australian Court of Appeal to resolve the divergence of authority because the words used, namely "without set-off (whether arising at law or in equity)" and in addition "free and clear of all deductions whatsoever", were unambiguous and precluded any potential for equitable set-off against liability for rent: see *Sandbank* at [36].

192 Perhaps the clearest statement of the line of authority in favour of the proposition that the words "without deduction" exclude set-off is to be found in the observation of Bryson J in *Batiste v Lenin* (2002) 10 BPR 19,441 ("*Batiste v Lenin*"). His Honour there said that in his opinion the literal meaning of those words make it clear that there is no room for reliance on any right of recoupment and the purpose of the words is to prevent the tenant from relying on rights or claims to be entitled to set-off, recoup or otherwise withhold payment of rent. He also said at [105] that:

> if the use of the words "without deduction" did not achieve this result I cannot see what they would achieve as the ordinary obligation of a debtor is to pay the whole debt.

193 An appeal from Bryson J's orders was dismissed: *Batiste v Lenin* (2002) 11 BPR 20,403. However, Sheller JA (with whom Giles JA and Santow JA agreed) said at [49] that he was not persuaded that Bryson J's view of the meaning of "without deduction" was correct, although he did not go on to decide the question.

194 The weight of appellate authority therefore does not support the view that "without deduction" excludes equitable set-off. Nevertheless, we see considerable force in the remarks of Bryson J set out above.

195 In any event, the words in question in the present case are, "without any deductions whatsoever". In accordance with the principles stated by Waite LJ in *Connaught Restaurants* at 510, the word "whatsoever" is an added word of exception which is relevant to the construction of the phrase used in the leases.

196 As Mason J observed in *Progressive Mailing House Pty Ltd v Tabali Pty Ltd* (1985) 157 CLR 17 at 29, the balance of authority in Australia and overseas is that the ordinary principles of contract law apply to leases.

197 The modern approach to construction of commercial contracts is to interpret them in a way which is consistent with business commonsense: *Investors Compensation Scheme Ltd v West Brunswick Building Society* [1998] 1 WLR 896 at 912–913 per Lord Hoffman. Lord Hoffman's remarks were quoted with approval by Gleeson CJ, Gummow and Hayne JJ in *Maggbury Pty Ltd v Hafele Australia Pty Ltd* (2001) 210 CLR 181 at [11].

198 The principle of objectivity in the interpretation of contracts stated by the High Court is to the same effect. It emphasises that the meaning of the words is to be determined by what a reasonable person would understand by the language in which the parties have expressed their agreement, in the light of the surrounding circumstances and object of the transaction: *Pacific Carriers Ltd v BNP Paribas* (2004) 218 CLR 451 at [22]; *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd* (2004) 219 CLR 165 at [42]; see also *International Air Transport Association v Ansett Australia Holdings Ltd* (2008) 234 CLR 151 at [8] per Gleeson CJ.

199 When considered in light of these principles, it is difficult to see how the words "without any deductions whatsoever" are consistent with an entitlement to maintain an equitable set-off. A commonsense businesslike approach to the construction of what reasonable people would understand by this expression is that

the parties intended that FEAP could not make any deduction of any kind from rent, including a deduction by way of equitable set-off.

200 As Bryson J said in *Batiste v Lenin,* when construing the phrase, which did not include the emphatic word "whatsoever", it is difficult to see what else the parties to the lease would have achieved by the use of this phrase.

201 Accordingly, even if we were of the view that FEAP could, on the facts of the case, assert an equitable set-off, we would have concluded that its entitlement to do so was excluded by the phrase "without any deduction whatsoever".

202 We should add that, in an appropriate case, the apparent harshness of such a result may be ameliorated by the well developed jurisdiction of equity to relieve against forfeiture for non-payment of rent: *Legione v Hateley* (1983) 152 CLR 406; *Meagher, Gummow & Lehane's Equity: Doctrines and Remedies* (Butterworths, 4th ed, 2002) at [18-025].

The Position of the Growers

203 The transcript of argument before the primary judge makes it clear that FEA Growers Group Inc ("Growers") was joined as a representative of the interests of the Growers so as to enable them to be heard on matters which affected them and, in particular, because their interests as sub-lessees or sub-sub-lessees may be affected.

204 The Growers' submissions in the appeal went to a number of issues, including the constraints upon directions that may be given on an application such as the present which sought to invoke s 424 of the Act.

205 The submissions of the growers generally supported those put forward by FEAP on the issues we have considered above and it is therefore unnecessary to say anything further about those issues.

206 However, the growers also sought to rely upon a notice of contention which purported to support the decision of the primary judge on a number of separate grounds.

207 Those grounds included the contention that the receivers have duties to the growers as well as a contention that FEA is estopped from impeding the rights of the growers to tend and harvest the timber.

