<u>Voidable Transactions under Division 2 Part 5.7A *Corporations Act*</u>

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INTRODUCTION

1. A liquidator's primary task in carrying out the winding up of a company is simple: get in all the assets available to the company's creditors and pay them out to the persons entitled to those assets according to law.
2. Where the winding up involves an insolvent company, the underlying premise of the winding up is to ensure that unsecured creditors share rateably in the assets available to meet their unpaid debts and claims: the pari passu principle. For all the in-roads, modifications and exceptions made by statute, it remains the guiding principle upon which insolvent administration is based.
3. Of course, the pari passu principle can be applied to the assets of the company on hand at the time of the winding up. However, creditors have an incentive to grab as much as they can before the fateful day, and the company and its controllers have an interest in paying out as much of the company's assets as possible to particular creditors (such as those holding personal guarantees) or to their own benefit, before the company is wound up, to the detriment of the general body of creditors.
4. For centuries, the law has sought to give effect to a broader notion of the pari passu principle by ensuring that some creditors (or other persons) are not unfairly benefited over the general body of creditors by the insolvent company by dealings prior to the winding up.
5. Provisions which permitted the recovery in bankruptcy proceedings of what would now be called unfair preferences have been on the statute books since 1570. Provisions which permitted the recovery in bankruptcy proceedings of what would now be called uncommercial transactions have been in place since 1604.
6. The statutory regime with which we are concerned today is contained in Part 5.7B of the *Corporations Act* 2001 (Cth) entitled "*Recovering property or compensation for the benefit of creditors of insolvent company*". That statutory regime was first introduced into Australian company law in 1993.

7. Prior to that time, the scheme which regulated liquidators' recovery actions was that provided for by s. 565 *Corporations Law* (and its legislative forebears). Section 565(1) *Corporations Law* provided:

> A settlement, a conveyance or transfer of property, a charge on property, a payment made, or an obligation incurred, by a company that, if it had been made or incurred by a natural person, would, in the event of his or her becoming a bankrupt, be void against the trustee in the bankruptcy, is, in the event of the company being would up, void against the liquidator.

8. The effect of this provision was to incorporate the avoidance provisions of the *Bankruptcy Act* into the corporations context. This created ambiguities in the operation of the avoidance provisions in the corporate context.
9. These ambiguities led the Harmer Commission to recommend the introduction of specific avoidance provisions in the then *Corporations Law*. The avoidance regime which now exists in Part 5.7B *Corporations Act* was thereafter introduced in the *Corporate Law Reform Act 1992* (Cth).
10. This explains why there are no cases on the provisions in Part 5.7B before 1993 and why cases from that earlier period in the corporate context are frequently concerned with provisions from the *Bankruptcy Act*.

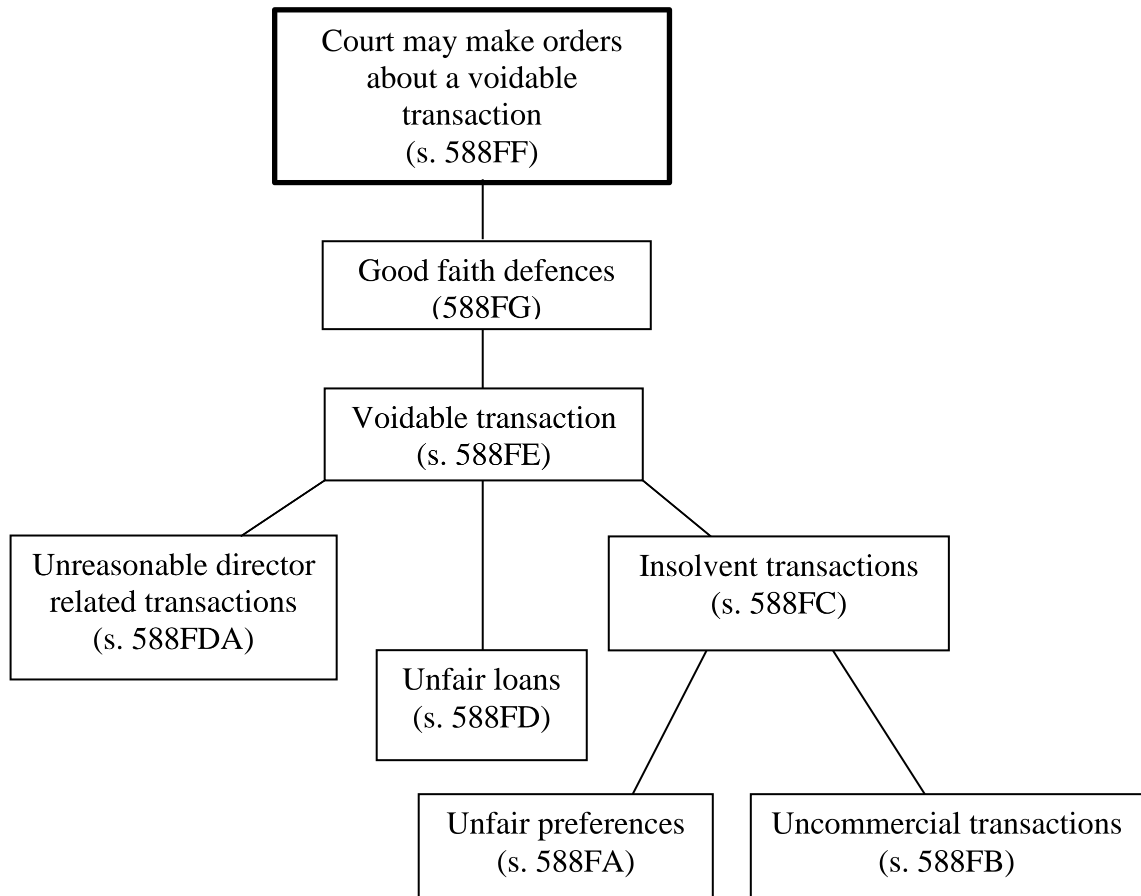
OVERVIEW OF THE STATUTORY REGIME FOR VOIDABLE TRANSACTIONS

11. The statutory regime introduced in 1993 is rather complex. Careful attention has to be paid to the particular structure of the Part and to the particular elements of each cause of action.
12. There are eight Divisions in Part 5.7B.
13. Brent and I will be concerned today with Division 1, entitled "Preliminary", and Division 2, entitled "voidable transactions".
14. There are, however, a number of other important provisions in Divisions 2A to 7. These relate to matters which include:
    (a) The circumstances in which PPSA security interests will vest in a company (Division 2A); and
    (b) Insolvent trading (Divisions 3 to 6).

Scheme of Division 2: Voidable transactions

15. For those who are unfamiliar with Division 2, it might come as a surprise to know that the causes of action conferred on liquidators by the Division are not to recover a

preference or to set aside an uncommercial transaction. Rather, the Division adopts the somewhat unwieldy approach shown in the diagram below:



16. There are a number of matters to note by way of overview.

Single cause of action under s. 588FF

17. The cause of action conferred by Division 2 is not one to set aside a preference or an uncommercial transaction. Strictly speaking, the cause of action is that created by s. 588FF. That section confers power on the Court, on the application of the liquidator, to make one or more of a wide range of orders if satisfied that a transaction is voidable under s. 588FE. Accordingly, the task of the liquidator is to make out all the elements of a voidable transaction under s. 588FE.

Four basic transactions

18. There are four basic kinds of transaction that can comprise a voidable transaction (**specific transactions**):
    (a) An unreasonable director related transaction;
    (b) An unfair loan;
    (c) An unfair preference which is also an insolvent transaction; and
    (d) An uncommercial transaction which is also an insolvent transaction.

19. The specific transactions route to voidable transaction status is as follows:
    (a) For each of the specific transactions, the elements are identified in the specific statutory provisions identified in the flow chart;
    (b) The additional requirement to make an unfair preference or an uncommercial transaction into an insolvent transaction is made out where the company is insolvent at the time of the transaction or becomes insolvent because of the transaction; and
    (c) The additional requirement that makes one of the four specific transactions into a voidable transaction is that the transaction in question occurred after certain dates determined by reference to the "relation-back day".

Timing issues under s. 588FE

20. The relation-back day is usually the date of the filing of the winding-up order or, if the winding up was preceded by some other insolvency administration (such as voluntary administration), the date of the commencement of that administration. Be aware, therefore, that in some circumstances, the identification of the correct relation-back day might require some careful consideration of the journey of the particular company to insolvency. The definition of "relation-back day"[1] refers one to Division 1A of Part 5.6, which contains the detailed provisions applicable.

21. The period in which a transaction may be impeached as a voidable transaction differs for each of the specific transactions:

[1] Section 9 *Corporations Act.*

(a) For an unfair preference, the transaction will be a voidable transaction if the transaction or an act done to give effect to it occurred within 6 months prior to the relation-back day;[2]

(b) For an uncommercial transaction, the voidable period is 2 years prior to the relation-back day;[3]

(c) An unfair loan is a voidable transaction whenever it was entered into; and

(d) An unreasonable director related transaction will be voidable if it is entered into 4 years prior to the relation-back day.

Sections 588FE(4) and (5): Extended periods for insolvent transactions

22. Section 588FE also introduces two additional distinct voidable insolvent transactions by way of identification of extended voidable transaction periods:

(a) Section 588FE(4) provides that an insolvent transaction is a voidable transaction if a related entity of the company was a party to the transaction and it was entered into within 4 years prior to the relation-back day; and

(b) Section 588FE(5) provides that an insolvent transaction is a voidable transaction if the company became a party to it "*for the purpose, or for purposes including the purpose, of defeating, delaying, or interfering with, the rights of any or all of its creditors on a winding up of the company*" and it was entered into within 10 years prior to the relation-back day.

23. There are a couple of points to note about these provisions.

24. **First**, the use of the expression "insolvent transaction" in each of those provisions means that not only will an uncommercial transaction be caught by those provisions, but so will an unfair preference. That is, despite 6 months being the commonly understood period applicable to transactions said to be unfair preferences, this period can be extended to 4 years if a party to the preference was a related entity, and 10 years if the purpose of the unfair preference was interference with the rights of creditors on a winding up. The provisions do not seem to be applied often[4] but it is something to be kept in mind.

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[2] Note s. 588FE(2) applies not to an unfair preference but to an insolvent transaction. This will also include an uncommercial transaction which is an insolvent transaction, though there follow specific provisions which deal with various kinds of uncommercial transaction.

[3] Section 588FE(3).

[4] For some examples where the provisions were discussed see *International Cat Manufacturing Pty Ltd & Anor v Rodrick & Ors* [2010] QSC 30 at [12] and [13]; *Warner v Wong, in the matter of Bellpac Pty Limited (Receivers and Managers Appointed) (In Liq) (No 5)* [2015] FCA 784 at [282] to [299].

25. **Second**, s. 588FE(5) is the method by which the concept of a transaction to defeat creditors is introduced into Division 2. Equivalent provisions exist in s. 228 *Property Law Act 1974* (Qld) and cognate statutory provisions in other states, and in s. 121 *Bankruptcy Act 1966* (Cth). Section 228 applies where there is an "*alienation of property...with intent to defraud creditors*". Section 121 uses the concept of purpose and is in generally analogous terms to s. 588FE(5).[5]

26. There are numerous authorities dealing with these provisions and their scope and application, particularly the character of the state of mind required.[6] While similar issues arise in all three, and cases on the other provisions can assist in the interpretation and application of the Corporations Act provision, careful attention must be paid to the particular form of the statutory provision.

