HIGH COURT OF AUSTRALIA

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Details of Filing

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IN THE HIGH COURT OF AUSTRALIA
ADELAIDE REGISTRY

No A10 of 2022

BETWEEN

DANIEL MATHEW BRYANT, IAN MENZIES CARSON, AND CRAIG DAVID CROSBIE IN THEIR CAPACITIES AS JOINT AND SEVERAL LIQUIDATORS OF GUNNS LIMITED (IN LIQUIDATION) (RECEIVERS & MANAGERS APPOINTED) (ACN 009 478 148) AND AUSPINE LIMITED (IN LIQUIDATION) RECEIVERS & MANAGERS APPOINTED) (ACN 004 289 730)
Appellants

and

BADENOCH INTEGRATED LOGGING PTY LTD (ACN 097 956 995)
Respondent

APPELLANTS' SUBMISSIONS

PART I: Certification

1. These submissions are in a form suitable for publication on the internet.

PART II: Issues

2. The appeal raises two issues:

(a) In enacting s.588FA of the *Corporations Act 2001* (**Act**), did Parliament intend to abrogate a liquidator's right to choose any point during the statutory relation back period, including the point of peak indebtedness, in an endeavour to show that from that point there was an unfair preference (the **peak indebtedness rule**)? and

(b) Will a continuing business relationship, within the meaning of s.588FA(3) of the Act, cease if the operative and mutual purpose of inducing further supply of goods or services is subordinated to a predominant purpose of recovering past indebtedness?

PART III: Section 78B notices

3. No notice is required to be given under s 78B of the *Judiciary Act 1903* (Cth).

PART IV: Decision below

4. This is an appeal from the decisions of the Full Court of the Federal Court of Australia (Middleton, Jackson and Charlesworth JJ) in *Badenoch Integrated Logging Pty Ltd v Bryant, in the matter of Gunns Limited (in liq) (receivers and managers appointed) (No 1)* [2021] FCAFC 64 and *(No 2)* [2021] FCAFC 111, allowing, in part, an appeal from the judgment in

Bryant, in the matter of Gunns Limited (in liq) (receivers and managers appointed) v Badenoch Integrated Logging Pty Ltd [2020] FCA 713 (Davies J).

PART V: Statement of facts

5. The facts are not in dispute and are set out in the reasons of Davies J and the reasons of the Full Court and contained in the Chronology. On 25 September 2012, the Appellants were appointed as the joint and several administrators of Gunns and Auspine. On 5 March 2013, the Appellants were appointed liquidators of Gunns and Auspine. The liquidators applied under s 588FF of the *Corporations Act 2001* for orders in respect of eleven payments totalling $3,360,876.16 made by the companies to the Respondent (**Badenoch**) in the six-month period before 25 September 2012, as unfair preferences under s 588FA. The application was granted by Davies J, in part, who found that Gunns and Auspine were insolvent on and from 30 March 2012 and ordered that Badenoch pay the liquidators the sum of $2,072,832.04 plus interest and costs comprising $820,956.07 (payments 1 and 2), $51,242.29 (being the net reduction in indebtedness in the running from the point of peak indebtedness immediately before payment 4 to 30 June 2012 when her Honour found the continuing business relationship within the meaning of s 588FA(3)(c) came to an end), and $1,200,633.68 (being the sum of payments 5 to 11 inclusive). A Full Court of the Federal Court (Middleton, Jackson, Charlesworth JJ) allowed an appeal by Badenoch, in part, and ordered Badenoch to pay the sum of $1,200,633.68 (being the sum of payments 5 to 11 inclusive) plus interest and costs. The Full Court held that the continuing business relationship ended on 10 July 2012 and that payments 1 to 4 and all debits between 26 March 2012 and 31 July 2012 were a single transaction within the meaning of s 588FA(3)(c) that did not constitute an unfair preference. In reaching that decision, the Full Court held that the primary judge erred in finding that the peak indebtedness rule in *Rees v Bank of New South Wales* (1964) 111 CLR 210 (‘*Rees*’) applied in Australia to claims made under s 588FA of the Act. The Court also found the principle in *Sutherland v Eurolinx* (2001) 37 ACSR 477 (‘*Eurolinx’*) should be treated with caution. The liquidators appeal from that judgment to the High Court, by special leave granted by Keane and Gleeson JJ. Badenoch seeks special leave to cross-appeal to contend that all eleven payments were an integral part of a continuing business relationship with the effect that the quantum of any preference would be $251,643.26.

PART VI: Argument

Issue 1: the Peak Indebtedness Rule

The liquidator's right of election

6. It has been the law, for more than a century, that preferences (once 'fraudulent', later 'undue' and now 'unfair') were "void as against" a trustee in bankruptcy or liquidator: e.g. *Insolvency Act 1890 (Vic)*, s 73; *Companies Act 1910 (Vic)*, s 209. This meant "voidable" 'at the instance' or 'election' of the trustee or liquidator: *Williams v Lloyd* (1934) 50 CLR 341, 373-374 (Dixon J); *Brady v Stapleton* (1952) 88 CLR 322, 333 (Dixon CJ, Fullagar J); *In re Gunsbourg* [1920] 2 KB 426, 456 (Younger LJ).

7. While the statutory period (in s 588FE) prescribes various periods within which the validity of a voidable transaction is "open to attack" by a liquidator (*Richardson v Commercial Banking Company* (1952) 85 CLR 110, 126 (Dixon, Williams and Fullagar JJ)), it has never been the law that a trustee or liquidator was bound to impugn, or apply to avoid, every voidable transaction entered into within that statutory period: *Rees*, 220-221 (Barwick CJ with whom Kitto J agreed), 233 (Taylor J). To the contrary, the liquidator has a right to elect which (if any) "voidable transactions" to apply to impugn: *NA Kratzmann v Tucker (No 1)* (1966) 123 CLR 257, 277 (Barwick CJ). That right is embodied in s 588FF(1) of the Act.

The ultimate effect and running account principles

8. Where a liquidator applied to impugn a payment, whether that payment was to be adjudged a preference has, since at least the enactment of s 95 of the *Bankruptcy Act 1924* (Cth) and the decision in *S Richards & Co Ltd v Lloyd* (1933) 49 CLR 49, 60 (Rich and Dixon JJ), 61-62 (Starke J), 64 (Evatt JJ), been determined by reference to the 'effect' of that impugned payment. Prior to the enactment of s 588FA, the relevant effect was that of giving one creditor a preference, priority, or advantage over the other creditors. The relevant effect is now that codified in s 588FA(1)(b) of the Act.

9. Since *Richardson*, where an impugned payment possessed a business purpose that so connected it with *subsequent* debits in an account that the impugned payment formed an integral or inseparable part of an entire transaction, the effect of the impugned payment was to be determined by the "ultimate effect" of the "whole" transaction "beginning with the payments challenged" and including any *subsequent* dealings or debits to the account: *Richardson*, 129, 133; *Rees*, 220-221 (Barwick CJ), 223 (Kitto J); *Queensland Bacon Pty Ltd v Rees* (1966) 115 CLR 266, 282, 284, 286, 290, 291, 300 (Barwick CJ), *Airservices Australia v Ferrier* (1996) 185 CLR 483, 489, 493-494 (Brennan CJ); 502, 503-504 citing (fn 65) *Re Weiss* [1970] ALR 654, 659-661 (Gibbs J) and (fn 66) *CSR Ltd v Starkey* (1994) 13 ACSR 321, 325 (Fitzgerald

P, McKenzie J with whom Pincus JA agreed), 505, 507, 509 (Dawson, Gaudron, McHugh JJ); 517-518 (Toohey J).

10. This principle was later applied to payments made to induce the supply of further goods or services on credit, where the value of goods supplied and amounts paid were recorded in a "running account": *Richardson* at 133; *Queensland Bacon*, 282-284, 290- 291, 300 (Barwick CJ), 316-317 (Menzies J); *Airservices*, 505-506, 507, 509-510 (Dawson, Gaudron, McHugh JJ), 517 (Toohey J) and was termed the "ultimate effect" or "running account" doctrine: *Rees*, 221-2 (Kitto J); *Airservices* 483, 502, 509 (Dawson, Gaudron, McHugh JJ). That doctrine is now embodied in s 588FA(3) of the Act: *V R Dye & Co (a firm) v Peninsula Hotels Pty Ltd (in liq)* [1999] 3 VR 201, 210 (Ormiston JA with whom Winneke P and Tadgell JA agreed).