208 Those contentions are misconceived. First, in a related matter *Norman v FEA Plantation Ltd* (2010) 191 FCR 39, Finkelstein J determined that the Receivers do not owe duties to the growers under s 601 FD(1)(c) of the Act. His Honour also determined that, even if the Receivers were under the duties imposed by s 601FD(1), that would not assist the growers because a duty to act in the best interests of the growers could not be a justification for the responsible entity or its officers to ignore bargains freely entered into: see also in that regard *Re Exceel; Worthley v England* (1994) 52 FCR 69 at 86–87; *Australian Securities and Investment Commission v Lanepoint Enterprises Pty Ltd* (2006) 64 ATR 524 at [39]; *Forest Marsh Pty Ltd v Pleash* (2011) 82 ACSR 164 at [81]. The growers were a party to that application and did not appeal from his Honour's orders. Moreover, we are not persuaded that his Honour erred in the ultimate conclusion to which he came.

209 Second, although the claim of estoppel was not developed during the course of the argument in the appeal, it is difficult to see how any representational conduct by FEAP could found an estoppel binding on the Receivers, whose primary duty was to their appointer, exercising powers under independently agreed financial arrangements. But, apart from this, we are unable to see from the example to which we were taken that FEAP made any statement or representation that would found an estoppel preventing the exercise of rights under the security documents.

210 The growers' other contentions rested upon the proposition that they have an interest in the land in the form of a profit-à-prendre.

211 That issue does not in our view arise in the present matter. We do not see that the finding we have made that FEAP is not entitled to assert an equitable set-off against its liability for rent for the month of August 2010 by reason of its cross-demand under the letter of commitment prejudices the enforcement of the rights of the growers, whatever they may be.

212 We see no reason to make orders in terms of those made in *Re Timbercorp Securities Ltd (in liq)* (2009) 74 ACSR 626.

Orders

213 We do not consider it appropriate to make the declarations or directions sought in the Notice of Appeal. In that connection the Receivers seek that:

> 1. The appeal be allowed.
> 2. The judgment be set aside and in lieu thereof there be declarations and directions as follows:
>   (a) A declaration that the First Respondent (**FEAP**) has repudiated, or otherwise breached essential terms of, any leases or sub-leases between Third Appellant (**FEA**) and/or the Fourth Appellant (**Tasmanian Plantation**) and/or the Fifth Appellant (**FEA Carbon**) (as lessor or sub-lessor) and FEAP (as lessee or sub-lessee) including those leases and sub-leases as described in Annexure A (**Leases**).
>   (b) A direction that the First and Second Appellants (**Receivers**) would be justified, and would otherwise be acting reasonably and appropriately, in causing FEA, Tasmanian Plantation and FEA Carbon to accept the repudiation by FEAP of the Leases and terminate them, or to forfeit the Leases.
>   (c) A declaration that the termination or forfeiture of the Leases results automatically in the termination or forfeiture of any profits-à-prendre, forestry rights and charges which are registered by or on behalf of FEAP in respect of the land subject to the Leases.
>   (d) Costs of the appeal and the proceeding below.

214 At the hearing before the primary judge the Receivers advanced three bases on which they alleged that FEAP had repudiated the leases, namely: (1) the failure of FEAP's administrators to confirm that FEAP was bound by and would comply with the leases; (2) the failure of FEAP to pay rent; and (3) FEAP's demonstrated incapacity to comply with its lease obligations. The primary judge rejected each of these bases and dismissed the proceeding with costs.

215 Although we have found that, in relation to the issue of the non-payment of rent, the primary judge erred by accepting that a set-off in equity was available to FEAP, his Honour also found that, irrespective of the availability of a set-off, the non-payment of rent would not, in any event, found a repudiation by FEAP as alleged by the Receivers. The Receivers did not challenge that finding on this appeal; nor did they challenge the other findings made by the primary judge that led his Honour to reject the other bases on which the Receivers had alleged that FEAP had repudiated the leases.

216 The appellants have not therefore demonstrated a case for the making of the declaratory relief or direction that they seek.

217 However, we would be prepared to make a declaration in the following terms:

> A declaration that FEAP is not entitled to maintain an equitable set-off against the rent due to FEA under the internal leases or sub-leases for the month of August 2010 by reason of the claims made pursuant to the letter of commitment by FEAP in letters dated 29 April 2010 and 5 May 2010.

218 We would also set aside the orders made by the primary judge on 24 December 2010.

219 One of the orders made on 24 December 2010 was that costs be reserved. On 3 June 2011, his Honour handed down a further judgment and made costs orders: *Norman, in the matter of Forest Enterprises Australia Ltd (Administrators Appointed) (Receivers Appointed) v FEA Plantations Ltd (Administrators Appointed) (Receivers Appointed) (No 3)* [2011] FCA 624.

220 It seems appropriate that we hear the parties on the question of costs of the hearing at first instance and on the appeal. Submissions may be made in writing.

221 Our preliminary view is that as between FEAP and FEA, costs should follow the event so that FEAP should pay FEA's costs of the proceeding before the primary judge and of the appeal.

222 We would also be inclined to the view that there ought to be no order as to the costs of the Growers at first instance or on appeal.

I certify that the preceding two hundred and twenty-two (222) numbered paragraphs are a true copy of the Reasons for Judgment herein of the Honourable Justices Jacobson, Nicholas and Yates.

Associate:

Dated: 9 August 2011