27. One particular difference between s. 588FE(5) and those other provisions is that s. 588FE(5) requires the liquidator to prove that the company was insolvent at the time the transaction was carried out. It is not enough to prove that it was carried out with the purpose of defeating or delaying creditors. It is difficult to see why this additional requirement is appropriate if the purpose to defeat or delay creditors is established. It adds to the difficulty of establishing this kind of voidable transaction. It might explain why s. 588FE(5) does not appear as decisive in many decided cases.

28. The problem was addressed to some extent by the introduction of s. 588FDA which makes unreasonable director related transactions voidable transactions without the requirement of proving insolvency.

Section 588FF: Orders about voidable transactions

29. Section 588FF(1) provides that on the application of the liquidator, the Court may make one or more of a range of orders where the Court is satisfied that a transaction is voidable under s. 588FE.

30. Section 588FF also identifies the limitation periods applicable to the causes of action conferred by that section. An application under s. 588FF(1) must be brought within 3

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[5] See s. 121(1)(b) *Bankruptcy Act*: this section includes further provisions to assist in demonstrating the purpose identified which are not present in s. 588FE(5).

[6] Leading authorities of recent times include: *PT Garuda Indonesia v Grellman* (1992) 107 ALR 199; *Cannane v J Cannane Pty Ltd* (1998) 192 CLR 557; *Trustees of Cummins v Cummins* (2006) 227 CLR 278 esp. at [36] to [41]; *Jedhar Pty Ltd v Grosse* [2004] QCA 167; *The Beach Retreat P/L & Anor v Mooloolaba Marina Ltd & Anor* [2008] QCA 224; *Chen v Marcolongo* (2009) 260 ALR 353; *Marcolongo v Chen* (2011) 242 CLR 546.

years after the relation-back day or 1 year after the appointment of the liquidator, whichever is the later.[7]

31. However, the *Corporations Act* also recognises that these periods can be insufficient. Section 588FF(3)(b) provides that the limitation period can be extended on application by the liquidator made prior to the expiry of the default limitation period. This requirement must be strictly complied with. It has been authoritatively determined that it covers the field and there is no scope for extensions to be granted under general provisions like s. 1322(4)(d) *Corporations Act*.[8]

32. Applications under this provision must be prepared with care, particularly if a "shelf" order is sought extending time generally, rather than with respect of specific claims. Particular care has to be taken in seeking such a shelf order if there are particular claims of which the liquidator is or should be aware at the time of the application. In that case, notice of the application might have to be given to the relevant potential respondent and orders sought specifically in respect of such potential claims.[9]

588FG: Defences

33. Although referred to as a defence provision, s. 588FG does not use that term. Rather it imposes limitations on the orders which a court can make under s. 588FF. It provides that a court is not to make an order under s. 588FF which materially prejudices the interests of two classes of persons.

    (a) The first class is persons who *were not* parties to the voidable transaction which the liquidator has established. Section 588FG(1) applies to that class of person. It applies where the third party received no benefit or, if they did, the benefit was received in good faith and without reasonable grounds for suspecting insolvency. A non-party does not have to show that they provided consideration for any benefit received.

    (b) The second class is persons who *were* parties to the voidable transaction. Section 588FG(2) applies to that class of person. It applies where the person:

        (i) Became a party to the transaction in good faith without reasonable grounds for suspecting insolvency; *and*

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[7] Section 588FF(3)(a).

[8] *BP Australia Ltd v Brown* (2003) 58 NSWLR 322 at [114]-[129] per Spigelman CJ with whom Mason P and Handley JA agreed; approved in *Gordon v Tolcher* (2006) 231 CLR 334 and [37]-[40]; *Grant Samuel Corporate Finance Pty Ltd v Fletcher* (2015) 317 ALR 301 at [23]-[25].

[9] *Fletcher (as Liquidators of Octaviar Administration Pty Ltd) v Anderson* (2014) 103 ACSR 236 a decision of the NSWCA.

(ii) Provided consideration or changed position in reliance on the transaction.

34. Despite the provision not being cast expressly in the form of a defence, it has been held that the onus of establishing that a person has the benefit of one of the exculpatory provisions lies on the respondent.[10]

KEY CONCEPTS: THE TRANSACTION

35. The concept of a "*transaction of the Company*" lies at the heart of Division 2.[11] The identification of the transaction which is to be analysed is a key step in pleading and proving any claim under s. 588FF.

36. Section 9 *Corporations Act* contains the following definition of "transaction":

> "***transaction***", in Part 5.7B, in relation to a body corporate or Part 5.7 body, means a transaction to which the body is a party, for example (but without limitation):
>
> (a) a conveyance, transfer or other disposition by the body of property of the body; and
> (b) a security interest granted by the body in its property (including a security interest in the body's PPSA retention of title property); and
> (c) a guarantee given by the body; and
> (d) a payment made by the body; and
> (e) an obligation incurred by the body; and
> (f) a release or waiver by the body; and
> (g) a loan to the body;
>
> and includes such a transaction that has been completed or given effect to, or that has terminated. [underlining added]

37. Where the transaction is obvious, i.e. one of the common commercial transactions identified in the definition, there will be no problem in identification.

38. However, more complex commercial arrangements can give rise to the question of whether different dealings between different parties can be consolidated so as to identify a transaction for the purposes of Division 2.[12]

39. Courts have been quite willing to accept that different dealings can be consolidated or taken together to identify a transaction.

40. In *Capital Finance Australia v Tolcher* (2007) 164 FCR 83, a decision of the Full Federal Court, Gordon J (with whom Heerey J agreed) observed:

> 120 As the trial judge said (at [25] and [26]), the term "transaction" is a word of wide connotation. It may include a series of events in a course of dealings initiated by a debtor intended to extinguish a debt: *Kalls Enterprises Pty Ltd (in liq) v Baloglow* (2007) 63 ACSR 557 at [103] and [211]; *Australian Kitchen Industries Pty Ltd v Albarran* (2004) 51 ACSR 604 at [24] and [30] and *Re Emanuel (No 14)* at 299-300. The events can occur at different times and in different forms:

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[10] *Cook's Construction Pty Ltd v Brown* (2004) 49 ACSR 62 at [1] per Young CJ (in Eq) with whom Hodgson and Santow JJA agreed.

[11] Section 588FA (Unfair preferences) and s. 588FD (Unfair loans) do not employ the term, but all other key provisions do.

[12] The definition in s. 9 does not preclude such a course: it is inclusive.

> *Mann v Sangria Pty Ltd [2001] NSWSC 172;* (2001) 38 ACSR 307 at [31] and [41]. The categories are not closed. It is not confined to transactions that are lawful or enforceable. The complexity of modern business relations necessarily requires the court to look objectively at the totality of the relationship between the parties in identifying and characterising the "transaction" for the purposes of the relevant provisions of Part 5.7B of the Corporations Act: *Mulherin v Bank of Western Australia Ltd; McCann v Bank of Western Australia Ltd* [2006] QCA 175 at [126]; *VR Dye & Co v Peninsula Hotels Pty Ltd (in liq)* [1999] VSCA 60; [1999] 3 VR 201 at [39] and *Airservices Australia v Ferrier* [1995] HCA 57; (1996) 185 CLR 483 at 502.

41. A transaction can arise from more than one specific dealing, but by what principle does one determine whether and to what extent separate dealings can be combined?

42. Different authorities provide several guidelines to the answer to this question:

    (a) As Gordon J observes, one must look at "*the totality of the relationship between the parties*";

    (b) Another approach is to identify "*a series of steps or dealings linked by some unifying plan or purpose or which are designed or implemented to meet a particular objective*";[13]

    (c) Dealings which are "*so closely bound together in events and in time that they should be characterised as the same transaction*".[14]

43. The definition provides that the transaction has to be one to which *the company is a party*. This does not require that in a transaction comprised in a number of dealings, the company has to participate in each such dealing.[15]

44. In the end, the question must, in my view, be approached in a purposive manner. This is reflected in the observations of the Full Federal Court in *Re Emanuel (No. 14)*[16] as follows (at 299):

> While s. 9 does not define "transaction", it does through the process of exemplification typify the form of conduct or dealing engaged in by a company that will be characterised as a transaction for its purposes – " a conveyance...of property", "an obligation incurred", "a release or waiver", etc. Common to the examples is the characteristic that the conduct of dealing engaged in by the debtor company has the consequence of effecting a change in the rights, liabilities or property of the company itself.

45. In my view, the guiding concept which will be applied by a Court in determining whether a series of dealings can properly be characterised as a transaction is whether the ultimate effect of those dealings is to affect "*the rights, liabilities or property of the company*". Reasonable minds will differ as to whether a particular series of

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[13] Muir JA in *Mulherin v Bank of Western Australia Ltd; McCann v Bank of Western Australia Ltd* [2006] QCA 175 at [126] applying *Re Emanuel (No 14) Pty Ltd (in liq); Macks v Blacklaw & Shadforth Pty Ltd* (1997) 24 ACSR 292 at 299 to 300 in more general terms than was articulated in that case.
[14] *Mann v Sangria Pty Ltd* 38 ACSR 307 at [41].
[15] This proposition was specifically rejected in *Re Emanuel (No 14)* at 299.
[16] (1997) 24 ACSR 292.

dealings has that effect and whether those dealings have a sufficient relationship with each other to properly be identified as a transaction.[17] If acting for a defendant or respondent in such a case, the vice to watch for is the selective choice by the liquidator of specific dealings out of a range of interconnected dealings directed at demonstrating that a voidable transaction has occurred.

46. It is somewhat artificial to consider the question of whether there is a transaction separate from the contexts where it is most relevant: s. 588FA (dealing with unfair preferences) and s. 588FB (uncommercial transactions).

47. Section 588FA provides that a transaction is an unfair preference if the company and creditor are parties to the transaction (even if someone else is also a party). Section 588FB (and the following provisions) applies to a transaction "of the company" being an uncommercial transaction "of the company" in certain circumstances.

48. There are two points to keep in mind arising from this difference.

49. **First**, for a transaction to give rise to an unfair preference the company and the creditor must be parties to it and the transaction must affect a debtor/creditor relationship between the company and the creditor.[18]

50. **Second**, the requirement under s. 588FB that the transaction be a transaction "of the company" has been held to require not that the company is in any formal sense a party to the transaction, but that the company is bound up in the transaction. Whether it is or not is a question of fact and degree.[19]

51. Finally, it should be kept in mind that the identification of the transaction has a role beyond identifying whether there is an unfair preference, uncommercial transaction or an unreasonable director-related transaction. That is:
    (a) It provides the basis for the identification of the content of the orders which can be made under s. 588FF; and
    (b) It provides the basis for determining whether a preference or uncommercial transaction is an insolvent transaction or a voidable transaction.

52. The latter follows because each of s. 588FC and s. 588FE makes a transaction an insolvent transaction and a voidable transaction respectively, depending on when "*the transaction was entered into, or an act was done for the purpose of giving effect to the transaction*".

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[17] See the difference in view between Lindgren J at [74] and the majority at [124] in *Capital Finance v Tolcher.*
[18] See Gordon J in *Capital Finance v Tolcher* at [117].
[19] *Kalls Enterprises Pty Ltd (In Liq) v Baloglow* (2007) 22 ACLC at [239] per Baston JA and Ipp JA at [212].

(a) For s. 588FC, insolvent transactions, the section requires proof of insolvency at either of those times.

(b) For s. 588FE, the section determines the periods identified in which transactions are voidable by reference to those times.