The whole transaction – where impugned payments procure subsequent supplies

11. In *Queensland Bacon*, Barwick CJ found (at 286), that in accordance with *Richardson* the 'running account' doctrine applied where "on the facts of any case, the court can feel confident that implicit in the circumstances in which the [impugned] payment [was] made [was] a mutual assumption by the parties that there will be a continuance of the relationship of buyer and seller with resultant continuance of the relation of debtor and creditor in the running account". In that case, his Honour held (at 282): "the [impugned] payments should be regarded as part of an overall series of not unrelated transactions and the net effect of the operations *from the date of the first impugned payment* to the date of commencement of the liquidation (or, where intervening facts so require, an earlier terminal date) is the determinant both of the fact and of the extent of the preference" (emphasis added).

12. The majority in *Airservices* noted the purpose of the doctrine was to ensure that the effect of a payment that induces the "further supply" of goods or services is evaluated by the 'ultimate effect' that payment has on the financial relationship of the parties: *Airservices* at 509 (Dawson, Gaudron, Toohey JJ). Their Honours said at 509: "To ignore the practical relationship between the [impugned] payments and the *subsequent* supply of services and the ultimate effect of the dealings between the parties would not advance the purpose for which s 122 was enacted. That purpose is to strike down those payments by a debtor… that have the effect of depleting the assets available to the general body of creditors. But it is no purpose of s 122 to prevent a debtor from making payments… if the purpose of the payments are *to acquire* goods or services equal to or of greater value than the payment" (emphasis added).

13. It has never been the law that in determining whether an impugned payment gave one creditor a preference over others, the effect of the impugned payment was to be assessed by reference to the value of goods or services supplied by that creditor *in the past: McKern v Minister Administering the Mining Act 1978 (WA)* (2010) 28 VR 1 at 43, [125] (Mandie JA (with whom Beach AJA agreed)). Were it otherwise, creditors who supplied goods or services on account would be entitled to recover a greater portion of their past indebtedness than other creditors, contrary to the object of Part 5.7B of the Act, which is to achieve fairness between the general body of creditors*: Fortress Credit Corporation (Australia) II Pty Ltd v Fletcher* (2015) 254 CLR 489, 500 [11], 505 [24] (French CJ, Hayne, Kiefel, Gageler and Keane JJ) and contrary to the fundamental precept of corporate insolvency law that the assets of the company are to be shared rateably amongst its creditors: *Airservices* at 516 (Toohey J).

The peak indebtedness rule

14. The logical corollary of the running account principle, together with the liquidator's right of election, is that, in order to maximise the return to the general body of creditors, a liquidator may apply under s 588FF(1) to impugn only those payments after the point of 'peak indebtedness' in a running account and seek to show that the net effect of those impugned payments, together with subsequent debits, from the date of the first impugned payment to commencement of the liquidation or end of the relationship, was to confer an unfair preference.

15. In *Rees*, the respondent submitted (214-215) that this was not permissible and that, in order to determine whether a creditor had received a preference, it was necessary to take into account all transactions in a running account within the relevant statutory period. This Court (Barwick CJ, Kitto and Taylor JJ) rejected that argument and made orders fixing the quantum of the preference by reference to the reduction of the company's indebtedness over only a part of the six-month statutory period. Barwick CJ (with whom Kitto J agreed and Taylor J implicitly agreed) said at 221: "*In my opinion the liquidator can choose any point during the statutory period in his endeavour to show that from that point there was a preferential payment and I see no reason why he should not choose, as he did here, the point of the peak indebtedness of the account during the six months period*". This principle became known as the 'peak indebtedness rule'.

16. While the 'peak indebtedness rule' did not arise for consideration in *Airservices*, as the liquidator in that case elected to impugn all payments within the statutory period and contended that the 'running account' principle did not apply, the majority nevertheless applied *Richardson*

at 132-133 (in which the Court referred to the connection between payments into an account and "subsequent" debits and the effect of those payments not being independent of "what followed") and the cases referred to at paragraph 9 above, including *Re Weiss* at 659-661 (in which Gibbs J found the extent of a preference was the net effect from the date of the first impugned payment to commencement of the liquidation, absent some other limiting event, and expressly applied the peak indebtedness rule in *Rees*). At no point, prior to the decision in *Badenoch*, was the correctness of the decision in *Rees* challenged.

17. It follows that the question whether Parliament intended to abrogate the 'peak indebtedness rule', properly understood, is whether, by enacting s 588FA of the Act, Parliament intended to: (1) abrogate the liquidator's right to elect which voidable payments to impugn; and (2) modify the running account principle so that the effect of an impugned payment is to be determined having regard to the value of past supplies of goods or services. For the reasons that follow, both questions should be answered: 'No'.

The enactment of Part 5.7B

18. Part 5.7B of the Act (including s 588FA) was introduced by the *Corporate Law Reform Act 1992* (Cth) which came into force on 23 June 1993. The Explanatory Memorandum to the *Corporate Law Reform Bill 1992*, noted at [27]-[29] that the proposed Part 5.7B contained revised and simplified provisions regulating antecedent transactions as recommended by the Australian Law Reform Commission in the report on its 'General Insolvency Inquiry' 1988 (Harmer Report), which provisions were aimed at setting out comprehensively the basis for the review of antecedent transactions in the context of companies.

19. The Harmer Report recommended that the policy underlying the antecedent transaction provisions, that transactions which involve the disposition of property within a relevant period prior to formal insolvency, in circumstances that are unfair to the general body of unsecured creditors, may be reviewed, should continue (noting that to change the policy would undermine a fundamental principle of insolvency law of equal sharing between creditors): [630]. The Report recommended that there should be separate provisions for antecedent transactions in bankruptcy and companies' legislation that should be "substantially uniform with appropriate modification only to take account of relevant difference between individuals and companies": [633]. While this involved a "substantial redrafting" of the existing preference provision, the aim of the new provision (s 588FA) was said to be to express the nature of a preference in clear and simple terms: [638]. In relation to the "running accounts" the Report noted that the courts

had developed the running account principle, citing *Queensland Bacon*, and recommended at [655] that the approach adopted by the courts be supported and reinforced with a statutory provision (s 588FA(3)) which would allow the court to have regard to the relationship between the parties and, if appropriate, the history of the transactions between them.

20. The Explanatory Memorandum to the *Corporate Law Reform Bill 1992* relevantly stated at [1040] that the change in the definition of unfair preference (in s 588FA) was intended to specify clearly what the previous expression 'the effect of giving a creditor a preference priority or advantage over other creditors' meant in the context of a corporate winding up; and at [1042] that s 588FA(3) was "aimed at embodying in legislation the principles reflected in the cases of *Queensland Bacon* and *Petagna Nominees Pty Ltd v Ledger* (1989) 1 ACSR 547.

21. In *Petagna*, the Court (Malcolm CJ, Wallace and Franklyn JJ) applied *Queensland Bacon* and *Richardson*. The applicable principles were set out by Franklyn J who cited with approval (at 563-565) a passage from McPherson, *The Law of Company Liquidation* 3rd ed (which relevantly relied on *Re Baronga Nominees Pty Ltd (in liq)* (1983) 8 ACLR 265 (Wells J); *Queensland Bacon,* 286; *M & R Jones Shopfitting Co Pty Ltd (in liq) v The National Bank of Australasia Ltd* (1983) 7 ACLR 445, 452 (Wootten J) and *Richardson*, 129); and summaries of principle in *M & R Jones* and *Re Weiss*. The principles referred to included that: "*the liquidator can choose any point during the statutory period in his endeavour to show that from that point there was a preferential payment*": *Petagna* at 564 from *M & R Jones* at 290, being identical in terms to the peak indebtedness rule in *Rees* at 221.

22. Of the authorities referred to in *Petagna*, *Richardson*, *Queensland Bacon*, *Re Weiss* and *Re Baronga* each adopted the net effect of the dealings beginning with the first impugned payment and including any subsequent dealings or debits, to the date of commencement of the liquidation, as determinative of the fact and extent of any preference, consistent with the peak indebtedness rule: *Richardson* at 129, 133 (Dixon, Williams and Fullagar JJ); *Queensland Bacon* at 262, 266, 282, 284, 286, 290, 291, 300 (Barwick CJ); *Re Weiss* at 658, 659, 661 (Gibbs J); *Re Baronga* 214 (Wells J). Moreover, both *Re Weiss* at 661 (Gibbs J) and *M & R Jones* at 284, 289, 290-291 (Wootten J) expressly applied the 'peak indebtedness rule'. Neither *Petagna*, nor any case referred to in it, doubted or disapproved *Rees*, which decision was binding on the Court.

The construction of s 588FA

23. Subsection 588FA(3) of the Act relevantly provides that: "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… 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: (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".

