[HIGH COURT OF AUSTRALIA.]

DOWNS DISTRIBUTING COMPANY PROPRIETARY LIMITED . . } APPELLANT,
DEFENDANT,

AND

ASSOCIATED BLUE STAR STORES PROPRIETARY LIMITED (IN LIQUIDATION) } RESPONDENT.
PLAINTIFF,

ON APPEAL FROM THE SUPREME COURT OF NEW SOUTH WALES.

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SYDNEY, *Aug.* 10, 11, 27.

Latham C.J., Rich and Williams JJ.

Companies—Liquidation—Preference, priority or advantage—"Ordinary course of business"—Goods sold—Purchase price unpaid at due date—Subsequent arrangement for payment by post-dated cheques—Cheques dishonoured—Purchasing company's ability to pay debts as they became due—Knowledge of vendor company—"Reason to suspect"—Good faith—Fraud—Companies Act 1936-1940 (*N.S.W.*) (*No.* 33 *of* 1936—*No.* 56 *of* 1940), *s.* 298 (1)—*Bankruptcy Act* 1924-1946 (*No.* 37 *of* 1924—*No.* 43 *of* 1946), *s.* 95 (1), (2) (*b*), (4).

Held, by the whole Court, that the expression "in the ordinary course of business" in s. 95 (2) (*b*) of the *Bankruptcy Act* 1924-1946, does not include the settlement of a debt between traders by a transaction involving the redelivery of goods sold together with other goods, subject to an arrangement that the debtor may again purchase the goods for cash, and, by *Rich* and *Williams* JJ., that the expression refers to a transaction into which it would be reasonable for a creditor and debtor to enter as a matter of business in the circumstances of the particular case uninfluenced by any belief on the part of the creditor that the debtor might be insolvent.

Held, by *Latham* C.J. and *Williams* J., that a transaction falls within sub-s. 4 of s. 95, so that a creditor is excluded from the category of a creditor dealing in good faith under sub-s. 2 (*b*), if, whatever the creditor may think or believe with respect to the circumstances of a transaction, those circumstances are such as to lead to an inference by the Court that there was reason to suspect according to the standards of an ordinary reasonable man that the debtor was unable to pay his debts as they became due, and that the effect of the transaction would be to give the creditor a preference over other creditors.

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Held, by *Latham* C.J., that the expression "the creditor . . . had reason to suspect" in s. 95 (4) of the *Bankruptcy Act* 1924-1946 refers to an objective test and should not be interpreted as meaning that the creditor had in his mind some knowledge or belief which to him amounted to reason to suspect.

Per Latham C.J. and *Williams* J.: Fraud should be strictly pleaded and proved.

The rule in *Ex parte James*, (1874) L.R. 9 Ch. 609, discussed.

Decision of the Supreme Court of New South Wales (*Roper* C.J. in Eq.) affirmed.

APPEAL from the Supreme Court of New South Wales.

In a suit brought in the equitable jurisdiction of the Supreme Court of New South Wales by Associated Blue Star Stores Pty. Ltd. (In liquidation) against Downs Distributing Co. Pty. Ltd. the statement of claim was substantially as follows:—

1. The plaintiff was duly incorporated under the provisions of the *Companies Act* 1936 (N.S.W.) as a company limited by shares on 27th March 1946.

2. A duly convened meeting of the plaintiff's shareholders held on 21st August 1946 resolved, by extraordinary resolutions, (i) that it had been proved to the satisfaction of the meeting that the plaintiff could not by reason of its liabilities, continue its business and that it was advisable to wind up the same, and accordingly that the plaintiff be wound up voluntarily, and (ii) that a specified accountant be and was thereby appointed liquidator for the purpose of such winding up.

A duly convened meeting of the creditors of the plaintiff held on 22nd August 1946, by resolution endorsed the action of the plaintiff's shareholders and confirmed the appointment of the specified accountant as liquidator.

3. The defendant was duly incorporated under the provisions of the *Companies Act* 1936 as a company limited by shares.

4. On or about 3rd July 1946 the defendant sold and delivered to the plaintiff goods to the value of £3,007 2s. 6d. on terms that the plaintiff should pay to the defendant as the price for such goods the sum of £2,176 17s. 6d. on 10th July 1946 and the sum of £830 5s. on 15th July 1946.

5. The plaintiff failed to pay the said sum of £2,176 17s. 6d. on 10th July 1946 and also failed to pay the said sum of £830 5s. on 15th July 1946.

6. On or shortly after 10th July 1946 the plaintiff and the defendant agreed that the indebtedness of the plaintiff to the defendant

should be paid and discharged by the issue to the defendant by the plaintiff of three post-dated cheques, the first of such cheques being for the sum of £1,000 payable on 15th July 1946, the second of such cheques being for the sum of £1,000 payable on 22nd July 1946 and the third of such cheques being for the sum of £1,007 2s. 6d. payable on 29th July 1946.