53. Circumstances might exist in which the formulation of the transaction will impact on whether the transaction is an insolvent or voidable transaction or not. In borderline cases, this will need to be carefully considered.

KEY CONCEPTS: INSOLVENCY

54. An unfair preference and uncommercial transaction will only be voidable if they are insolvent transactions.

55. Insolvent transaction is defined in s. 588FC in the following terms:

> A transaction of a company is an insolvent transaction of the company if, and only if, it is an unfair preference given by the company, or an uncommercial transaction of the company, and:
> (a) any of the following happens at a time when the company is insolvent:
> (i) the transaction is entered into; or
> (ii) an act is done, or an omission is made, for the purpose of giving effect to the transaction; or
> (b) the company becomes insolvent because of, or because of matters including:
> (i) entering into the transaction; or
> (ii) a person doing an act, or making an omission, for the purpose of giving effect to the transaction.

56. A company is insolvent at a particular time if the company cannot establish that it is able to pay all its debts as and when they became due and payable.[20]

57. That provision has been accepted as invoking a cash flow test rather than a balance sheet test.

58. A useful summary of the principles applicable in determining insolvency is given by Palmer J in *Southern Cross Interiors Pty Ltd (in liq) v Deputy Commissioner of Taxation* (2001) 53 NSWLR 213 at [54]:

> [54] In my opinion, the following propositions may now be drawn from the authorities:
>
> i) whether or not a company is insolvent for the purposes of CA s95A, s459B, s588FC or s588G(1)(b) is a question of fact to be ascertained from a consideration of the company's financial position taken as a whole: *Sandell v Porter*, *Pegulan Floor Coverings Pty Ltd v Carter* (1997) 24 ACSR 651 and *Powell v Fryer*;
>
> ii) in considering the company's financial position as a whole, the Court must have regard to commercial realities. Commercial realities will be relevant in considering what resources are available to the company to meet its liabilities as they fall due, whether resources other than cash are realisable by sale or borrowing upon security, and when such realisations are achievable*: Sandell v Porter*, *Taylor v ANZ*, *Newark and Sheahan v Hertz*.

[20] Section 95A(1) and (2) *Corporations Act.*

> iii) in assessing whether a company's position as a whole reveals surmountable temporary illiquidity or insurmountable endemic illiquidity resulting in insolvency, it is proper to have regard to the commercial reality that, in normal circumstances, creditors will not always insist on payment strictly in accordance with their terms of trade but that does not result in the company thereby having a cash or credit resource which can be taken into account in determining solvency: *Bank of Australasia v Hall* (1907) 4 CLR 1514, at 1528*; Norfolk Plumbing* at 615; *Taylor v ANZ* at 784; *Guthrie v Radio Frequency Systems Pty Ltd* (2000) 34 ACSR 572, at 575;
>
> iv) the commercial reality that creditors will normally allow some latitude in time for payment of their debts does not, in itself, warrant a conclusion that the debts are not payable at the times contractually stipulated and have become debts payable only upon demand: *Antico* at 331; *Hall v Aust-Amec* (supra*); Melbase* (supra) at 199; *Carrier* (supra) at 253; *Cuthbertson & Richards Sawmills Pty Ltd v Thomas* (supra) at 320*; Lee Kong* (supra) at 112;
>
> v) in assessing solvency, the Court acts upon the basis that a contract debt is payable at the time stipulated for payment in the contract unless there is evidence, proving to the Court's satisfaction, that:
>
> • there has been an express or implied agreement between the company and the creditor for an extension of the time stipulated for payment; or
>
> • there is a course of conduct between the company and the creditor sufficient to give rise to an estoppel preventing the creditor from relying upon the stipulated time for payment; or
>
> • there has been a well established and recognised course of conduct in the industry in which the company operates, or as between the company and its creditors as a body, whereby debts are payable at a time other than that stipulated in the creditors' terms of trade or are payable only on demand:
>
> *Newark* at 260; *Antico* (supra) at 331; *Melbase* (supra); *Cuthbertson & Richards Sawmills Pty Ltd v Thomas* (supra); *Powell v Fryer* (supra) at 600;
>
> vi) it is for the party asserting that a company's contract debts are not payable at the times contractually stipulated to make good that assertion by satisfactory evidence: *Powell v Fryer* (supra) at 600; *Melbase* (supra); *Cuthbertson & Richards Sawmills Pty Ltd v Thomas* (supra).

59. A useful guide to matters which might indicate cash flow insolvency has been formulated[21] identifying matters such as continuing losses, creditors paid outside terms, enforcement warrants issued and the like.

60. Expert evidence from liquidators or experienced insolvency accountants can be led on the issue of solvency (as to which see observations below), though the matter will ultimately be one for the Court.

[21] *ASIC v Plymin (No. 1)* (2003) 46 ACSR 126 at [386] and *Lewis v Doran* (2004) 50 ACSR 175 at [75].

What is a "debt" under s. 95A?

Unliquidated damages not a debt

61. The current state of the authorities supports the view that unliquidated damages are not debts for the purpose of determining insolvency under s. 95A. That position is worth examining.

62. In *Bank of Australasia v Hall* (1907) 4 CLR 1514, the High Court considered the meaning of the word "debts" in s. 107 of the *Insolvency Act 1874* (Qld). Section 107 provided for the recovery of preferences. It provided:

> Every conveyance assignment gift delivery or transfer of property or charge thereon made every payment made every obligation incurred and every judicial proceeding taken or suffered by any debtor unable to pay his debts as they become due from his own moneys in favour of any creditor or any person in trust for any creditor with a view of giving such creditor a preference over the other creditors shall if a petition for adjudication in insolvency be presented against such debtor within six months after the date of making taking paying or suffering the same and adjudication of insolvency be made on such petition be deemed fraudulent and void as against the trustee of the insolvent appointed under this Act but this section shall not affect the rights of a purchaser payee or incumbrancer in good faith and for valuable consideration. Provided that pressure by a creditor shall not be sufficient to exempt any transaction from the operation of this section.

63. On 7 July 1905, Mr Robertson needed funds to pay wages of miners in his colliery. He obtained the funds from the Bank on the condition, inter alia, that he gave security for a significant existing overdraft facility.

64. At that time, he was involved in proceedings against a Mr Phillipson in which Mr Robertson sued for the balance purchase money for a ship sold to Mr Phillipson and Mr Phillipson counterclaimed for rescission and damages for misrepresentation.

65. On 10 August 1905, judgment was handed down in favour of Mr Phillipson. Mr Robertson then did the equivalent of presenting his own petition. His trustee sought to set aside the security given to the Bank as a preference under s. 107.

66. An issue before the High Court was whether, as at 7 July 1905, Mr Phillipson was unable to pay his debts as they became due, and in particular, whether the claim by Mr Phillipson (which had not reached judgment) should be taken into account.

67. As is the case in the *Corporations Act*, there was no definition of debt in the *Insolvency Act.*

68. It was contended by the Bank that Mr Phillipson's claim was not a debt for the purposes of assessing solvency at 7 July 1905. The Bank contended that only debts in the strict sense (which could support a petition for insolvency) were debts under s. 107.

69. The High Court rejected that contention and included Mr Phillipson's claim in determining insolvency as at 7 July 1905. Separate reasons were given by the four judges in the majority.[22] The reasons advanced for that conclusion were:

(a) Previous authorities had held that in bankruptcy statutes for the avoidance of preferential payments to creditors, a "creditor" meant anyone who could prove in the bankruptcy and that approach was consistent with the policy of the provision; and

(b) A wide construction of the word "debts" should be adopted because such a construction gave effect to the object of the provision for the avoidance of preferences, which requires regard to be had to the positions of all persons who would be entitled to claim on the bankrupt estate.

70. Of particular interest in the second respect were the observations of O'Connor J. His Honour noted that the word debt could be given a wide or narrow meaning. He said (at 1534):

> [Phillipson's] right against the debtor was therefore a right to recover, not a liquidated amount, but an unliquidated amount by way of damages for breach of warranty and fraudulent misrepresentation arising out of the contract. Until determined by judgment of a Court no amount would be actually payable, and no "debt"—using that word in its narrow sense—would be in existence. But there can be no doubt that Phillipson's claim would be a liability provable in the administration of the debtor's estate under sec. 140 of the Act, and the question is, can such a liability be taken into account in considering the debtor's position under sec. 108? During the argument the controversy turned upon what is the proper interpretation of the word "debts." <u>Like all general expressions it is capable of a narrow and a wide interpretation. The former would, strictly speaking, cover only money demands, fixed, liquidated, and payable at the material date. The latter would include such a liability as that of the debtor to Phillipson before the damages had been awarded</u>.

71. His Honour then looked to the purpose of the provision to assess which construction the legislature should be taken to have intended. His Honour concluded that the broader meaning should be adopted. His Honour held:[23]

> The governing circumstance in all three sections [viz. ss 107, 108 and 109 of the Insolvency Act] is the same, namely, that the debtor at the time of the transaction was unable to pay his debts as they became due out of his own moneys. Such a condition of affairs might well be described as impending insolvency, and the policy of the sections would appear to be that at such a crisis the debtor should not be allowed to so deal with his property as to prejudice the interests of those who, in the event of his subsequent insolvency, would be entitled to a share of it in distribution. In charging the Court with the duty of determining whether the debtor's affairs had reached that crisis at the time of the transaction impeached, <u>it surely must have been intended that it should make as real an inquiry into the existence of the debts and of the moneys available to pay them as they became due as a man of business would make if he had to determine the same issue for himself, having due regard to the interests of all those who would be entitled to claim against his estate in the event of adjudication</u>. [emphasis added]

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[22] Per Griffith CJ at 1526-1527, per Barton J at 1531, per O'Connor J at 1533-1537 and per Isaacs J at 1547, 1549.

[23] At 1537.2, but the whole of that page and 1538 are worth reading.

72. The case supports the proposition that under s. 107 *Insolvency Act*, "debts" referred to provable debts in the estate of the bankrupt, including (therefore) claims for damages.

73. This matter was reviewed in *New Cap Reinsurance Corporation Pty Ltd (in Liq) v A E Grant* (2008) 68 ACSR 176. In that case, one question before White J was whether New Cap's reinsurance liabilities should be included when considering whether the company was insolvent under s. 95A. The issue arose because New Cap contended that its obligations under its indemnity policies were obligations in respect of claims for damages and therefore should not be included in the analysis of its solvency.

74. White J rejected New Cap's characterisation of its obligations, but did consider whether, if it was correct, they should be included under s. 95A.

75. White J considered that on the authority of *Hall*, the reinsurance obligations would be taken into account even if they were claims for damages because they would have been provable in a winding up of New Cap.[24]

76. However, his Honour also considered the case of *Box Valley Pty Ltd v Kidd* [2006] NSWCA 26. In that case:

> ...the company alleged to be insolvent traded in grains. The plaintiff was a supplier of grain. It had not been paid. It sued the directors for allowing the company to trade when it was insolvent. The company entered into contracts with the plaintiff to buy grain in late May and early June 2001. At that time it had looming liabilities under contracts which it had already entered into to sell white cottonseed at prices well below the then market price. These contracts were deliverable on 31 July 2001 and 17 August 2001. The company had contracted to supply 35,000 tonnes of white cottonseed at an average price of $182.24. It did not have the white cottonseed to supply and at the relevant dates at which it entered into contracts with the plaintiff, the market price for white cottonseed was $228-$250 a tonne. Its potential liability under its sale contracts was critical to its solvency. The company went into administration on 21 June 2001 when its director formed the view that a fall in the market price to below $184.24 was unlikely.