24. If read literally, and without context, s 588FA(3) could be construed to mean that, where there exists a running account, all debits and credits in that account, for the duration of the relationship between the parties, must be taken together, as if they constituted a single transaction, in determining whether the effect of that single transaction (entire relationship) is to confer an unfair preference. Such a construction would lead to the incongruous result, contrary to the objects of the Act, that any creditor who supplied goods or services on 'running account' would be immune from the operation of the unfair preference regime altogether and entitled to retain any payments made to them in the statutory period notwithstanding those payments may have resulted in the creditor recovering a greater proportion of their unsecured debts than other creditors. The Full Court in *Badenoch* accepted that this construction would lead to an absurd result (FC[84]) but then left this construction open (FC2, [21]-[22]).

25. The Court can depart from such a literal construction: *Cooper Brooks (Wollongong) Pty Ltd v Federal Commissioner of Taxation* (1981) 147 CLR 297, 305 (Gibbs J), 311 (Stephen J), 321 (Mason, Wilson JJ); *Taylor v Owens – Strata Plan No 11564* (2014) 253 CLR 531, [37]-[38] (French CJ, Crennan and Bell JJ), [65]-[66] (Gageler, Keane JJ) and should do so where there is some other interpretation of the provision that would promote the purpose or object of the Act: s 15, *Acts Interpretation Act 1901* (Cth).

26. There is one construction of s 588FA that: is open on the words and language of the provision; is consistent with the object and purpose of Part 5.7B of the Act; and is consistent with the principles (set out above), including the peak indebtedness rule, that s 588FA of the Act was intended to embody. Specifically, the "transaction" to which s 588FA(1), 588FA(3)(a) and 588FA(3)(d) refer is the transaction the liquidator has applied to impugn under s 588FF.

Consistent with authority, it is the effect of that *impugned* transaction that is to be considered. By operation of s 588FA(3)(d), the impugned transaction may only be taken as a preference if and to the extent that the single transaction described in s 588FA(3)(c) (of which it forms part) is adjudged an unfair preference. As to what constitutes that single transaction: the reference in s 588FA(3)(c) to the (impugned) transaction being an integral part of a "continuing" business relationship or running account is, in context, a reference to the relationship between the impugned payment(s) and any "continuing" or subsequent dealings (supplies of goods or services or debits to the running account). The reference in s 588FA(3)(c) to "all transactions forming part of the relationship" is a reference to that relationship, consisting of the impugned transaction(s) together with any further goods or services supplied by the creditor as part of the continuing business relationship. This construction is reinforced by s 588FF(3)(b) which contemplates further goods or services being supplied, with the effect that the company's net indebtedness may increase or decrease as a result of further transactions forming part of the relationship. On this construction, the fact and extent of any preference is then determined by the net reduction in the level of indebtedness from the point of the first impugned payment to the end of the continuing business relationship.

27. This construction is open on the language of s 588FA, is consistent with the authorities s 588FA was intended to embody (*Rees*, 214–15, 220–1, 233; *Queensland Bacon*, 282; *N A Kratzmann*, 277; *Airservices* at 509–10; *Richardson*, 129), and serves, rather than defeats, the purpose of the running account principle, which is to strike down those payments by a debtor that have the effect of reducing the assets available to the general body of creditors but not those that have the purpose or effect of inducing the supply of goods or services of equal or of greater value: *Airservices*, 509 (Dawson, Gaudron, Toohey JJ). This construction is also consistent with the peak indebtedness rule in *Rees*, as the liquidator can elect (under s 588FF) which payments to impugn, with the effect of those payments being adjudged by reference to the net reduction in indebtedness in the running account from the point of the first impugned payment to the end of the continuing business relationship. Unlike the interpretation preferred by the Full Court, this interpretation does not require reading into s 588FA a statutory relation-back date from s 588FE of the Act, nor does it introduce the arbitrary result, inconsistent with the object of Part 5.7B, that would arise if such a period was read into the provision: FC[121]; c.f. FC[117].

28. The Appellants' interpretation – and the peak indebtedness rule – also does not suffer from two fundamental difficulties that arise from reading a relation-back date from s 588FE

into s 588FA, as the starting point for the single transaction. First, where the company is found to have become insolvent *within* the applicable relation-back period, as was the case here, using the start of the relation-back period as the start of the single transaction in s 588FA(3)(c) will result in transactions being included in that 'single transaction' that were not entered into at a time when the company was insolvent. As a transaction may only be avoided as an unfair preference if it is also an 'insolvent transaction' within the meaning of s 588FC (by operation of (s 588FE(2), 588FE(5)), a single transaction, so comprised, would arguably never be voidable. This issue is exacerbated where a longer relation-back period, such as that in s 588FE(4)(c) or 588FE(5)(c), applies. In this case, Gunns and Auspine were found to be insolvent from 30 March 2012 [FC[4]] and the administrators were appointed on 25 September 2012 [FC[3]]. In the result, applying the six month relation-back period in s 588FE(2), the 'single transaction' found by the Full Court, and declared in paragraph 5 of its orders, includes two transactions (on 26, 28 March) that occurred prior to the date of insolvency.

29. Second, there are various relation-back periods that can apply to an unfair preference ranging from 6 months to 10 years, depending on the parties to the transaction and purpose of the transaction. Where the preference is given to an unrelated third party, a relation-back period of 6 months applies (588FE2)(b)(i)); where the transaction is with a related entity, 4 years applies (588FE(4)(c)); where the transaction's purpose is to defeat the rights of other creditors, 10 years applies (588FE(5)(c)). Fixing the start of the single transaction in s 588FA(3)(c) by reference to the start of the applicable relation-back period would lead to the perverse result that the 'running account' defence would operate more favourably to parties intending to defraud creditors, and to related party recipients of a preference, than to innocent, unrelated third parties.

The intention of Parliament in enacting s 588FA

30. Following the introduction of s 588FA, the question of whether the introduction of s 588FA was intended to effect a substantive change in the common law of unfair preferences was considered by Ormiston JA (with whom Winneke P and Tadgell JA agreed) in *V R Dye*. That case involved the application of the 'ultimate effect' doctrine. Ormiston JA relevantly found that while the current provisions were differently expressed, they were not intended to make any significantly different provision for identifying what was an unfair preference: at 209. His Honour said that s 588FA was but a manifestation of a more general policy of the law of insolvency prohibiting preferences that had been read into the common law before any legislative provisions applied: at 212; and that the provision could only be interpreted having

regard to its history and obvious purpose: at 211. His Honour noted that the running account principle had been explicitly recognised in s 588FA(3), which appeared to be a codification of the implied exception to running accounts read into earlier legislation: at 210. His Honour found that while s 588FA(3)(c) might appear to have affected an alteration to the law, its purpose was to embody the established law: at 210. His Honour concluded that the new provisions were consistent with the earlier provisions intended to avoid changes that dislocated the statutory order of priorities amongst creditors (at 215) and should be construed in the same way as the former provisions except to the extent that the language clearly pointed to a contrary conclusion: at 212. The only language the Court identified as pointing to a contrary conclusion was the definition of the word 'transaction'.

31. Neither the Victorian Court of Appeal in *McKern* at [25] – [27] (Nettle JA), [118] (Mandie JA (with whom Beach AJA agreed)), nor the New South Wales Court of Appeal in *Beveridge v Whitton* [2001] NSWCA 6 at [30] per Heydon JA (with whom Mason P and Powell JA agreed) nor the Full Federal Court in *Federal Commissioner of Taxation v Kassem* (2012) 205 FCR 156 at 163 [50] (Jacobson, Siopis and Murphy JJ)) were prepared to hold that the decision in *V R Dye* was plainly wrong. The Full Court in *Badenoch* ought to have found likewise: *Farah Constructions v Say-Dee Pty Ltd* (2007) 230 CLR 89, 151, particularly where the 'peak indebtedness rule' is in truth *not* a common law exception to the law of unfair preferences, but the application of a right of election expressly recognised in s 588FF and of the running account principle expressly recognised in s 588FA(3).

32. The question whether the peak indebtedness rule itself was abrogated by the introduction of s 588FA, was considered by Master Burley in *Olifent v Australian Wine Industries Pty Ltd* (1996) 19 ACSR 285. His Honour rejected the literal construction of s 588FA(3), as a preference would rarely if ever occur; found the provision was silent on the point at which the single transaction in s 588FA(3)(c) commenced; found that because "the nature and ambit of the running account defence under the former provisions [was] essentially the same as the defence provided for under the current provisions" and because there was no clear language in s 588FA(3) altering or varying the situation that pertained under the former provisions, Parliament did not intend to alter the position; and followed *Rees*: at 292.