7. The first of the said cheques was duly presented by the defendant on 15th July 1946 and was paid by the defendant's bankers.

8. On or about 22nd July 1946 the plaintiff requested the defendant to refrain from presenting the second of the said cheques for payment until 25th July 1946 which the defendant agreed to do.

9. On or about 25th July 1946 the second of the said cheques was duly presented by the defendant for payment and was dishonoured by the plaintiff's bankers, and had not since been paid.

10. The third of such cheques was duly presented for payment by the defendant on or about 29th July 1946 and was dishonoured by the plaintiff's bankers, and had not since been paid.

11. On or about 1st August 1946 the plaintiff delivered to the defendant goods to the value of approximately £2,007 2s. 6d.

12. In consideration of the plaintiff selling to the defendant the goods mentioned in par. 11 the defendant agreed to pay to the plaintiff the said sum of £2,007 2s. 6d. which said sum was thereupon appropriated and set off by the defendant against the amount owing to it by the plaintiff.

13. Other than the sum so appropriated and set off no consideration passed from the defendant to the plaintiff in consideration of the delivery by the plaintiff to the defendant of the said goods.

14. On and between 3rd July 1946 and 1st August 1946 and thereafter the plaintiff was unable to pay its debts as they became due from its own money.

15. The appropriation by the defendant of the sum of £2,007 2s. 6d. (being the purchase price of the goods referred to in pars. 11 and 12) towards payment of the debt due to the defendant by the plaintiff of the same sum had the effect of giving to the defendant a preference, a priority or an advantage over the other creditors of the plaintiff.

16. Alternatively, the delivery by the plaintiff to the defendant on 1st August 1946 of goods to the value of approximately £2,007 2s. 6d. had the effect of giving to the defendant a preference, a priority or an advantage over other creditors of the plaintiff.

The plaintiff claimed: (1) a declaration—(*a*) that the payment by the plaintiff to the defendant of the sum of £2,007 2s. 6d. on 1st

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August 1946 was a payment made by the plaintiff which was then unable to pay its debts as they became due from its own money in favour of the defendant, a creditor of the plaintiff, having the effect of giving to the defendant a preference, a priority or an advantage over the other creditors of the plaintiff and that, the plaintiff having been wound up within six months thereafter such payment was void, or, alternatively, (*b*) that the delivery by the plaintiff to the defendant of goods to the value of approximately £2,007 2s. 6d. on 1st August 1946 effected a transfer of such goods by the plaintiff which was then unable to pay its debts as they became due from its own money in favour of the defendant, a creditor of the plaintiff, having the effect of giving to the defendant a preference, a priority or an advantage over the other creditors of the plaintiff and that, the plaintiff having been wound up within six months thereafter, such transfer was void, and,

(2) an order (*a*) that the defendant do pay to the plaintiff the sum of £2,007 2s. 6d., or, alternatively, (*b*) that the defendant do transfer to the plaintiff the goods delivered by the plaintiff to the defendant on 1st August 1946.

In its statement of defence the defendant pleaded that it did not know and therefore could not admit the facts alleged in pars. 1, 2, 14 and 16 of the statement of claim. The defendant did not admit that the resolutions mentioned in par. 2 of the statement of claim, or the effect of those resolutions, were sufficiently or correctly set forth. In answer to par. 12 of the statement of claim the defendant said that on or prior to 1st August 1946 it was mutually agreed by and between the plaintiff and the defendant that in consideration that the plaintiff would sell and deliver to the defendant goods to the value of £2,007 2s. 6d. the defendant would accept the same in full satisfaction and discharge of the sum of £2,007 2s. 6d. then due and owing by the plaintiff to the defendant and in pursuance of the said agreement and not otherwise the said goods were sold and delivered to the defendant and save as aforesaid the defendant denied that in consideration of the plaintiff selling to the defendant the goods mentioned in par. 11 of the statement of claim the defendant agreed to pay to the plaintiff the said sum of £2,007 2s. 6d. or any other sum or that such sum or any other sum was thereafter or at all set off by the defendant against the amount owing to it by the plaintiff or any part thereof. The defendant repeated these allegations in answer to pars. 13 and 15 of the statement of claim, and, in further answer to par. 13, save as aforesaid, denied that the said sum or any sum was appropriated or set off as alleged in par. 13 and denied that except as therein alleged no consideration passed

from the defendant to the plaintiff in consideration of the delivery by the plaintiff to the defendant of the said goods, and, in further answer to par. 15, denied that there was any appropriation by the defendant of the sum of £2,007 2s. 6d. or any other sum towards payment of any debt due to the defendant by the plaintiff or the same or any other sum and did not know and could not admit that any such appropriation, if made, had the effect of giving to the defendant a preference, a priority or an advantage over the other creditors of the plaintiff. In further answer to the statement of claim the defendant said: (i) that at all material times it was a purchaser of the said goods in good faith and for valuable consideration and in the ordinary course of business and (ii) that the transfer of the said goods was for valuable consideration and that the transaction took place before the commencement of the winding up of the plaintiff and that the defendant had not at the time of the transaction notice of any act of the plaintiff which if committed by an individual would have constituted an available act of bankruptcy and that the transaction was in good faith and in the ordinary course of business.