77. White J summarised the reasoning and result in *Box Valley* as follows:

> 63 Court of Appeal (Bryson and Basten JJA and Gzell J) unanimously held that the fact that the company had an impending liability to pay substantial damages which it would not be able to pay, did not mean that it was unable to pay its debts as and when they became due and payable within the meaning of s 95A. Bryson JA said (at 476-477 [14]):
>
>> "*The debts referred to in the test of solvency in s 95A are only part of the debts or claims provable in winding-up referred to in s 553(1); and for the purposes of s 588G the debts which come under consideration are not be identified in the case of an insolvent company with the debts provable referred to in s 553E. The word "debt" is used in s 95A of the* Corporations Act *without any supporting definition. An entitlement*

[24] See [60]. His Honour adopted Palmer J's view in *Southern Cross Interiors Pty Ltd (in Liq) v DCT* (2001) 53 NSWLR 213 at [32] that the test for insolvency under s. 95A *Corporations Act* did not materially differ from that in earlier Bankruptcy statutes and considered that the same could then be said for s. 95A and s. 107 *Insolvency Act* (Qld) considered in *Hall*.

> *to claim damages for breach of a contractual obligation to sell and deliver goods is not a debt within the ordinary meaning of that word.*"

64 His Honour also said (at 477 [15]), that "... *an obligation ... which when it comes into existence will be an obligation for unliquidated damages, is not a debt*" citing *Shephard v Australia & New Zealand Banking Corporation Ltd* (1996) 41 NSWLR 431 at 443-445; (1997) 15 ACLC 1802 at 1813-1814; *Shepherd v Australia& New Zealand Banking Group* (1996) 14 ACLC 987 at 997; *Hawkins v Bank of China* (1992) 26 NSWLR 562 at 572-578. Those authorities dealt with the expression "*incur a debt*" in s 556 of the Companies (NSW) Code. It appears that Bryson JA considered that the word "debts" in s 95A of the *Corporations Act*, should have the same meaning as it had in the phrase "incurs a debt" in s 556(1) of the Companies (NSW) Code. That section provided, in substance, that a person who was a director of the company, or took part in its management at a time when the company incurred a debt, was guilty of an offence if, at that time, there were reasonable grounds to expect that the company would not be able to pay all its debts as and when they became due. The equivalent provision in the *Corporations Act* is s 588G.

65 If the Court's attention had been drawn to *Bank of Australasia v Hall* the same view may not have been taken that the words "debt" and "debts" should have the same meaning in the *Corporations Act*, whatever the context in which they are used.

66 Basten JA noted (at 488 [61]) that it was not argued that the company incurred a debt by entering into agreements to sell white cottonseed to third parties. His Honour observed that:

> "*As the white cottonseed market rose, the likelihood of default under the sale contracts increased until it became at least highly probable, around 21 June 2001. The likelihood that the Company would therefore become liable to damages for breach of the sale contracts rose to a similar level. However, whilst a breach would have given rise to damages which were unliquidated, it could not be said that the Company had thereby incurred a debt. The position of the Company may, on that approach, have become commercially untenable, but it was not insolvent in the sense defined by s 95A, at any time prior to 15 June 2001.*

67 It would appear from this paragraph that his Honour was of the view that even when the liability for damages had crystallised, the liability to pay damages would not be a debt to be considered for the purposes of s 95A.

68 Gzell J, also referring to *Hawkins v Bank of China*, *Shephard& Ors v ANZ Banking Corporation Ltd & Anor* and to *Sunbird Plaza Pty Ltd v Maloney* [1988] HCA 11; (1988) 166 CLR 245 concerning the distinction between a claim for unliquidated damages for breach of contract and a claim in debt, said (at [73]):

> "*On the authorities, a claim for damages for breach of contract is not a debt for the purposes of the definition solvency and insolvency in the* Corporations Act *2001 (Cth), s 95 A.*"

69 His Honour did not refer to any authority which considered this question in the context of s 95A.

78. His Honour considered that *Box Valley* not only did not consider *Hall* but was inconsistent with it, though his Honour rightly identified that he was bound to follow *Box Valley* and did so.[25] Subsequent authorities have adopted White J's reservations about *Box Valley*, along with his Honour's conclusion that he must follow it.[26]

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[25] At [71].

[26] *Re Centro Properties Ltd* (2011) 87 ACSR 131 at [45]-[46]; *Re FA Gowrie Pty Ltd (Deregistered)* (2011) NSWSC 1061 at [19].

79. Reference must also be made to McDougall J's judgment in *White Constructions v White* (2004) 49 ACSR 220 at [307] to [317], where his Honour (adopting the narrow view identified by O'Connor J) concluded that the claim identified in that case was not a debt to be considered under s. 95A because it was a claim for unliquidated damages. His Honour also did not consider *Hall*.

80. On the basis of these authorities, the state of law appears to be that a claim for damages is not a debt to be taken into account in assessing solvency at a point in time prior to the claim merging in a judgment.

81. It is arguable, however, that this position is unsatisfactory both in respect of authority and reasoning.

82. As to authority, one can cavil with White J's position that there is no sufficient difference between the provision under consideration in *Hall* and the position under s. 95A. In particular, his Honour does not appear to consider that s. 533 *Corporations Act* expressly provides that both debts and claims against the company can be admitted to proof. There does not appear to have been any such express provision in the *Insolvency Act*. It was not referred to by the High Court if there was. This distinction was of importance in the reasoning in *Box Valley*.

83. However, it is desirable that the position of *Hall* be authoritatively determined.

84. As to reasoning, it is arguable that there is something unsatisfactory about the idea that a claim cannot be taken into account in determining solvency if it has not merged in a judgment, no matter how certain the liability is, or how significant the amount. The factual circumstances of *Hall*, *New Cap* and *Box Valley* highlight that unsatisfactory situation.

85. The position that all such claims are excluded as a matter of law from an assessment of solvency sits uncomfortably with O'Connor J's persuasive observation as to how the test for insolvency ought to be approached:

> In charging the Court with the duty of determining whether the debtor's affairs had reached that crisis at the time of the transaction impeached, it surely must have been intended that it should make as real an inquiry into the existence of the debts and of the moneys available to pay them as they became due as a man of business would make if he had to determine the same issue for himself, having due regard to the interests of all those who would be entitled to claim against his estate in the event of adjudication.

Claims based on unjust enrichment

86. There is some recent authority, applying *Box Valley*, to the effect that claims for money based on restitutionary causes of action would also be excluded from an

assessment of solvency under s. 95A. In *In the matter of Lorie Najjar & Sons Pty Limited (in liquidation)* (2013) 94 ACSR 561, Black J was considering whether, in assessing solvency under s. 95A, the Court was required to take into account an obligation on the company in question to pay a contribution to another party which had paid a debt to AMP, which both the company and the other party were liable to pay.

87. Based on *Box Valley*, his Honour concluded it was not. He held:

> **[67]** It is not necessary to resolve these complexities, because, in my view, any liability of the Company to Grenstar in respect of the AMP loan is not presently a debt, is not presently due for payment and the Company is not presently insolvent by reason of any future inability to pay it, if that claim is ultimately brought by Grenstar and established. The test for solvency is set out in s 95A of the Corporations Act, which provides that a person (including a company) is solvent if, and only if, that person is able to pay all the person's debts as and when they become due and payable. Any future claim by Grenstar for equitable contribution or unjust enrichment would be a claim for an unascertained liability and would not deprive the Company of solvency for the purposes of s 95A of the Corporations Act: *White Constructions (ACT) Pty Ltd (in liq) v White* [2004] NSWSC 71 ; (2004) 49 ACSR 220 at [317]; *Box Valley Pty Ltd v Kidd* [2006] NSWCA 26; *Re Centro Properties Ltd* [2011] NSWSC 1171 ; (2011) 87 ACSR 131 at [45]–[46]; *Re F & A Henry (Gowrie) Pty Ltd (deregistered)* above at [19]. The Liquidator did not contend that *Box Valley* was wrongly decided or that I should not follow it. Notwithstanding the reservations expressed by White J in *New Cap Reinsurance Corporation Ltd (in liq) v A E Grant* [2008] NSWSC 1015 ; (2008) 68 ACSR 176, I am bound to follow that decision and I do so.
>
> **[68]** The Liquidator advanced several responses to the issue arising from *Box Valley v Kidd* in additional submissions, after that issue was raised in the course of oral submissions. The Liquidator contended, first, that a fundamental element of a debt is that the amount of the obligation is liquidated and, in that case, it does not matter that the obligation may be contingent. That submission does not assist the Liquidator, since a claim for contribution or unjust enrichment in respect of the repayment of the AMP loan is not a liquidated claim. The Liquidator also points out that a claim against a guarantor in respect of a principal debtor's obligation to repay a sum of money may give rise to a contingent debt: *Hawkins v Bank of China* (1992) 26 NSWLR 562 ; (1992) ACSR 349. While that proposition is correct, it also does not assist the Liquidator, since the AMP loan has been repaid and there is no room for a claim under a guarantee of it and the Company was not a guarantor of the ING debt, to which I refer below. [emphasis added]

88. Things might not be quite as clear as his Honour identifies.

89. **First**, in *Hall*, O'Connor J expressly held that an obligation to repay money in circumstances of total failure of consideration gives rise to a debt.[27]

90. **Second**, to the extent that the reasoning relies on the conclusion that a restitutionary claim is not a liquidated claim, it is open to dispute. At least to the extent that claims based on restitution are still properly characterised as common or money counts, they can be characterised as claims for liquidated sums.[28] However, it is doubtful that such characterisation remains appropriate given that the basis of the money counts was the

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[27] *Bank of Australasia v Hall* (1907) 4 CLR 1514 at 1533.

[28] *Mason and Carter's Restitution Law in Australia* (2nd Edn) at [114]-[119]; *Alexander v Ajax Insurance Co Ltd* [1956] VR 436 at 445 .

implied contract theory, which has been rejected by the High Court.[29] The precise character of a restitutionary claim might still need to be clarified, although there might be no more to it than the observation in *Australia and New Zealand Banking Group Ltd v Westpac Banking Corp*,[30] where the High Court stated at 673:

> The common law right of action may arise in circumstances which also give rise to a resulting trust of specific property or funds or which would lead a modern court to grant relief by way of constructive trust. However, notwithstanding that the grounds of the action for recovery are framed in the traditional words of trust or use and that contemporary legal principles of restitution or unjust enrichment can be equated with seminal equitable notions of good conscience, the action itself is not for the enforcement of a trust or for tracing or the recovery of specific money or property. It is a common law action for recovery of the value of the unjust enrichment and the fact that specific money or property received can no longer be identified in the hands of the recipient or traced into other specific property which he holds does not of itself constitute an answer in a category of case in which the law imposes a prima facie liability to make restitution.

91. However, although the measure of enrichment might be such that in many cases the claim might be characterised as a liquidated sum, it is difficult to fit it into the narrow approach to debt.

92. It is likely to remain the case that restitutionary causes of action would not give rise to debts in the strictest meaning of the term,[31] and therefore that they will not be taken into account under s. 95A while the strict position in *Box Valley* commands the field.

Presumptions to assist proof of insolvency

93. The test for insolvency is deceptively simple. It can be very difficult to prove. There are difficulties of evidence (proving numerous debts or the true state of complex third party legal relationships) and difficulties of law (as to whether, and to what extent, a particular liability ought to be taken into account).