The decision in Timberworld

33. In *Timberworld Ltd v Levin* (2015) 3 NZLR 365, the New Zealand Court of Appeal held at [99] that the peak indebtedness rule was not part of the law in New Zealand, as Parliament

did not adopt it when enacting provisions of its *Companies Act 1993* (NZ) (**NZ Act**), in similar terms to s 588FA. That the peak indebtedness rule is no more than the application of the running account principle in s 588FA(3) following an election under s 588FF does not appear to have been argued in *Timberworld*, nor does the origin and development of the principle (as set out above) and the fact that it formed part of the *ratio decidendi* in *Rees* and was part of the settled law which s 588FA was intended to embody: [82]. Instead, the Court treated the rule as "a dictum" of Barwick CJ in *Rees*: [35] which Australian courts "seem to have assumed… had the weight of authority and sufficient pedigree to warrant its direct application": [41] but which did not form part of the law of New Zealand unless it was adopted in terms: [68].

34. In construing the equivalent of s 588FA(3)(c), the Court found that the section required all payments and all supplies of goods within the continuing business relationship to be netted-off against one another as: "the plain meaning of 'all transactions' is just that". Having found that, however, the Court added to the contrary: "[o]f course where the business relationship began before the start of the two year period, only the transactions occurring within the period are taken into account": at [68], [69]. In doing so, the Court read into the provision, as the start of the single transaction, the relation-back period in s 292(1) of the NZ Act (equivalent to s 588FE(2) of the Act): [28] without any explanation.

35. In rejecting the continued operation of the peak indebtedness rule, the Court relied on the decision in *Airservices*, on which the Court said "the Australian legislation had relied": [74]. In fact, *Airservices* was decided well after Part 5.7B had been enacted, albeit it related to events and applied to law as it stood prior to the enactment of Part 5.7B: *Airservices*, 526 (Toohey J). The Court found that, while the peak indebtedness rule did not arise in *Airservices* [84], if the principle in *Airservices* was that the ultimate effect must be considered, "there is no doubt that the peak indebtedness rule does violence to that principle": [80]-[81]. This conclusion seems to have proceeded on the (false) assumption that because the majority in *Airservices* had stressed at 502 that a payment could not be viewed in isolation from the general course of dealing between the creditor and debtor: [78], that it was the "ultimate effect" of the course of dealing, over the entirety of that relationship, which was determinative of the fact and extent of any preference. To the contrary, while the relationship and course of dealings between the parties remains relevant to determining the purpose of an impugned payment, and the connection between it and other transactions, it is the "ultimate effect" of the impugned payments, together with the value of further or fresh supplies procured by or connected with

those payments, that is determinative of the fact and extent of any preference: [79], *Airservices* 505. The peak indebtedness rule embodies, and does not offend, this principle.

36. The Court later found (at [87]-[92]) that the peak indebtedness rule operated arbitrarily, as the quantum of a preference may be affected by a trade creditor's credit terms, whereas if all payments and supplies in a running account were taken as a single transaction, all trade creditors would be treated equally. It is true that if all payments and supplies in a running account were treated as a single transaction, usually beginning with a zero balance and by definition ending with a debit, then trade creditors would be *equally* immune from the unfair preference regime, to the detriment of the general body of unsecured creditors who had also supplied goods or services of a value that exceeded payments received by them but were unable to avail themselves of that defence. However, this is contrary to the objects of Part 5.7B and is not a sound reason for abrogating the peak indebtedness rule.

37. The Court in *Timberworld* appears to accept that its construction of the provision results in a preferred class of 'trade creditors' who are treated more favourably than the general body of creditors. The Court said, at [95], "on a policy level, it was the purpose of enacting [the provision] to give effect to Parliament's intention to set apart certain trade creditors from the general pool of unsecured creditors" so that "trade creditors would have an incentive to continue providing value to companies in distress" and that: "Parliament took the decision to set aside a particular group of creditors who continue to provide credit and goods on the assumption of future trade. This is seen as having distinct commercial benefits in the context of liquidation" at [98].

38. There is no such legislative intention underlying s 588FA(3) of the Act. To the contrary, this runs contrary to the object of Part 5.7B of the Act. To the extent that there is a benefit in trade creditors *continuing* to provide *fresh* goods and services to companies in distress, that object is served by permitting - as the peak indebtedness rule does - those trade creditors to retain that proportion of any impugned payment which secures the provision of <u>further</u> goods or services of greater or equal value. Beyond this, it is neither necessary nor appropriate, nor consistent with authority, to modify the 'running account' principle so as to create a preferred class of unsecured creditors who are (in practical terms) excluded from the operation of the unfair preference regime altogether (as construing s 588FA(3)(c) to include all transactions in a relationship or running account would do).

The decision of Davies J at first instance

39. Davies J was right to find that the peak indebtedness rule continued to apply after the introduction of s 588FA(3): at J[109]; that there was nothing in the extrinsic material to suggest otherwise: J[108]; and that *Olifent*, *V R Dye* and those cases that continued to apply the peak indebtedness rule after the introduction of s 588FA(3) including *Sutherland v Lofthouse* (2007) 64 ACSR 655 were "plainly correct": [105], [107].

40. Her Honour was also right to reject the finding in *Timberworld* that the peak indebtedness rule was inconsistent with the 'ultimate effect principle' in *Airservices* and to find, to the contrary, that because the rationale for the 'running account' doctrine is the connection between a payment and subsequent supplies, there is no inconsistency between the peak indebtedness rule and the 'ultimate effect doctrine'. In doing so, her Honour correctly applied *Airservices* at 509: J[106].

41. Having found that there existed a continuing business relationship between 17 April 2012 and 30 June 2012 (as to which see Issue 2, below) and that the liquidators had elected to impugn payment 4 within that period, Davies J correctly calculated the net reduction in indebtedness over that period from the point of peak indebtedness immediately before payment 4 (of $1,416,563.31) to the end of the continuing business relationship on 30 June 2012 ($1,365,321.02) as $51,242.29: J[99], J[109]. Put differently, the result of the single transaction within that period (which consisted of payment four ($678,929.63) and the subsequent debit for services ($627,687.34) dated 30 June 2012) was to confer an unfair preference on Badenoch in the sum of $51,242.29.

The decision of the Full Court

42. Badenoch appealed. The Full Court allowed the appeal, in part, relevantly finding that the liquidators were not entitled to apply the peak indebtedness rule for the purpose of determining whether there was an unfair preference under s 588FA(1): FC[123]. In reaching that conclusion, the Full Court erred in a number of respects.

43. First, the Full Court began by construing the words "all transactions forming part of the relationship" in subsection 588FA(3)(c) of s 588FA, literally, and without consideration of the statutory or historical context of that provision or the purpose or objects of the Act (as set out above). On the basis of that literal construction, the Full Court agreed with the Court in *Timberworld* that, on its face, s 588FA(3) is intended to give the creditor the benefit of "all of the dealings between the parties": FC[82]-[83], contrary to the peak indebtedness rule.

44. Having found that, on its literal meaning, s.588FA(3)(c) did not allow the peak indebtedness rule, the Full Court then rejected that literal construction and accepted, as had been found in *Olifent*, that the literal meaning would lead to the absurd result that trade creditors would effectively be made immune from the voidable preference regime: (FC[84]).

45. The Full Court noted at (FC[85]) that it was common ground that the end date for the single transaction was either the date of cessation of the continuing business relationship or the date of liquidation and that the issue in dispute was when the single transaction is said to begin.

46. The Full Court was wrong to characterise the liquidators' reliance on the peak indebtedness rule (FC[86]) as agreement that s 588FA(3) was to be construed by reference to s 588FE (FC[87]). The liquidators' position is and was that it is not open on the language of s 588FA to read in a relation-back date from s 588FE, and there are several relation back dates ranging from 6 months to 10 years that can apply to an unfair preference, depending on who the recipient is and the circumstances: s 588FE(2)(b)(i), 588FE(4)(c) and 588FE(5)(c). Reading in the applicable relation-back day would lead to the perverse results referred to in [29] above. This submission was rejected by the Full Court on the erroneous premise that the longer statutory periods in s 588FE related to "other types of voidable transactions": (FC[122]).

47. While the Full Court noted that the Explanatory Memorandum at [1042] said s 588FA(3) was "aimed at embodying in legislation the principles reflected in the cases of [*Queensland Bacon* and *Petagna*]" (FC[90]), the Full Court declined to consider the status of the 'peak indebtedness principle' in *Rees* at the time those cases were decided, on the basis that *Rees* was decided in the context of a different statutory provision: (FC[95]). This was in error, as the status of the peak indebtedness rule in *Rees* was material to understanding the principles Parliament intended to embody in s 588FA and to the principles of construction to be applied.