Section 298 (1) of the *Companies Act* 1936-1940 (N.S.W.) provides that "any such . . . delivery of goods, payment, execution or other act relating to property as would, according to the law of bankruptcy for the time being in force, if made or done by or against an individual be void or voidable in the event of his bankruptcy, shall, if made or done by or against a company, be deemed in the event of such company being wound up under this Act to be void or voidable in like manner."

The *Bankruptcy Act* 1924-1946, by s. 95, provides, so far as material: "(1) Every . . . transfer of property . . . every payment made, every obligation incurred . . . by any person unable to pay his debts as they become due from his own money, in favour of any creditor or of any person in trust for any creditor, having the effect of giving to that creditor . . . a preference, a priority or an advantage over the other creditors, shall, if the debtor becomes bankrupt on a bankruptcy petition presented within six months thereafter be void as against the trustee in bankruptcy. (2) Nothing in this section shall affect—(*a*) the rights of any person making title in good faith and for valuable consideration through or under a creditor of the bankrupt; or (*b*) the rights of a purchaser (or) payee . . . in good faith and for valuable consideration and in the ordinary course of business. (3) The burden of proving that the provisions of the last preceding sub-section have been complied with shall lie upon the person who

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relies upon their having been complied with. (4) For the purposes of this section a creditor shall not be deemed to be a purchaser, (or) payee . . . in good faith if the . . . transfer . . . payment or obligation were made or incurred under such circumstances as to lead to the inference that the creditor knew or had reason to suspect that the debtor was unable to pay his debts as they became due, and that the effect of the . . . transfer . . . payment or obligation would be to give him a preference, a priority or an advantage over the other creditors."

Roper C.J. in Eq. made a decree whereby it was declared that the payment by the plaintiff to the defendant of the sum of £2,007 2s. 6d. on 1st August 1946 was a payment made by the plaintiff which was then unable to pay its debts as they became due from its own money in favour of the defendant, a creditor of the plaintiff, having the effect of giving the defendant a preference, a priority or advantage over the other creditors of the plaintiff, and that, the plaintiff having been wound up within six months thereafter such payment was void. The defendant was ordered to pay to the plaintiff within a specified period the sum of £2,007 2s. 6d.

From that decision the defendant appealed to the High Court.

Further material facts appear in the judgments hereunder.

Barwick K.C. (with him *Isaacs*), for the appellant. The evidence establishes that the transaction was not in the nature of a purchase by the appellant of certain goods from the respondent. On a strict analysis of the facts there were two transactions, namely a loan transaction by the appellant to the respondent, goods being taken in pledge as security, the proceeds of the loan being utilized in payment of an existing debt by the respondent to the appellant. Those transactions were in the ordinary course of business. The appellant's managing director, who was held to be an astute and honest man, had no reason to suspect insolvency or to suspect that the transactions would have the effect of giving a preference to the appellant, therefore the matter does not come within s. 95 (4) of the *Bankruptcy Act* 1924-1946. The issue in this case is wholly subjective, namely, was the transaction "in the ordinary course of business" within the meaning of that expression in s. 95 of the *Bankruptcy Act*, and was it bona fide. It is very significant that it was a real transaction proposed with an insurance company. The test is not whether it was the normal procedure of the parties in question, but whether it was a fair and reasonable transaction

without knowledge of bankruptcy (*Robertson* v. *Grigg* (1)). The word " fair " so used is the antithesis of " oppressive." It was found as a fact that the appellant was not aware of the insolvency. The words " in the ordinary course of business " are satisfied if the transaction is a business transaction, but for the purposes of s. 95, the idea of want of bona fides and doing something with a view to bankruptcy was re-introduced in sub-s. 4 of s. 95 in the expression " knew or had reason to suspect."

[LATHAM C.J. referred to *Tomkins* v. *Saffery* (2).]