94. Section 588E assists in proving insolvency by creating a rebuttable statutory presumption of insolvency in specific circumstances.[32]

95. The presumptions apply to claims under 588FF and to a number of other statutory causes of action under Part 5.7B including insolvent trading, called "recovery proceedings" in the section.[33]

96. The presumptions on which a liquidator can rely under s. 588E are:

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[29] *Mason and Carter* at [131] to [132].
[30] (1988) 164 CLR 662.
[31] *Rothwells Limited v Nommack (No 100) Pty Limited* [1990] 2 Qd R 85 at 87-88 where McPherson J held that a debt in the strict sense arises from a judgment, a promise to pay under seal or quid pro quo for executed consideration.
[32] The presumptions are identified as being rebuttable in s. 588E(9).
[33] See s. 588E(1).

(a) **First**, by s. 588E(3), if a company is being wound up and:

(i) it is proved to be insolvent on a date within 12 months of the relation-back day; or

(ii) it must be presumed to be insolvent under one of the other presumptions in s. 588E(4) to (8) on a date within 12 months of the relation-back day;

then it will be presumed to have been insolvent from that date until the relation-back day;

(b) **Second**, by s. 588E(4), if a company has breached s. 286(1) or (2) *Corporations Act* by failing to keep adequate accounting records at all or for the required seven year period, it will be presumed to have been insolvent for the period to which the failure relates;

(c) **Third**, by s. 588F(8), if a company has been proved to be insolvent at a particular time in a recovery proceeding, it is presumed that the company was insolvent at that time in another recovery proceeding.

97. Section 588E(4) is subject to three statutory exceptions:

(a) Section 588E(5), which excludes the provision where a contravention of s. 286(1) (obligation to keep financial records) is minor or technical;

(b) Section 588E(6), which excludes the provision where a contravention of s. 286(2) (obligation to retain financial records) is the result of an act of destruction of which a particular respondent is innocent; and

(c) Section 588E(7), which excludes s. 588E(4) in a claim based on an unfair preference (unless the creditor is a related party of the company).

98. Section 588E(8) is in the nature of an exception to the rule that judgment estoppels only arise between parties and their privies.

99. The exceptions to the presumptions and the conditions on their application might on occasions make it nearly as much trouble to establish that the presumption arises as it would have been to prove insolvency, at least where the case for insolvency is compelling.[34]

100. However, in complex cases, resort to the presumption might well be of great assistance. It has the effect of shifting all the difficulties of proof of insolvency from

[34] See for example *Fisher v Divine Homes Pty Ltd* [2011] NSWSC 8 where subtleties as to how inadequate the records were and in what periods defeated the presumption.

the liquidator to the respondent. In a complex and multi-faceted liquidation, the place of s. 588E(8) is something which ought to be considered strategically.[35]

Expert evidence on insolvency

101. The scope and nature of expert evidence to prove insolvency is a substantial topic itself. One matter to highlight, however, is the importance of direct involvement of solicitors and counsel in the development of that evidence.

102. Even experienced insolvency practitioners are not, and cannot be, alive to all the issues which might affect proof of insolvency (such as questions of categorisation of claims as debts, discussed above).

103. Further, even experienced insolvency practitioners might not be skilled at formulating their opinions in a form which is properly focussed on issues, contains clear reasoning and is otherwise admissible, persuasive and useful.

104. In the writer's view, counsel and solicitors ought not to approach preparation of this kind of expert evidence or indeed any expert evidence in a "set and forget" manner, i.e. by washing their hands of the process on delivery of instructions.

105. Lawyers can and should be involved in guiding experts in formulating issues and addressing the correct question and otherwise seeking to ensure that expert opinion is relevant, admissible and *useful*. *Cross on Evidence* [on-line service] states at [29080]:

> What is the role of the legal practitioner in preparing the expert's report? Since an independent expert is expected to be non-partisan, the consultation with the parties' legal advisers which may be proffered to ensure that the report is directed to the issues before the court, must not be permitted to distort the substance of the witness's opinion so that it loses its essential character as an independent report unaffected as to form or content by the exigencies of litigation.[1] By "exigencies of litigation" is meant a desire to procure victory for the side calling the expert at all costs. It is legitimate for legal practitioners to identify the real issues for the expert, to indicate when the report fails to direct itself to the real issues, to point out obscurities and gaps in the reasoning, to indicate that the report fails to distinguish between the assumed facts and the opinion which is supposed to be based on them, and to indicate that the report does not explain how the opinion is substantially based on the expert's specialised knowledge.

106. The point is explained by Lindgren J (in an outburst of obvious frustration) in *Harrington-Smith on behalf of the Wongatha People v State of Western Australia (No 7)* [2003] FCA 893; 130 FCR 424 at [16] to [27]. In that case his Honour was confronted with some 30 reports from historians and social scientists of varying length and quality. Lindgren J said:

> Unfortunately, in the case of many of the experts' reports, little or no attempt seems to have been made to address in a systematic way the requirements for the admissibility of evidence of expert opinion. Counsel protested that, in order to ensure that the requirements of

[35] See the discussion in *McPherson's Law of Company Liquidation* [on-line service] at [11.2050].

admissibility are met, lawyers would have to become involved in the writing of the reports of expert witnesses. In the same vein, counsel said, in supporting the admission of certain parts of a report, that they were written in the way in which those qualified in the particular discipline are accustomed to write.

Lawyers **should** be involved in the writing of reports by experts: not, of course, in relation to the substance of the reports (in particular, in arriving at the opinions to be expressed); but in relation to their form, in order to ensure that the legal tests of admissibility are addressed. In the same vein, it is **not** the law that admissibility is attracted by nothing more than the writing of a report in accordance with the conventions of an expert's particular field of scholarship. So long as the Court, in hearing and determining applications such as the present one, is bound by the rules of evidence, as the Parliament has stipulated in subs 82(1) of the NT Act, the requirements of s 79 (and of s 56 as to relevance) of the Evidence Act are determinative in relation to the admissibility of expert opinion evidence.

…

…in the case of many of the present reports, it is difficult to avoid the impression that no attempt at all has been made to address the criteria of admissibility of expert opinion evidence. The difficulty of my task is increased as a result. My impression is that in some cases, beyond the writing of an initial letter of instructions to the expert, lawyers have left the task of writing the reports entirely to the expert, even though he or she cannot reasonably be expected to understand the applicable evidentiary requirements. Such a course may have been followed because of a commendable desire to avoid any possibility of suggestion of improper influence on the author. But I suggest that the distinction between permissible guidance as to form and as to the requirements of s 56 and 79 of the Evidence Act, on the one hand, and impermissible influence as to the content of a report on the other hand, is not too difficult to observe. It does not serve the interests of anyone, including those of the expert witness, to deny him or her the benefit of guidance of the kind mentioned.

UNFAIR PREFERENCES

Elements

107. A transaction will be an unfair preference under s. 588FA(1) if:

(a) The company and a creditor of the company are parties to a transaction; and

(b) The transaction results in the creditor receiving from the company in respect of an unsecured debt that the company owes the creditor more than the creditor would receive from the company in respect of the debt if the transaction were set aside and the creditor were to prove for the debt in a winding up of the company.

108. A transaction which meets those elements **will** be an unfair preference even if it occurs because of an order of a Court or a direction of an agency.

109. A transaction which meets those elements **will not** be an unfair preference if it comprises part of a running account: s. 588FA(3).

Debtor/creditor relationship

110. Given the approach taken to debts in s. 95A referred to above, one might imagine that the same approach would be taken in s. 588FA to the word debt. Like s. 95A, s. 588FA refers to debt, without any extension to its meaning to "*all claims against the company*" as occurs in s. 553(1).

111. Despite that, however, a broader meaning of debt has been applied to the word in s. 588FA, adopting an approach analogous to the approach identified in *Hall* above, though seemingly without too much soul searching about the issue.

112. In *Capital Finance v Tolcher*[36], a decision of the Full Federal Court referred to above, Gordon J (with whom Heery J agreed)[37] relevantly observed (at [122]):

> The Second Deed, in its terms, imposed an obligation on LSE to make certain payments to Capital Finance on specific dates: see [102] and [103] above. It specified a liquidated sum in money as presently due and owing on a particular date — by LSE to the Capital Companies. "Creditor" is not defined in the Corporations Act. Its meaning is flexible and varies according to its context: see, by way of example, *Environmental & Earth Sciences Pty Ltd v Vouris* (2006) 152 FCR 510 at [40]-[41] and *Dimos v Willetts* (2000) 2 VR 170 at [106]-[108]. In the present context, it can be taken to include persons who had existing rights in relation to monetary claims against LSE and who would be entitled to prove in a winding up of LSE under s 553 of the Corporations Act. The relevant date for ascertaining which persons or entities were creditors who might prove in the winding up was the date the administration commenced: *Re Crawford House Press Pty Ltd* (1995) 17 ACSR 295 at 298 and *Environmental & Earth Sciences* 152 FCR 510 at [41].

113. The current on-line edition of *McPherson's Law of Company Liquidation* also confidently asserts the underlined proposition but the authorities referred to in (other than *Tolcher*) do not consider the point directly.[38] The primary basis for the proposition seems to be that the previous law was as stated in *Tolcher* and that it was not intended to change that law when the 1992 amendments were made.[39]

Is the creditor unsecured?

114. A payment to a creditor will only be caught by s. 588FA if it is a payment to an unsecured creditor.

115. An interesting issue in this regard is whether restitutionary claims not arising from equitable doctrines can be secured debts. Mr Porter confesses that when this came up recently in practice, he asserted that restitutionary claims not based in equitable doctrines were personal claims and therefore did not give rise to proprietary rights.

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[36] (2007) 164 FCR 83.

[37] Lindgren J agreed in Gordon J's conclusion on 588FA in short terms: see [79] to [83].

[38] [11.770] and footnotes 1-3.

[39] See Ormiston JA in *VR Dye v Peninsula Hotels* [1999] 3 VR 201 at [33] to [34].

116. An early decision to the contrary which had been subject to sustained criticism was *Chase Manhattan Bank v Israeli-British Bank (London) Ltd* [1981] Ch 105, which held (at 119) that "*a person who pays money to another under a factual mistake retains an equitable property in it and the conscience of that other is subjected to a fiduciary duty to respect his proprietary right*".