48. Having considered the decision in *Rees* (FC[92]-[94]) and having observed that Kitto J had agreed with Barwick CJ, and the form of orders made by the Court in *Rees* (FC[94]), which orders could only have been made if all three judges had applied the peak indebtedness rule, the Full Court ought to have found that the rule formed part of the *ratio decidendi* of *Rees*, which was binding on the Court in *Petagna*.

49. The Full Court considered *Queensland Bacon* and *Petagna*, being the cases the Explanatory Memorandum said Parliament had intended to embody in s 588FA(3), and noted that (FC[100]) in *Petagna* at 564, Franklyn J had cited the principle that "the liquidator can

choose any point during the statutory period in his endeavour to show that from that point on there was a preferential payment" (being the precise language in *Rees* at 221).

50. Notwithstanding the principle was in identical terms to *Rees* at 221, the Full Court found that Franklyn J's reference to the liquidator being able to "choose any point during the statutory period in his endeavour to show that from that point on there was a preferential payment" was not a reference to the peak indebtedness rule, but was a reference to "the freedom to choose the point from which to show that the transactions have ceased to be a part of a continuing business relationship" (FC[101]). There was and is no such principle. To the contrary, it is apparent from the decision in *M & R Jones*, from which the statement of principle in *Petagna* was extracted verbatim, that the reference was to the peak indebtedness rule, which rule was invoked and applied in that case: *M & R Jones*, 284, 290.

51. The Full Court appears to have taken the statement: "this does not mean that the connection between [the impugned payment] and dealings prior to the chosen date is to be ignored" to be an "important qualification" to the peak indebtedness rule with the effect that "it was Parliament's intention to allow creditors to have the benefit of earlier dealings within a continuing business relationship when determining whether there has been an unfair preference": (FC[102], [104]). That finding was in error. It is clear from the Explanatory Memorandum that Parliament intended to embody the common law relating to running accounts as it existed at the time of *Queensland Bacon* and *Petagna*. As set out above, it was not the law at that time, or at any time, that in determining whether an impugned payment was an unfair preference, a trade creditor was to be given the benefit of <u>earlier</u> dealings (that is, be permitted to set-off the value of past supplies and recover past indebtedness ahead of other creditors) nor was that the position expressed in *Queensland Bacon*, *Petagna* or any of the cases cited therein.

52. While the authority for the proposition in *Petagna* at 564 that prior dealings cannot be ignored is not clearly cited, this is likely to be a reference to the principles in *Richardson* at 129 that "in considering what is the effect of a transaction impeached… there are two things that it is important to have clearly in mind. One of them is the kind of "effect" which the provision treats as decisive. It must be "the effect of giving the creditor a preference, priority, or advantage over other creditors… The second thing is that the effect is the consequence of the payment and where the payment forms an integral and inseparable part of an entire transaction its effect as a preference involves a consideration of the whole transaction". While the Court in *Richardson* began that analysis with the payments that were "challenged" (129)

and treated the whole transaction as consisting of the impugned payments and subsequent debits to the account, they did not treat prior dealings as irrelevant. Those dealings were relevant to ascertaining the purpose or business character of the impugned payments and whether the impugned transactions, together with the subsequent debits, formed an integral part of some 'whole' or 'entire' transaction. The Court said (131-132) "We have come to the conclusion that [with one exception] … none of the deposits had the effect of giving the respondent bank a preference, priority, or advantage over the other creditors… They were not, in our opinion payments made to the bank independently of the [prior] arrangement by [the bankrupt] with [his banker] that the latter should honour cheques outstanding, but on the contrary, they were made only to enable him to meet cheques which [the bankrupt] had given or was about to give… what is important here is the severability of the deposits from the payments out of the account; the payments out which were entered subsequent, whatever the actual sequence… [the Bank] was not seeking to get money into the account for the benefit of the bank but out of it for the benefit of [the bankrupt]… In considering whether the real effect of a payment was to work a preference its actual business character must be seen and when it forms part of an entire transaction which if carries out to its intended conclusion will leave the creditor without any preference, priority or advantage over other creditors the payment cannot be isolated and construed as a preference". The Court concluded (135) that "the burden of showing that a preference resulted is upon the Official Receiver, and we know that in the result there was none actually enjoyed by the bank. To infer that at a point [when the impugned payments were received] the bank had obtained one but that it was freely sacrifices by the spontaneous making of further advances by honouring cheques would we think be wrong. The true reading of the circumstances… is that the deposits were made in the footing that so far as the respective deposits would carry, the cheques coming in would be honoured".

53. While *Airservices* had not been decided at that time, the majority in *Airservices* explained the same principle in the following way at 502: "If the purpose of a payment it so 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… looks to the ultimate effect of the transaction (citing *Rees*) … 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 before, during and after that period. Resort must be had to the business purpose and context of the payment to determine whether it gives a creditor a preference over other creditors. To have the effect of giving the

creditor a preference… the payment must ultimately result in a decrease in the net value of the assets that are available to meet the competing demands of other creditors". The majority then cited the "wider transaction" principle in *Richardson* noting that if the purpose of a payment was to secure assets or goods, of greater or equal value, the payee receives no advantage over other creditors.

54. In the result, while *Richardson* and *Airservices* do stand for the proposition that prior dealings are not irrelevant, *Airservices* did not doubt or disapprove the decision in *Rees*, which was cited with approval, nor did the Court in *Airservices* purport to qualify the peak indebtedness rule. Neither case stands for the proposition that in assessing the effect of an impugned payment, trade creditors are entitled to set-off the value of past supplies against impugned payments in determining whether those payments have resulted in a preference.

55. The Full Court dismissed the decision in *V R Dye* as "adding little to the discussion" as the finding that Parliament did not intend to affect any change to law of preferences was subject to the qualification: "except to the extent that the language of s588FA clearly points to a contrary conclusion", which the Full Court said it did: (FC [110]). In doing so, the Full Court relied on the literal interpretation of s 588FA(3)(c) it had previously rejected at (FC[83]-[84]).

56. The Full Court found that *Olifent* and the decisions that applied *Rees* after the introduction of s 588FA, including *Sutherland v Lofthouse*, were wrongly decided (FC[111]) because: there was no legislative intention in the language of the statute and the legislative material to adopt the peak indebtedness rule: (FC[112); the peak indebtedness rule could not be reconciled with the doctrine of 'ultimate effect' in *Airservices*: (FC[118]); and the abolition of the peak indebtedness rule is consistent with the stated purpose of Pt 5.7B of the Act which is, in essence, to do fairness between unsecured creditors: (FC[119]). Each of these findings was in error.

57. The finding that there was no legislative intention to adopt the peak indebtedness rule was in error as it: reversed the principle of legality*: Potter v Minahan* (1908) 7 CLR 277, in circumstances where the peak indebtedness rule was open on the language of s 588FF and s 588FA (read together); depended on the literal construction of s 588FA(3)(c) that it had expressly rejected: (FC[84]); and was based on an erroneous interpretation of the legislative material (see [47]-[52] above);

58. The finding that the peak indebtedness rule could not be reconciled with the doctrine of 'ultimate effect' in *Airservices* was in error, as it relied on the literal interpretation of

s 588FA(3)(c) and on an erroneous interpretation of *Airservices* and *Richardson* as standing for the proposition that, in determining whether the ultimate effect of an impugned payment is to confer a preference, the Court must look to "all payments (both impugned and non-impugned) and all supply (both past and future) forming part of the continuing business relationship and otherwise falling within the relevant statutory period": (FC[116]-[117); c.f Davies J (J[106]), see also [52] to [53] above).

59. Both the Court in *Timberworld*: at [82] and the Full Court (FC[102]; [116]) criticised the peak indebtedness rule on the basis that it ignores the dealings between the parties prior to the point of peak indebtedness. Those concerns are misplaced. The peak indebtedness rule does not ignore past payments or supplies. To the contrary, the liquidator's election to impugn payments after (but not before) the point of peak indebtedness involves a predetermination by the liquidator that the creditor can retain those prior payments in full, as those payments secured the supply of goods or services of greater value. Payments and supplies, both before and after the point of peak indebtedness, are treated in the same way with the creditor being permitted to retain payments to the extent that they procure further supplies to the value of those supplies.

60. The finding that the abolition of the peak indebtedness rule would be consistent with the purpose of Part 5.7B to do fairness between unsecured creditors (FC[119]) was in error for the reasons set out in [36]-[38] above. To the contrary, to permit trade creditors to retain payments for goods or services supplied in the *past* (FC[120]) that did not procure the supply of goods or services of value (that is, recover past indebtedness), but not other unsecured creditors, would create a preferential class of unsecured creditors immune (in whole or in part) from the unfair preference regime, contrary to the objects of Part 5.7B (see FC[84]; [37]-[38] above).