117. That approach had not found favour with commentators. However, in *Wambo Coal Pty Ltd v Ariff,*[40] White J concluded that a claim for money paid under a mistake could give rise to a proprietary remedy based on broader principles applicable to constructive trusts:

> 38 In *Westdeutsche Landesbank Girozentrale v Islington London Borough Council*, Lord Browne-Wilkinson also said (*obiter*) (at 715) that:
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> "*Although I do not accept the reasoning of Goulding J,* Chase Manhattan *may well have been rightly decided. The defendant bank knew of the mistake made by the paying bank within two days of the receipt of the moneys. The judge treated this fact as irrelevant ... but in my judgment it may well provide a proper foundation for the decision. Although the mere receipt of the moneys, in ignorance of the mistake, gives rise to no trust, the retention of the moneys after the recipient bank learned of the mistake may well have given rise to a constructive trust: see* Snell's Equity*, page 193; Pettit,* Equity of the Law of Trusts*; 7th ed (1993) p 193; Metall und Rohstoff AG v Donaldson Lufkin & Jenrette Inc [1990] 1 Qb 391, 473-474.*"
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> 39 The defendant submitted that this reasoning was unconvincing (citing *Meagher Gummow & Lehane's Equity: Doctrine and Remedies* at [14-015] and in any event, was *obiter* and did not form part of the law of England and Wales. The reason for the last proposition is that Lord Browne-Wilkinson said (at 716) that although it might be in accordance with principle to impose a remedial constructive trust on the defendant who knowingly retained property of which the plaintiff had been unjustly deprived, it still remained to be decided whether English law should follow the United States and Canada in adopting the remedial constructive trust.
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> 40 The remedial constructive trust is part of the law of Australia. No such difficulty arises in Australia where the High Court has endorsed the remedial constructive trust in *Muschinsky v Dodds* [1985] HCA 78; (1985) 160 CLR 583 and *Baumgartner v Baumgartner* [1987] HCA 59; (1987) 164 CLR 137 (and see *Bathurst City Council v P W C Properties* [1998] HCA 59; (1998) 195 CLR 566 at [40]- [41]). However, I respectfully doubt whether a trust based on the retention of moneys known to have been paid by mistake would be properly categorised as a remedial constructive trust. Where property is stolen, the property is trust property in the hands of the thief and can be traced into the hands of a third party who receives the property otherwise than as a bona fide purchaser of the legal estate for value without notice. The property is trust property in the hands of the thief because the thief is bound in conscience to hold the property on behalf of its true owner. Whether the trust is characterised as a resulting trust (*Robb Evans of Robb Evans & Associates v The European Bank Ltd* [2004] NSWCA 82; (2004) 61 NSWLR 75 at 100-101), or as a constructive trust (*Westdeutsche Landesbank v Islington London Borough Council* per Lord Browne-Wilkinson at 716), the trust is of an institutional rather than a remedial character. It arises because the conscience of the thief is bound.
>
> 41 In the same way, where property is acquired by fraud and there is a complete failure of consideration, the trust arises immediately on the receipt of the property (*Orix Australia Corporation Ltd v Moody Kiddell & Partners Pty Ltd* [2005] NSWSC 1209 at [155]- [156] and cases cited). So, in *Neste Oy v Lloyds Bank plc* [1983] 2 Lloyd's Rep 658, referred to with apparent approval in *Re Goldcorp Exchange Ltd* [1995] 1 AC 74 at 104, where the payee

[40] (2007) 63 ACSR 429.

received payment from its principal of moneys which were not impressed with an express trust, but which were to be used in performance of a contract which the payee knew could not take place, the payee held the payment on trust for the payer from the time of its receipt. The circumstances which created the trust in *Neste Oy* were that the payee knew (as was the fact) that there could be no performance under its contract, so that there was a total failure of consideration for the payment, and the payment could not in conscience be retained. The trust was an institutional trust which attached to the moneys from the time of receipt.

42 I do not see why, in principle, a constructive trust arising from the retention of moneys known to have been paid by mistake, and for which there was no consideration, would not arise from the time the payee acquired such knowledge, if the moneys paid could still be identified at the time such knowledge was acquired. Such a trust is as much an institutional trust as a trust imposed on property in the hands of the thief.

118. This decision has been cited and applied in later cases, but without further detailed reasoning.[41] The approach of Lord Browne-Wilkinson relied upon has itself been the subject of criticism.[42] The possibility of a proprietary remedy for payments made under mistake on this basis was however contemplated by the High Court in *ANZ v Westpac* at 673. The full analysis of this issue is one which could absorb a paper by itself. For present purposes, it is noted as an area where an unexpected assertion that a creditor is secured might arise.[43]

Running Account: s. 588FA(3)

119. Where a debtor company has had a continuing business relationship with a creditor (which is reflected by the operation of a running account), difficulty in identifying preferential treatment can arise. Section 588FA(3) *Corporations Act* attempts to deal with these difficulties. It provides:

(3) Where:

(a) a transaction is, for commercial purposes, an integral part of a continuing business relationship (for example, a running account) between a company and a creditor of the company (including such a relationship to which other persons are parties); and

(b) in the course of the relationship, the level of the company's net indebtedness to the creditor is increased and reduced from time to time as the result of a series of transactions forming part of the relationship;

then:

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[41] See, for example, *Horticulture Innovation Australia Ltd v Westley* [2015] NSWSC 1292 at [54], *Riverwood Legion & Community Club Ltd v Repaja & Co Pty Ltd* [2015] NSWSC 383 at [11] and *Focus Metals Pty Ltd v Babicci & Anor* [2014] VSC 380 at [112] and [113]; *Credit Union Australia Ltd v Lyons* [2009] NSWSC 118

[42] *Meagher Gummow and Lehane's Equity: Doctrines and Remedies* (4th edn) at [14-010].

[43] See also the judgment of Muir JA in *Williams v Peters* [2010] 1 Qd R 475 which concerned a claim in respect of an unfair preference relating to mistaken payments in which a trust was alleged by the respondent, but the case was decided on the basis that if a trust could have arisen, it did not because the payment was made into an overdraft account.

> (c) subsection (1) applies in relation to all the transactions forming part of the relationship as if they together constituted a single transaction; and
>
> (d) the transaction referred to in paragraph (a) may only be taken to be an unfair preference given by the company to the creditor if, because of subsection (1) as applying because of paragraph (c) of this subsection, the single transaction referred to in the last-mentioned paragraph is taken to be such an unfair preference.

120. The effect of s. 588FA(3) can be summarised as follows: a group of transactions on a running account that occur during the relevant period (usually six months ending on the relation-back day) are to be viewed as constituting a single transaction and each individual transaction will only be regarded as an unfair preference to the extent that the "single transaction" constitutes a preference by virtue of the provisions of s. 588FA(1).[44]

121. The former version of s. 588FA(3)[45] was considered by the High Court in *Airservices Australia v Ferrier* (1996) 185 CLR 483 . In that case the appellant creditor (Airservices) was a public authority which supplied transport and navigational services to Compass, the debtor airline. At the beginning of each month, Airservices would debit Compass' account for services rendered the preceding month – often including extra amounts as penalties for late payments of earlier invoices. The services were vital for the continued operation of the airline. Indeed, despite Compass' indebtedness to Airservices continuing to grow substantially during the preference period, the parties' arrangement remained largely unchanged.

122. The High Court held that this arrangement was a "running account". The majority (Dawson, Gaudron and McHugh JJ) said (at 502-503):

> If a payment is part of a wider transaction or a "running account" between the debtor and the creditor, the purpose for which the payment was made and received will usually determine whether the payment has the effect of giving the creditor a preference, priority or advantage over other creditors. If the sole purpose of the payment is to discharge an existing debt, the effect of the payment is to give the creditor a preference over other creditors unless the debtor is able to pay all of his or her debts as they fall due. <u>But if the purpose of the payment is to induce the creditor to provide further goods or services as well as to discharge an existing indebtedness, the payment will not be a preference unless the payment exceeds the value of the goods or services acquired. In such a case a court, exercising jurisdiction under s 122 of the Bankruptcy Act, looks to the ultimate effect of the transaction. Whether the payment is or is not a preference has to be "decided not by considering its immediate effect only but by considering what effect it ultimately produced in fact".</u>
>
> As a consequence, a payment made during the six month period cannot be viewed in isolation from the general course of dealing between the creditor and the debtor before, during and after that period. Resort must be had to the business purpose and context of the payment to determine whether it gives the creditor a preference over other creditors. <u>To have the effect of giving the creditor a preference, priority or advantage over other creditors, the payment must</u>

[44] *Olifent v Australian Wine Industries Pty Ltd* (1996) 19 ACSR 285.

[45] Being s. 565 of the *Corporations Law 1995* (Cth) which incorporated the relevant section from the Bankruptcy Act as explained in paragraph 7 above.

> ultimately result in a decrease in the net value of the assets that are available to meet the competing demands of the other creditors …
>
> If at the end of a series of dealings, the creditor has supplied goods to a greater value than the payments made to it during that period, the general body of creditors are not disadvantaged by the transaction — they may even be better off. The supplying creditor, therefore, has received no preference … If the effect of the payments is to reduce the initial indebtedness, only the amount of the reduction will be regarded as a preferential payment.
>
> …
>
> …Even where payments are expressly made for the purpose of reducing a debt earlier incurred as well as for the purpose of obtaining further goods or services, only the amount representing the reduction of the opening debt for the period will be regarded as a preference. But in such a case, the circumstances of each payment made for the purpose of reducing the debt have to be examined in order to determine the issue under s 122(2)(a), unless it is clear that the creditor's "knowledge in relation to the [debtor's] solvency and in relation to the effect of any permanent reduction in the [debtor's] indebtedness … was the same throughout the period". (emphasis added, footnotes omitted)

123. Their Honours[46] then explained the essential features of a "running account" saying (504-506):

> A running account between traders is merely another name for an active account running from day to day, as opposed to an account where further debits are not contemplated. **The essential feature of a running account is that it predicates a continuing relationship of debtor and creditor with an expectation that further debits and credits will be recorded**. Ordinarily, a payment, although often matching an earlier debit, is credited against the balance owing in the account. Thus, a running account is contrasted with an account where the expectation is that the next entry will be a credit entry that will close the account by recording the payment of the debt or by transferring the debt to the bad or doubtful debt a/c.
>
> If the record of the dealings of the parties fits the description of a "running account", that record will usually provide a solid ground for concluding that they conducted their dealings on the basis that they had a continuing business relationship and that goods or services would be provided and paid for on the credit terms ordinarily applicable in the creditor's business. When that is so, a court will usually be able to conclude that the parties mutually assumed that from a business point of view each particular payment was connected with the subsequent provision of goods or services in that account. Sometimes, however, the transactions recorded in the account may be so sporadic that a court cannot conclude that there was the requisite connection between a payment and the future supply of goods even though the account was kept "in the ordinary form of a running account in which debits and credits are recorded chronologically and in which payments are not shown as attributable to any particular deliveries but are brought generally into credit" (emphasis added, footnotes omitted)

124. The High Court's reasoning in *Airservices Australia v Ferrier* has been adopted on a number of occasions with specific reference to s. 588FA(3). As Nettle JA (with whom Neave and Redlich JJA agreed) said in *Sutherland v Lofthouse* (2007) 214 FLR 157 at 166 at [34]:

> As Ormiston JA explained in V R Dye & Co v Peninsula Hotels Pty Ltd (in liq) [1999] 3 VR 201 at 210], the section represents an application to the winding up of companies in insolvency of the implied exception as to running accounts to s 122 of the Bankruptcy Act 1966 (Cth). As such it embodies the principles reflected in Richardson v Commercial Banking Co of Sydney Ltd (1952) 85 CLR 110], Queensland Bacon v Rees (1966) 115 CLR 266] and Airservices Australia v Ferrier (1996) 185 CLR 483]. That means that, in determining whether

[46] Per Dawson, Gaudron and McHugh JJ.

> a payment constitutes a preference for the purposes of s 588FA(3), the effect of a payment on the other creditors must be ascertained objectively…

125. Although s. 588FA(3) is often referred to as a "defence", it is now settled that the plaintiff must disprove the defence (if raised) as an essential element of the cause of action in an unfair preference claim. In *Sutherland v Eurolinx* (2001) 37 ACSR 477 at [167], Santow J said:

> Finally, the codification of the so-called running account has become definitional of what is an "unfair preference". That means that, in terms of onus, what was once merely a defence is now an ingredient or element of that which the Plaintiff liquidator must prove in establishing whether it is a preference (and its dimension). The onus in that sense has shifted to the party attaching [sic] the payments.[47]

126. Thus, it can be said that the essential elements of the running account "defence" are:

    (a) A continuing relationship of debtor and creditor such as to establish a "running account". On this point, it is possible for a running account to exist, despite the creditor having reasonable grounds to suspect the insolvency of the company. In *Sutherland v Eurolinx*, Santow J said (at [163] and [164]):

    > …If it be put that actual knowledge of insolvency must invariably terminate the necessary business relationship then I would not accept that proposition. That would presuppose, incorrectly, that a subjective suspicion of insolvency cannot coexist with an assumption of a continuing business relationship between creditor/payee and debtor/payer. That is incorrect as an invariable proposition, on the authority of Airservices Australia. Knowledge of insolvency in that case did coexist for all the payments, including the nine not set aside. The statements of principle by the High Court clearly do admit of that coexistence of knowledge and running account; they make no distinction between subjective and objective knowledge.
    >
    > However, the Plaintiff's qualification may legitimately be put somewhat lower. One may accept that a level of actual suspicion, if it finally reaches actual subjective knowledge of insolvency, may, but not necessarily, lead to the termination of that continuing business relationship and its associated mutual purpose of payment to induce further supply. Thus the fact of such actual knowledge may (but need not necessarily) rebut, as even one of two purposes, that purpose of inducing the creditor to maintain the relationship by providing further supply. An example of the latter case is to be found in the circumstances surrounding the last payment in Airservices Australia itself. There, as I have explained, the latter purpose was subordinated to getting the creditor's money back.

    (b) That payments made to the "running account" are made in the mutual expectation that the creditor will continue to supply the debtor.

127. In proving the second point above, it is necessary to look at the particular circumstances from which the expectation may be inferred since there will (usually) be no express statement by the company that a payment is being made in the

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[47] See also *Clifton (As Liquidator of Adelaide Fibrous Plasterboard Linings Pty Ltd (In Liq)) and Anor v Csr Building Products Pty Ltd* [2011] SASC 103 at [66].

expectation that the creditor will continue supply. As Barwick CJ said in *Queensland Bacon Pty Ltd v Rees* (1966) 115 CLR 266 at 286:

> In my opinion, it is enough if, on the facts of any case, the court can feel confident that implicit in the circumstances in which the payment is made is a mutual assumption by the parties that there will be a continuance of the relationship of buyer and seller with the resultant continuance of the relation of debtor and creditor in the running account, so that, to use the expressions employed in Richardson's case (1952) 85 CLR 110 at 113: "it is impossible" — I interpolate, in a business sense — "to pause at any payment into the account and treat it as having produced an immediate effect to be considered independently of what followed …

128. However, the point at which a running account ceases to exist is when the mutual purpose of inducing further supply is subordinated to a predominant purpose of recovering past indebtedness. In *Sutherland v Eurolinx*, Santow J said (at [147] and [148]):

> That is, the basis of a running account is a continuing relationship between the debtor and creditor with an expectation that further debits and credits will be so incurred.
>
> For that defence to be maintained, there are some essential prerequisites. First, there must be no cessation of that mutual assumption of payment and reciprocal supply throughout the relevant period. Second, those payments must continue to have as at least one operative, mutual purpose, namely inducing further supply. I would add that such purpose must not come to be subordinated to a predominant purpose of recovering past indebtedness. As the decision in Airservices Australia makes clear (see for example the majority judgment at 510), knowledge or even actual suspicion, though it be such as to negate the good faith defence, does not of itself preclude reliance upon the running account defence for a payment so received. What still requires explanation is the implication flowing from the majorities' conclusion that the last payment, and only the last, fell outside the running account defence. This was said to be because the payee in Airservices had demanded payment and received it with knowledge of insolvency. It was therefore held to be "looking backwards rather than forwards, looking to the partial payment of the old debt rather than the provision of continuing services". And this was so, notwithstanding that the supply of services did continue thereafter, probably influenced by safety considerations.

129. In determining whether or not a preference has been given, the correct approach is stated by White J in *Tectron Industries Pty Ltd v Taylor* [2006] SASC 175 at [39]:

> …The effect of the defence is that where, as in this case, persons trade regularly with each other on credit terms and the liability of one rises with each purchase and falls with each payment, one does not…consider each payment in isolation. Instead one looks at the overall effect to determine the extent by which the supplier has been advantaged by the payments. <u>This is done by comparing the highest amount owing during the relation back period with the amount owing at the last day. The difference between these two figures is the amount of the preference.</u> (emphasis added)

130. Finally, it is not necessary for a defendant to establish that a continuing business relationship existed throughout the whole of the relation-back period. While a number of the cases might appear to refer to the running account period as being the same as the relation-back period, that is simply because the running account in those cases happened to have existed for the whole of the relation-back period.

131. Section 588FA(3) does not refer to the term "relation-back period" but rather refers to a "continuing business relationship". The critical period is obviously the period in which a genuine running account functions as part of a "continuing business relationship". Thus in *Sutherland v Eurolinx*, Santow J (at [140]) specifically referred to the running account period as being referrable to the actual period in which the relevant transactions occurred:

> …I would measure the preference, if any, by reference to the period of the relevant transactions constituting the running account, **within the 6 months relation back period**. I would do so by reference to the highest amount owing **during** the relation back period, not necessarily "at the beginning", compared to the amount owing on the last day, following Rees; see also Barlow "Voidable Preference — the High Court Re-considers" (1998) 26 ABLR 82 at 92. (emphasis in original)

132. For the reasons discussed above, it can be discerned that a plaintiff would ordinarily be looking to set aside three types of payments pursuant to s. 588FA(3):

(a) **First**, payments made by a company to a creditor (during the relation-back period) when no "running account" existed;

(b) **Second**, payments made by a company to a creditor (during the relation-back period) following the cessation of a "running account"; and

(c) **Third**, the difference between the highest amount the company owed the creditor during the period of the running account (within the relation-back period) and the amount that the company owed on the last day of that period (which may or may not be the last day of the relation-back period).

UNCOMMERCIAL TRANSACTIONS

Elements

133. A transaction will be an uncommercial transaction if:

(a) The transaction is a transaction of the company; and

(b) It may be expected that a reasonable person in the company's position would not have entered into the transaction.

134. The matter is determined having regard to:

(a) The benefits if any to the company of entering into the transaction;

(b) The detriment to the company of entering into the transaction;

(c) The benefits to other parties to the transaction; and

(d) (Unhelpfully), any other relevant matter.

Nature of an uncommercial transaction

135. A convenient summary of the nature of an uncommercial transaction is as follows:[48]

> 51. In *Demondrille Nominees Pty Ltd v Shirlaw* [1997] FCA 1220; (1997) 25 ACSR 535 at 548, Foster, Lindgren and Madgwick JJ observed that, relevantly, s 588FB of the then *Corporations Law* sought to balance the interests of the unsecured creditors of a company being wound up and those who would otherwise be the beneficiaries of pre-winding up transactions entered into by the company and their purpose was:
>
> > To prevent a depletion of the assets of a company which is being wound up by, relevantly, "transactions at an under-value" entered into within a specified limited time prior to the commencement of the winding up: see explanatory memorandum, para 1014.
>
> Their Honours also observed, by reference to the explanatory memorandum, that a transaction is uncommercial, for the purposes of s 588FB, where there is a bargain of such magnitude that it could not be explained by normal commercial practice: *Demondrille Nominees Pty Ltd v Shirlaw* above at 548; see also *McDonald v Hanselmann* [1998] NSWSC 171; (1998) 28 ACSR 49 at 53; *Skouloudis Group Pty Ltd (in liq) v Planet Enterprizes Pty Ltd* [2002] NSWSC 239; (2002) 41 ACSR 369 at [14]- [15]. In *Lewis v Doran* [2005] NSWCA 243; (2005) 54 ACSR 410 at [136], where Giles JA observed that the description of an "uncommercial transaction" in s 588FB(1) of the *Corporations Act* is directed primary attention to a balancing of benefit and detriment, only in the broadest sense involving undervalue. Whether a reasonable person in the company's circumstances would not have entered into the transaction is determined by an objective inquiry by reference to the factors specified in s 588FB(1): *Tosich Construction Pty Ltd (in liq) v Tosich* (1997) 78 FCR 363 at FCR 367; *Old Kiama Wharf Company (in liq) v Betohuwisa Investments Pty Ltd* [2011] NSWSC 823; (2011) 85 ACSR 87 at [35].

136. Similarly, in *Super Art Australia Pty Ltd v Foden* [2014] FCA 1168, Davies J summarised the relevant principles as follows:

> 44. The principles to be applied under s 588FB were not in controversy and may be summarised as follows:
>
> a. It is an objective standard to determine whether a transaction is uncommercial for the purposes of s 588FB: *Tosich Construction Pty Ltd (in liq) v Tosich* (1997) 78 FCR 363 at 367;
>
> b. Four criteria are to be considered, being the four factors listed in s 588FB: (1) the benefits enjoyed by the company; (2) the detriment to the company; (3) the respective benefits others received; and (4) any other relevant matter;
>
> c. The objective criteria are not considered in some vacuum but by reference to “the company’s circumstances”, which must include the state of knowledge of those who were the directing mind of the company, such as its controlling director or directors: *Tosich* (1997) 78 FCR 363 at 367;
>
> d. For a transaction to be “uncommercial” for the purposes of s 588FB, the transaction must result in “a bargain of such magnitude that it could not be explained by normal commercial practice”: *Demondrille Nominees Pty Ltd v Shirlaw* (1997) 25 ACSR 535; [1997] FCA 1220.
>
> e. The fact that a transaction is entered into when a company is insolvent “is not of itself sufficient to make the transaction an uncommercial transaction within the meaning of s 588FB”: *Buzzle Operations Pty Ltd (in liq) v Apple Computer Australia Pty Ltd* (2010) 238 FLR 384; [2010] NSWSC 233 at [222].

137. Although undervalue lies at the heart of the provision, it does not exhaustively identify the circumstances in which a transaction will meet the statutory test.

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[48] *In the matter of Ashington Bayswater Limited (in Liq)* [2013] NSWSC 1008 per Black J.

Because of the objective character of the inquiry and requirement for an assessment of benefit and detriment (not just value received and paid), it is possible that a transaction which was a genuine arms' length transaction and was considered subjectively to be in the company's interests could nonetheless be found to be uncommercial under the section.[49] And the reverse could also be true, at least in theory.

138. Another matter to keep firmly in mind when applying the objective test is that the test is what a reasonable person would have done *at the time*. Section 588FB will inevitably be applied where there is an insolvency and the temptation will be to see things through that prism. However, "*what a reasonable person would have done must be judged according to the circumstances at the time, including proper perception of the future, but without the influence of hindsight*".[50]

UNREASONABLE DIRECTOR RELATED TRANSACTIONS

139. It is observed above that under Division 2 is it necessary to demonstrate that the uncommercial transaction is also an insolvent transaction before it will be a voidable transaction. This limitation seems inappropriate, particularly where directors have made gifts or entered into undervalue transactions at a time when the company was solvent but which were to their benefit or the benefit of their related entities.

140. That situation was remedied by the introduction of s. 588FDA.

141. That provision identifies, in effect, a sub-category of uncommercial transactions which are voidable transactions without having to be insolvent transactions in particular circumstances.

142. The sub-category of transactions is defined in s. 588FDA(1)(a) which provides that a transaction of the company is an unreasonable director-related transaction if the transaction is:

    (a) A payment by the company;

    (b) A transfer by the company of property of the company;

    (c) An issue of securities; or

    (d) The incurring of an obligation to do any of those things.