Conclusion on peak indebtedness

61. The peak indebtedness rule is consistent with the 'running account' doctrine, which recognises that a payment which secures the *further* supply of goods or services of greater or equal value is not detrimental to other creditors: *Airservices*, 502; *Richardson*, 113.

62. The peak indebtedness rule best serves the purpose of Part 5.7B and s 588FA of the Act, which is to achieve fairness between unsecured creditors: *Fortress Credit*, 500 [11], 505 [24]; *Airservices* at 509, whilst preserving the efficacy of the running account doctrine, as it permits a creditor to retain only so much of any impugned payment as secures the provision of further goods and services of greater or equal value, whilst allowing the liquidator to recover any

greater amount for the benefit of the general body of creditors. The amount recovered by the liquidator is not lost to the creditor, but is exchanged for a right to prove for the recovered amount in the liquidation: s 588FI.

63. The Appellants' proposed construction of s 588FA in which the words 'all transactions forming part of that relationship' in 588FA(3)(c) are taken to mean the transactions impugned under s 588FF together with all continuing or subsequent credits and debits is: open on the language of s 588FA and 588FF; consistent with the running account doctrine at common law: *Rees*, 214–15, 220–1, 233; *Queensland Bacon*, 282; *NA Kratzmann*, 277; *Airservices* at 509–10; *Richardson*, 129; consistent with and preserves the peak indebtedness rule; and best serves the purpose and objects of Part 5.7B.

64. By contrast, the literal interpretation of s 588FA(3)(c) left open by the Full Court (FC2 [22]), in which a single transaction in s 588FA(3)(c) consists of all transactions in a running account or continuing business relationship, would have the effect of creating a preferred class of trade creditors that are effectively exempt from the operation of the unfair preference regime: (FC[84]). Badenoch's proposed construction, in which the single transaction consists of all transactions within an applicable relation-back period, would also create a preferred class of creditors who are entitled to retain a greater proportion of unsecured debts than other unsecured creditors (such as statutory creditors), regardless of whether the payments received secured the further supply of goods or services. The quantum of any preference would be determined, arbitrarily, by reference to the change in a running account over the applicable relation-back period. It also leads to the perverse outcomes referred to in paragraph [29] above. Both constructions are contrary to the purpose of s 588FA and the pre-existing law that s 588FA was intended to "embody" and would result in a substantive change to the law of unfair preferences, which Parliament did not intend: *Dye* at 212; *Beveridge,* [30]; *McKern*, [25]-[27]; *Kassem*, [50].

65. It was incumbent upon the Full Court to construe s 588FA, as a whole, so as to best give effect to the purpose and language of that provision while maintaining the unity of that section and Part 5.7B as a whole: *Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355, [70]. Having found that s 588FA(3)(c) could not be given its literal interpretation (FC[84]), that subsection ought to have been construed so as to fulfil its function, without destroying or undermining the attainment of the objects of s 588FA and Part 5.7B: *DP v Commonwealth Central Authority* (2001) 206 CLR 401, [130] (Kirby J).

66. Save for the presumption that payments will be connected with further supplies, neither the ultimate effect or running account doctrine, nor the application of it that is the peak indebtedness rule, discriminate between unsecured creditors, nor do they recognise a preferential class of trade creditors. Each principle permits a creditor to retain only that proportion of a payment that secures further value. No creditor is permitted to recover past indebtedness. Payments that have the purpose or effect of recovering past indebtedness are recoverable to be distributed rateably amongst all creditors. As the correct principles recognise the value of further supplies procured by a payment, they have the added effect of not discouraging continued supply of goods or services on credit to companies in financial distress.

End date of the single transaction

67. It was common ground between the parties that the relevant end date for the single transaction within the meaning of s 588FA(3)(c) is either the date of the cessation of the continuing business relationship or the date of liquidation, whichever is earlier: (FC[85]). Davies J relevantly found that payments 3 and 4 formed part of a continuing business relationship: (FC[75]) but that payments 5 to 11 were not part of the continuing business relationship, with the relationship coming to an end on 30 June 2012: (FC[23]). Both findings were appealed. The Full Court found that the continuing business relationship continued up to the end of June 2012: (FC[75]) and identified no error with her Honour's findings of fact. The Full Court upheld both findings: (FC[75], [79]).

68. When the parties were asked to make submissions on the form of orders to be made to give effect to the Court's reasons, Badenoch submitted that the Full Court had found that the continuing business relationship ended on 31 July 2012 (citing other parts of the Court's reasons. [60], [76], [78], [79]).

69. The Full Court published further reasons. In those reasons, the Full Court found, contrary to its first reasons (FC[75]), that the continuing business relationship ended on 10 July 2012: (FC2[9]) and found that an invoice dated 31 July 2012 reflected services delivered in the period to 10 July 2012. On the basis of these findings, the Full Court concluded that the invoice was a transaction that was an integral part of the continuing business relationship: (FC2[9]). The Full Court added the invoice of $194,273.06 dated 31 July 2012 to its running account, thereby extinguishing any preference during the continuing business relationship.

70. The Full Court then found that its conclusion as to the end date of the continuing business relationship rendered it unnecessary to resolve the dispute concerning the start date of the single

transaction absent the peak indebtedness rule (FC2[21]) and stated that the Court's reasons should not be understood as making any finding on that question: (FC2[15]). The Full Court said this question may be deferred to a case where the outcome depends on it: (FC2[22]). The Full Court nevertheless made orders defining and declaring the single transaction, by reference to all transactions within the 6-month relation back period, including two debits on 26 and 28 March 2012, prior to the insolvency date.

71. The Full Court erred in substituting its own end date to the continuing business relationship and in finding that the debit on 31 July 2012 formed part of the single transaction. Having identified no error with the findings of Davies J, and having upheld those findings in respect of payments 3 and 4 and 5 to 11: (FC[23],[24],[73],[75]-[76]) and made its own finding that the continuing business relationship ended on 30 June 2012 (FC[75]) the Full Court was not free to substitute its own date for the end of the continuing business relationship in its second reasons or to incorporate the debit on 31 July 2012: *Robinson Helicopter Co Inc v McDermot*t (2016) 90 ALJR 679, 687 [43] (French CJ, Bell, Keane, Nettle & Gordon JJ).

Conclusion as to peak indebtedness

72. For these reasons, the Full Court ought to have dismissed Ground 1 of the appeal and confirmed the decision of Davies J below (J[109]).

Issue 2: the principle in *Sutherland v Eurolinx*

73. The purpose of Part 5.7B of the Act is to achieve fairness between all creditors by ensuring sums paid by the company prior to the liquidation are distributed equitably *pari passu* amongst all unsecured creditors: *Fortress Credit*, 500 [11], 505 [24]; *Airservices* at 516 (Toohey J).

74. Not all creditors can rely on the fact that they have supplied further goods or services of value, for which they have not been paid, to resist repaying sums received by them as an unfair preference. Creditors who cannot rely on s 588FA(3) also cannot set-off their unpaid debts against a claim under s 588FA: *Morton as Liquidator of MJ Woodman Electrical Contractors Pty Ltd v Metal Manufacturers Pty Limited* [2021] FCAFC 228. What separates those creditors who can rely on s 588FA(3) and those who cannot is not the relationship of debtor and creditor, nor the fact of further supplies of value, nor the existence of a running account, but the creditor demonstrating a "clear" connection between the impugned payments and the subsequent supplies which makes it impossible to separate them in determining the effect of the payments. In determining whether there is such a connection, the purpose of the payments is paramount.

The applicable principles

75. In *Richardson*, the Court held that the effect of an impugned payment was to be adjudged by its "real effect", having regard to the business character of the payment. The Court said "in considering whether the real effect of the payment was to work a preference its actual business character must be seen and when it forms part of an entire transaction which… will leave the creditor without any preference… over other creditors the payment cannot be isolated and construed as a preference": 132. The Court considered the purpose of the impugned payment determinative of whether the effect of the impugned payment was to be assessed in isolation. The Court referred to the example of a debtor who pays something off a grocer's account in order to induce the shopkeeper to give further supplies not giving a preference if that is the "clear basis of the payment" and said: "it is enough… that the payments into the… account possessed… a business purpose common to both parties which so connected them with the subsequent debits… as to make it impossible to pause at any payment… and treat it has having produced an immediate effect to be considered independently of what followed…": 133.

76. That business purpose cannot be solely the reduction of indebtedness. In *Rees*, Taylor J said at 232 that it is sufficient for a payment to be a preference for the appellant to show that the payment was made partly to enable the company to continue trading, in some limited fashion, and partly in permanent reduction of its indebtedness. His Honour said "To my mind the payments made in pursuance of an agreement to this effect are void to the extent to which they were, consistently with the arrangement in question, appropriated by the respondent in permanent reduction of the overdraft": 232. The Court declared the payments void: 233.

77. The principle applies no differently where there is a running account. In *Queensland Bacon*, Barwick CJ referred to two situations in which the ultimate effect principle operated: first, where the payment is part of a larger single transaction; the other, where the payment is linked with a "running account": 284. As to the latter, his Honour said at 297: "whether the payments did have the effect of giving this appellant a preference… depends on whether or not the payments were made on the basis of a *continuance* of supply". Menzies J took a more restrictive view that where the object of the arrangement was to bring about a reduction of existing liability, payments made in carrying out that arrangement would constitute preferences: 317. On either view, it was a precondition to the operation of the ultimate effect principle that the "clear" basis of the impugned payments be the *continuance* of supply.

78. The test as restated by Wootten J in *M & R Jones* at 290 was extracted in *Petagna*, which the Explanatory Memorandum said s.588FA(3) was intended to embody (as above). Wootten J found that this test was not satisfied where the bank had declined to continue the running arrangement at the same level of credit; demanded a substantial reduction in the level of the company's account; and insisted that the running account be conducted at a very much lower level going forward: 290.

79. The majority in *Airservices* confirmed that it was not the term "running account", but the inferences that could be drawn from it, that was material. The majority said at 505: "[i]f 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… Thus, it is not the label "running account" but the conclusion that the payments in the account were connected with the future supply of goods or services that is relevant, because it is that connection which indicates a continuing relationship of debtor and creditor. It is this conclusion which makes it necessary to consider the ultimate and not the immediate effect of individual payments. The majority found that there was a "running account" in the requisite sense, as the account was an active one with daily dealings between the parties, services were rendered, payments were made and the balance of the account rose and fell as the debits and credits were recorded. The majority said: "the facts recorded in the "running account" indicate that Compass and Airservices had a continuing relationship which contemplated further debits and credits and that the individual payments were intended to continue and not determine that relationship": 507. The majority then applied the ultimate effect principle to all but the last payment in that case. As to the last payment, the majority found that Airservices had a strong suspicion Compass would fold the following day and had demanded payment, supported by a bank guarantee and imposed liens. The majority found that while there was a running account and further services had been supplied after the making of the last payment, the payment was a preference. The majority said at 510: "the better view on the evidence is that in making its demand Airservices was looking backwards rather than forwards; looking to the partial payment of the old debt rather than the provision of continuing services". It follows that the inference that there is a clear connection between a

payment and subsequent services that may be drawn from a running account, will be displaced if in fact the purpose of continuing supply is subordinated to that of reducing indebtedness.

80. In *Re Baronga*, Wells J observed at 214 that "when Barwick CJ … spoke of a "mutual assumption by the parties that there will be a continuance of the relationship of buyer and seller with resultant continuance of the relation of debtor and creditor in the running account" his Honour was asserting, by necessary implication, there would be such a meeting of the minds of the parties as would support that submission. It follows that if the creditor receives payment upon an assumption that is other than that described by Barwick CJ, the foundation that might have existed for the relationship referred to is absent, and the creditor loses the chance of invoking the running account principle". Master Burley found in *Olifent* at 289 that this approach was equally applicable to the expression "continuing business relationship" in s 588FA(2). His Honour further identified examples of payments that might be received other than on the basis of the "mutual assumption", including payments which were received by the creditor other than in the ordinary course of business or with bankruptcy in mind.

81. In *Eurolinx*, Santow J identified at 504 some "essential prerequisites" for the running account principle to be maintained: "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 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…" His Honour reasoned (at 505) that the last payment in *Airservices* was a preference because the demand for payment at a time when Airservices knew of Compass's parlous circumstances invited the inference that the payee's predominant concern was no longer continued supply but to get its previous accounts paid; continued supply had receded in significance as a mutual purpose to the point where it was no longer treated as governing the parties' relationship or was subordinated to getting paid.

82. The principle in *Eurolinx* that the purpose of continuance of supply must not be subordinated to a predominant purpose of recovering past indebtedness has been applied many times since, including by Peek J in *Clifton v CSR Building Products Pty Ltd* [2011] SASC 103. In that case, Peek J found (at [72] and [74]) that the running account had been interrupted, and there ceased to be a continuing business relationship, after the creditor issued a letter of demand, implemented various stop supplies and agreed to deliver products of lesser value in return for payments of greater value toward past liability. In *Hussain v CSR Building Products ltd* (2016) 246 FCR 62, Edelman J rejected a submission that notice of insolvency had

destroyed the continuing business relationship as the payments in question had been made for at least one operative purpose of inducing further supply: [223]. His Honour noted that no stop had put on the account and that the parties mutually assumed that there would be a continuance in their relationship as buyer and seller. His Honour later said it was very strongly arguable that the relationship had ended by a later date at which time CSR was aware of the insolvency and had placed a stop on the Group's account: [225].

The decision at first instance

83. Consistent with these authorities, Davies J found that payments 1 and 2 (made on 30 March and 13 or 16 April 2012) were made with the parties "looking backwards rather than forwards; looking to the partial payment of the old debt rather than the provision of continuing services": (J[99]). There was ample evidence to support this finding, undeniably so in the case of Badenoch, including: an admission by Mr Badenoch that he knew Gunns was not able to pay its debts to Badenoch on time (J[36]); an email from Badenoch to Gunns on 1 March 2012 in which Badenoch asked: "Are Gunn's [sic] solvent?" (AFM 247); a letter of demand sent by Badenoch's solicitors on 20 March 2012 threatening legal proceeding if Gunns did not pay $645,951.75 owing within 7 days; notification in the same letter that Badenoch "will not be providing any further Services until the non-payment for the past Services has been rectified": (AFM 264); that supplies were in fact stopped until after payments had been made (J[46]); and the fact that the payments were made pursuant to a payment plan, recorded in emails on 23 March 2012 (AFM 269, 272) and 25 March 2012 (AFM 273), in which Gunns proposed to make payments of over $1 million in a week with a similar amount in a further 2 weeks in return for Badenoch agreeing to resume supply as normal only after the payments had been made. In those emails, Gunns said "*Our objective is to keep the mill running, so I figure we may as well pay the money to you in order to get the deliveries back on track asap*". Badenoch responded: "*we value our relationship, and we are understanding of your position however we need to ensure that we have adequate measures in place to protect our exposure and business which I am sure you will appreciate*". Badenoch accepted the payment terms but said it would only transport current stocks once the first payment was made and restart harvesting operations "as normal" after the second payment. Supply was to be on modified trading terms including a $1m limit on liability. If exceeded, services would cease immediately.

The decision of the Full Court

84. Badenoch appealed this finding. The Full Court allowed the appeal and found that both payments formed part of a single transaction within the meaning of s.588FA(3)(c) that continued until 10 July 2012. In reaching this conclusion, the Full Court considered legal principles relevant to the existence or cessation of a continuing business relationship (FC[46]ff), including the principle in *Eurolinx*:(FC[49]-[50]). The Full Court noted that this conclusion had been extrapolated from the majority judgment in *Airservices* (FC[51]) but said there was some ambiguity in the majority's reasoning in that case. It was possible, the Full Court said, that the majority did not accept that there was any mutual purpose of inducing supply in respect of the final payment: (FC[53]) The Full Court said the reference by the majority to "rather than" in the expression "looking to the partial payment of the old debt rather than the provision of continuing services" supported this construction: (FC[53]). The Full Court said (FC[54]) the principle in *Eurolinx* should be treated with some caution, as it would not be consistent with the rationale behind s 588FA(3) of the Act, which recognises that payments made to induce further supply did not disadvantage the general body of creditors unless the total payments exceeded the total value of goods or services acquired. The Full Court said, to take an "unduly restrictive" approach to the existence of a mutual assumption of a continuing business relationship in this context: (FC[54])

85. To the contrary, it is only if the payment is an integral part of a continuing business relationship - from which it can be inferred there is a clear connection between the impugned payments and continuance of supply - that the principle in s 588FA(3) applies. To read this precondition down on the basis that the running account principle does not disadvantage other creditors because it only permits the retention of payments where the creditor made further supplies of equal value, ignores that the running account defence is not available to all creditors who have made further supplies of value. To take an unduly permissive approach to the existence of a continuing business relationship (such that there need not be a clear connection between payments and supplies where there is a running account) would permit those creditors who supply goods or services on running account, to avail themselves of a defence that other creditors (such as statutory creditors) cannot. In doing so, trade creditors can secure a greater return on their past indebtedness than other creditors, contrary to the purpose of Part 5.7B.