[49] *Buzzle Operations Pty Ltd (in Liq) v Apple Computer Australia Pty Ltd* (2011) 29 ACLC 11-024 at [86].
[50] Lewis v Doran (2005) 219 ALR 555 at [159].

143. The particular circumstances in which those transactions are voidable transactions are where such a transaction is to the benefit of a director or close associate of a director, or for their benefit: s. 588FDA(b).

144. If a transaction meets those two limiting provisions, and is otherwise an uncommercial transaction, it will be an unreasonable director related transaction. In that case it will be a voidable transaction if entered into within 4 years of the relation-back day.

UNFAIR LOANS

145. Section 588FD applies to loans in respect of which the interest or charges are "extortionate".

146. In determining whether interest or charges are extortionate regard is had to:
   (a) The risk to which the lender was exposed;
   (b) The value of any security in respect of the loan;
   (c) The term of the loan;
   (d) The schedule for payments of interest and charges and for repayments of principal;
   (e) The amount of the loan; and
   (f) Any other relevant matter.

PARTICULAR ISSUES RELATING TO S. 588FF

Scope of orders which can be made

147. Section 588FF is in the broadest possible terms. It provides:

> **Courts may make orders about voidable transactions**
>
> (1) Where, on the application of a company's liquidator, a court is satisfied that a transaction of the company is voidable because of section 588FE, the court may make one or more of the following orders:
>
> (a) an order directing a person to pay to the company an amount equal to some or all of the money that the company has paid under the transaction;
> (b) an order directing a person to transfer to the company property that the company has transferred under the transaction;
> (c) an order requiring a person to pay to the company an amount that, in the court's opinion, fairly represents some or all of the benefits that the person has received because of the transaction;
> (d) an order requiring a person to transfer to the company property that, in the court's opinion, fairly represents the application of either or both of the following:
> (i) money that the company has paid under the transaction;
> (ii) proceeds of property that the company has transferred under the transaction;
> (e) an order releasing or discharging, wholly or partly, a debt incurred, or a security or guarantee given, by the company under or in connection with the transaction;

> (f) if the transaction is an unfair loan and such a debt, security or guarantee has been assigned--an order directing a person to indemnify the company in respect of some or all of its liability to the assignee;
> (g) an order providing for the extent to which, and the terms on which, a debt that arose under, or was released or discharged to any extent by or under, the transaction may be proved in a winding up of the company;
> (h) an order declaring an agreement constituting, forming part of, or relating to, the transaction, or specified provisions of such an agreement, to have been void at and after the time when the agreement was made, or at and after a specified later time;
> (i) an order varying such an agreement as specified in the order and, if the Court thinks fit, declaring the agreement to have had effect, as so varied, at and after the time when the agreement was made, or at and after a specified later time;
> (j) an order declaring such an agreement, or specified provisions of such an agreement, to be unenforceable.
>
> (2) Nothing in subsection (1) limits the generality of anything else in it.
>
> (3) An application under subsection (1) may only be made:
>
> (a) during the period beginning on the relation-back day and ending:
> (i) 3 years after the relation-back day; or
> (ii) 12 months after the first appointment of a liquidator in relation to the winding up of the company;
> whichever is the later; or
> (b) within such longer period as the Court orders on an application under this paragraph made by the liquidator during the paragraph (a) period.
>
> (4) If the transaction is a voidable transaction solely because it is an unreasonable director-related transaction, the court may make orders under subsection (1) only for the purpose of recovering for the benefit of the creditors of the company the difference between:
>
> (a) the total value of the benefits provided by the company under the transaction; and
> (b) the value (if any) that it may be expected that a reasonable person in the company's circumstances would have provided having regard to the matters referred to in paragraph 588FDA(1)(c).

148. This provision gives the Court plenary power to adjust the legal position between a company and a party to a voidable transaction.

149. Note in particular s. 588FF(1)(d): that provision creates, in the writer’s view, a statutory right equivalent to tracing. Whether it picks up the established rules of tracing does not appear to have been considered.[51]

150. Some procedural issues arising from this provision are considered next.

The correct applicant

151. Under the previous recovery regime there had been some doubt as to the correct applicant in statutory recovery proceedings: the liquidator in his or her own right, the liquidator suing as agent of the company or the company in liquidation itself.

[51] A brief review found little authority was found on the use of this provision. Brereton J in *In the matter of Great Wall Resources Pty Ltd (in liq)* [2013] NSWSC 354 described the provision as giving the Court the power to “craft a propriety remedy”. But no order was made in that case. Windeyer AJ in *Bellach v Chamberlain* [2011] NSWSC 528 at [20] contemplated using the provision to transfer a sum of money arising by reason of a resulting trust in that case, but refused to do so.

152. Section 588FF removed that ambiguity, conferring standing to bring an application for relief under that section on the liquidator.[52] However, in many cases the orders made in a successful application under s. 588FF will affect the interests and property of the company by adjusting transactions and requiring payments to and sometimes by the company. Further, even where the Court decides to order a simple payment of money, i.e. under 588FF(1)(a), the payment must be made to the company. The liquidator does not obtain property in the payment.[53]

153. It is therefore arguable, at least, that in most cases the company ought to be a party.

154. Not much seems to turn on inclusion of the company as a party. It is suggested in *McPherson* that it will affect the position on security for costs, though that seems unlikely as a general rule for reasons to be dealt with next.

Security for costs

155. As a starting proposition, it is relevant to note that courts have traditionally adopted different approaches to individual parties and corporate parties when it comes to security for costs. The approach was summarised by Megarry VC in *Pearson v Naydler* (1977) 1 WLR 899 at 904 as follows:

> In relation to security for costs, there seems to me to be an essential distinction between natural persons and limited companies as plaintiffs. For a natural person, the basic rule is that he will not be ordered to give security for costs, however poor he is... In the case of a limited company, there is no basic rule conferring immunity from any liability to give security for costs. The basic rule is the opposite...

156. In the case of *Green (as liquidator of Arimco Mining Pty Ltd) v CGU Insurance Ltd* [2008] NSWCA 148, Hodgson JA (with whom Campbell JA agreed) set out the considerations relevant to ordering security against a liquidator (at [45] and [46]):

> In my opinion, on the basis of this review of cases, and especially on the basis of the previous Court of Appeal decisions in Hession and Melville, a court considering applications for security for costs against liquidators should not treat the matter as being entirely at large, but should have regard to guidelines, which I would express as follows:
>
> (1) Liquidators suing personally are generally to be treated in the same way as natural persons, so that, on the one hand, costs orders will be made against them if proceedings fail, and, on the other hand, security for costs may be ordered against them when the conditions set out in UCPR 42.21 are satisfied or (on appeal) there are "special circumstances" within UCPR 51.50. Although security for costs can be ordered (at first instance only) in other circumstances, this is not the usual or normal course; and it is relevant that, in order that security for costs be ordered in other circumstances on an appeal, where at general law security was more readily granted, "special circumstances" are required. It is to be noted also that mere inability to meet

[52] *Sibroll Pty Ltd v Mitch Properties Pty Ltd* (2007) 212 FLR 1 at [11].

[53] Octavo Investments Pty Ltd v Knight (1979) 144 CLR 360 at 372.

costs orders does not amount to special circumstances (Transglobal Capital Pty Ltd v Yolarno Pty Ltd [2004] NSWCA 136) and thus does not of itself put an onus on an appellant to prove that an order for security would stultify the appeal.

(2) Where the plaintiff is a company in liquidation, and not the liquidator, then security for costs will more readily be ordered, although the court's discretion is unfettered (Bell Wholesale P/L v Gates Export Corporation (No 2) (1984) 8 ACLR 588) and there is no presupposition in favour of granting security (Bryan E Fincott P/L v Eretta P/L [1987] FCA 102; (1987) 16 FCR 497). However, the court will not refuse to order security on the ground that this will frustrate the litigation unless the company proves that those who stand behind the company and would benefit from the litigation are unable to provide security (Bell Wholesale).

(3) Cases in which security for costs might be ordered against a natural person or a liquidator outside those provided for in UCPR 42.21 include cases where (in addition to proof that there is reason to believe the plaintiff will be unable to pay the defendant's costs) the plaintiff has dissipated assets and/or has not paid previous costs orders (especially if those costs orders were in favour of the defendant) and/or brings a weak case to harass the defendant and/or brings a case for the benefit of others (albeit not solely for their benefit as apparently required by UCPR 42.21(1)(e)). There is of course a sense in which a liquidator is suing for the benefit of others; but what was decided in Cowell and Strand Wood was that this was not of itself sufficient to justify security for costs in relation to a person who has the statutory right and duty to do this.

In my opinion, it would be an oversimplification to say that underlying these guidelines is a broader principle that defendants should be protected against being unable to collect costs ordered against plaintiffs unless this would stultify the litigation. Certainly, these are relevant considerations; but in my opinion also relevant are the considerations that there should not be undue inhibitions on less wealthy persons from seeking vindication of their rights against more wealthy persons, and that there could be such inhibitions if it was in every case open to defendants to apply for security for costs on the basis of some evidence (or even on the basis of fishing notices to produce) suggesting inability to pay costs, and to claim that security should be given unless the plaintiff can prove it would stultify the litigation. In my opinion these considerations make it desirable that guidelines be adhered to, even though the question is ultimately for the court's discretion.

157. Basten JA (dissenting but not on these principles) then said at [74] and [75]:

Within this scheme of principle, when a liquidator is a plaintiff, as for example in a misfeasance suit, rather than bringing proceedings in the name of the company, he or she might properly be seen as suing for the benefit of others. However, as Hodgson JA explains, a liquidator has not been treated as a nominal plaintiff for the purposes of orders for security. The underlying concern in relation to a nominal plaintiff is that those substantially interested in the outcome of the proceedings have retreated behind an impecunious individual so as to avoid putting their own resources at risk of an adverse costs order. As explained by Campbell JA at [83], the position of the liquidator is materially different and there are sound policy reasons for not applying that principle to a liquidator.

Where a liquidator sues unsuccessfully in his or her own name, the successful defendant is likely to obtain an order for costs payable by the liquidator personally. It follows that where the nature of the proceedings allows, the liquidator will not sue personally where proceedings can properly be brought in the name of the company and is unlikely to sue personally unless indemnified in relation to a possible adverse costs order. With respect to individual plaintiffs generally (including liquidators), neither impecuniosity, the nature of the resources relied upon to bring the proceedings nor the possibility of indemnity in the case of failure, will usually be considerations warranting an order for security for costs. (Given that impecuniosity is not relevant in such cases, the existence of an indemnity may well provide a greater degree of comfort to a defendant than would otherwise be the case.) The question is why a different approach should be adopted in relation to a liquidator funded by commercial business interests which have no separate and pre-existing interest in the outcome of the proceedings.

158. *Green* has been followed by the Victorian Supreme Court and applied by the New South Wales Court of Appeal in *Zakka v Elias t/as Cadmus Lawyers* [2012] NSWCA 277.

159. What if the company is added as party? In the writer's view, this is unlikely to make a difference in most cases because the claim of the company will mirror that of the liquidator, in which circumstances, the Court will usually disregard the inclusion of the corporate defendant in exercising its discretion unless the corporate defendant raises distinct issues from the liquidator[54] (which is unlikely in the case posited here).

B. Porter and B. Reading
13 April 2016

[54] See, for example, at *Fiduciary Ltd v Morningstar Research Pty Ltd* (2004) 208 ALR 564 at [53] to [63].