86. As to the test that should be applied, the Full Court rejected the test in *Eurolinx*, stating that it would be wrong to say that the mutual assumption of a continuing business relationship ceased whenever the purpose of a payment tips in favour of recovering past indebtedness:

(FC[54]). The Full Court gave the example of where a creditor insists on payment of an invoice before continuing to supply on terms as an example of where a continuing business relationship may not come to an end: (FC[54]) see also (FC[48](f) citing *Clifton* at [71] and *Hussain* at [223]).

87. In doing so, the Full Court substituted a "sole purpose" test for the "predominant purpose" test in *Eurolinx* with, such that a continuing business relationship will not cease unless the sole purpose of a payment is the reduction in indebtedness. If inducing further supply is any part of the purpose of a payment, however small, the running account principle will apply. This test would almost invariably be satisfied, as further supply is always likely to be at least a subsidiary purpose, with the result that trade creditors who supply goods on a running account would be entitled to the benefit of the running account defence, where other creditors are not, even where the predominant purpose of a payment is the recovery of past indebtedness (c.f. *Richardson*). It is also difficult to reconcile a sole purpose test with *Richardson* and *Airservices*. In each case, the court disallowed the final payment. In *Airservices*, this was despite further supplies, in which case inducing further supply must at least be an operative purpose.

88. By contrast, the predominant purpose test in *Eurolinx* is consistent with the authorities set out above; is consistent with the language and purpose of s 588FA; is readily capable of application; and achieves fairness between all creditors. A creditor who receives a payment made for the predominant purpose of recovering past indebtedness, should not be entitled to set off against that payment the value of further services, when other creditors who may have supplied further services, cannot.

Findings of the Full Court

89. While the Full Court disagreed with the primary judge's conclusion that payments 1 and 2 did not form part of a continuing business relationship (FC[72]) it identified no error on the part of the primary judge save for her Honour's application of the principle in *Eurolinx*.

90. The Full Court noted the letter of demand, and that the payments related to past indebtedness for services provided in January and February, but said subsequent correspondence focused on the desire to "get deliveries back on track": (FC[65]). It relied on Gunns' email of 23 March 2012 (AFM 269) which reflected the predominant purpose of Gunns to re-open the mill. That may also have been a subsidiary purpose of Badenoch, but it was certainly not Badenoch's predominant purpose, as is evident from Badenoch's response on 23 March 2012 which stated its purpose was to "protect [its] exposure and business": (AFM 272).

The Full Court applied the sole purpose test, which would have been satisfied if further supply was any purpose of Badenoch, or alternatively conflated the purpose of Gunns with that of Badenoch, to find that the predominant purpose test was satisfied. In either case, the Court erred.

91. The Full Court found that the measures adopted by Badenoch were "unprecedented", and that Badenoch had applied additional pressure on Gunns to have its invoices paid but found that did not mean there ceased to be a mutual assumption of a continuing relationship of debtor and creditor: (FC[68]). The Court concluded that the intended outcome remained to obtain payment for past services *so that further services could be supplied*: (FC[67]). In so finding, the Court failed to take into account that that demands, threats of legal action, and a stoppage of supply until past indebtedness were repaid, at a time when Badenoch had asked whether Gunns was insolvent, were all indicative of a purpose (on the part of Badenoch at least) inconsistent with the existence of a continuing business relationship; and impermissibly took into account "the context of the entire business relationship" and the value of subsequent supplies (FC[65]) which were irrelevant.

92. The Full Court did not refer to the evidence that Badenoch feared or suspected that Gunns may have been insolvent, including the admission by Mr Badenoch that he knew Gunns was not able to pay its debts to Badenoch on time (J[36]), or the email on 1 March 2012 in which Badenoch asked "Are Gunns solvent?" ([J32]; AFM 247) but noted that Davies J had accepted the evidence of Messrs Badenoch that they believed Badenoch would eventually be paid (J[116]). The Full Court concluded, without disclosing any basis, that to the extent Badenoch did have serious initial reservations about Gunns' willingness and ability to pay, "we consider these reservations would have been addressed in the course of negotiations in March 2012": (FC[71]).

93. The Full Court characterised Badenoch's conduct in implementing the supply stoppage, issuing the demand and proposing a credit limit as "effectively seeking assurance from Gunns that it would be paid for its services": (FC[71]). That characterisation was inaccurate. Badenoch's conduct in stopping supply (J[46]); demanding payment; threatening legal action (J[46]; AFM 264); and imposing a credit limit (J[49]; AFM 273) for the express purpose of "protect[ing its] exposure and business" went well beyond "seeking assurances". The Full Court said that entry into the payment schedule and receiving the two payments "ought to have gone some way to allay Badenoch's concerns": (FC[71]). That the making of the impugned payments may have gone some way towards allaying Badenoch's concerns is immaterial to

Badenoch's purpose in seeking those payments. That Badenoch had such concerns, which had not been allayed at the time the arrangement was entered into, supports, rather than contradicts, the inference that Badenoch's predominant purpose is seeking the payments was the recovery of past indebtedness not the continuation of a supply that had ceased.

94. The Full Court did not identify that the inference that there is a clear connection between impugned payments and further supplies, which may be drawn where a payment is made during the ordinary course of a continuing business relationship, is not available where the relationship or running account has been suspended, terminated or reinstated on materially different terms: *M&R* at 290; *Airservices* at 505.

95. It was on this basis, that the Full Court allowed Ground 2 of the appeal in part and found that Davies J had erred in finding that payments 1 and 2 were not part of a continuing business relationship: (FC[72]).

96. Had the Full Court applied the predominant purpose test, the Full Court should have dismissed Ground 2 of the appeal.

PART VII: Orders sought

97. The Appellants seek the orders set out in the Notice of Appeal.

PART VIII: Time estimate

98. The Appellants estimate that 2.5 hours will be required for their oral argument.

Dated 6 May 2022

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IN THE HIGH COURT OF AUSTRALIA

ADELAIDE REGISTRY

No A10 of 2022

BETWEEN

DANIEL MATHEW BRYANT, IAN MENZIES CARSON, AND CRAIG DAVID CROSBIE IN THEIR CAPACITIES AS JOINT AND SEVERAL LIQUIDATORS OF GUNNS LIMITED (IN LIQUIDATION) (RECEIVERS & MANAGERS APPOINTED) (ACN 009 478 148) AND AUSPINE LIMITED (IN LIQUIDATION) RECEIVERS & MANAGERS APPOINTED) (ACN 004 289 730)

Appellants

and

BADENOCH INTEGRATED LOGGING PTY LTD (ACN 097 956 995)

Respondent

ANNEXURE TO THE APPELLANTS' SUBMISSIONS

Pursuant to paragraph 3 of the *Practice Direction No 1 of 2019*, the Appellants set out below a list of the constitutional provisions, statues and statutory instruments referred to in these submissions.

No.	Title	Provision(s)	Version
	Statutory Provisions		
1.	*Acts Interpretation Act 1901* (Cth)	s 15	Historical version (27 December 2011 – 11 April 2013)
2.	*Bankruptcy Act 1924* (Cth)	s 95	Act no longer in force (8 October 1924 – 1965)
3.	*Companies Act 1910* (Vic)	s 209	Act no longer in force (4 January 1911 – 1915)
4.	*Companies Act 1993* (NZ)	s 292(1)	Historical version (01 December 2014 – 30 April 2015)
5.	*Corporations Act 1989* (Cth)	s 82	Act no longer in force (13 March 2000 – 15 July 2001)

No.	Title	Provision(s)	Version
6.	*Corporations Act 2001* (Cth)	ss 588FA, 588FA(3), 588FA(3)(c), 588FE, 588FF(1), 588FA(1)(b), 122, 588FA(1), 588FA(3)(a), 588FA(3)(d), 588FF, 588FF(3)(b), 588FE(2), 588FE(5), 588FC, 588FE(4)(c), 588FE(5)(c), 588FE(2)(b)(i), 588FA(2), 588FI and Part 5.7B	Historical version (30 January 2012 to 19 April 2012, 20 April 2012 to 27 June 2012, 25 July to 30 September 2012)
7.	*Corporate Law Reform Act 1992* (Cth)	s 588FA and Part 5.7B	Current (24 December 1992 – present)
8.	*Insolvency Act 1890* (Vic)	s 73	Act no longer in force (10 July 1890 – 1897)
9.	*Judiciary Act 1903* (Cth)	s 78B	Historical version (27 December 2011 – 30 September 2011)