It is not necessary to relate this transaction to the particular business of the parties concerned (*Burns* v. *McFarlane* (3)). The judge of first instance worked from the circumstances of the transaction to a positive state of mind in the appellant's managing director which the evidence denies and is inconsistent with the acceptance of the managing director as an honest witness. Subsection (4) of s. 95 is directed to assuming the subjective condition in the creditor (*S. Richards & Co. Ltd.* v. *Lloyd* (4)). Mere temporary financial embarrassments are not insolvency (*Bank of Australasia* v. *Hall* (5)). In the light of the facts, even on a wide view of sub-s. (4) of s. 95, it cannot be said that there was reason to suspect that the respondent was unable to pay its debts in the sense of being insolvent and that payment of the particular debt would give a preference. The debt was dishonestly contracted by the respondent, and its liquidator, an officer of the Court, should not be permitted to pursue that dishonesty and take the benefit (*Ex parte James* ; *In re Condon* (6) ; *In re Tyler* (7) ; *In re Thellusson* (8) ; *In re Wigzell* ; *Ex parte Hart* (9) ; *Official Assignee* v. *Goldstein* (10) ; *Cock* v. *Smith* (11) ; *Williams* on *Bankruptcy*, 15th ed. (1937), p. 243).

A. R. Taylor K.C. (with him *Manning*), for the respondent. The submission made on behalf of the appellant that in substance this is a suit by the respondent's liquidator to obtain the benefit of the original contract under which the goods were bought which contract was induced by fraud and therefore the Court, in its discretion, should not assist the liquidator, is not well founded. The cases on this point are collected and discussed in *Williams* on *Bankruptcy* 15th ed. (1937), pp. 229-242. In substantially all of those cases the common characteristic was that there had been a payment to

(1) (1932) 47 C.L.R. 257, at p. 268.
(2) (1877) 3 App. Cas. 213.
(3) (1940) 64 C.L.R. 108, at pp. 124, 125.
(4) (1933) 49 C.L.R. 49, at p. 60.
(5) (1907) 4 C.L.R. 1514, at p. 1528.
(6) (1874) L.R. 9 Ch. 609.
(7) (1907) 1 K.B. 865, at pp. 868, 869, 871, 873.
(8) (1919) 2 K.B. 735, at pp. 747, 754.
(9) (1921) 2 K.B. 835.
(10) (1921) 29 C.L.R. 377, at p. 386.
(11) (1909) 9 C.L.R. 773, at p. 792.

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the trustee which had been made under a mistake of law, subsequently discovered, and in those cases it was directed that the moneys be repaid. *In re Thellusson* (1) was a different type of case. The lender in that case in no circumstances could have proved for a debt. All the cases following upon *Ex parte James*; *In re Condon* (2) were where there had been either an over-payment or a double payment under a mistake of law or fact or were moneys for an innocent third party which had come into the hands of the Receiver. In recent years that case has been applied only in *Re Docker* (3) which was a case of a double payment made in error.

[WILLIAMS J. referred to *Scranton's Trustee* v. *Pearse* (4).]

In all the cases emphasis was laid upon the fact that advantage had been taken of an innocent party. The principles involved have never been for the benefit of any person who had not paid in good faith. That fact is a complete answer to the submission made on behalf of the appellant. The subsequent transaction does not affect the position. There is no evidence or finding that the original contract was induced by fraud. There was abundant evidence that early in July the respondent could not pay the appellant for further goods. Profit was not a primary motive in the second transaction, the delivery of the goods was to operate as a discharge of the debt—see the statement of defence—and it was subject to a condition entitling the respondent to re-purchase the goods within a reasonable time. On the facts the judge of first instance was entitled to find that the appellant's managing director had reason to suspect that the respondent was unable to pay its debts as they became due. The onus of proving the absence of such reason or suspicion has not been discharged by the appellant. The test under s. 95 (4) of the *Bankruptcy Act* is not subjective in the sense that it looks to the mind of the particular person concerned. Even if the subjective test be applied there is sufficient evidence to support a finding that the appellant's managing director, an astute business man, at least had reason to suspect, and that he knew that the respondent could not pay its debts. If the meaning of the section as put forward on behalf of the appellant be correct a new issue of fact would have been raised which was not before the judge of first instance, namely, whether the said managing director with his knowledge and training had reason to suspect. The statement in *Robertson* v. *Grigg* (5) is not an exhaustive statement as to what might be said to be the ordinary course of business but this view was followed in *S. Richards & Co. Ltd.* v. *Lloyd* (6) where the

(1) (1919) 2 K.B. 735.
(2) (1874) L.R. 9 Ch. 609.
(3) (1938) 10 A.B.C. 97.
(4) (1922) 2 Ch. 87.
(5) (1932) 47 C.L.R., at p. 267.
(6) (1933) 49 C.L.R. 49.

Official Receiver succeeded on evidence which was not as strong from the point of view of inference as the case now before the Court. The significance which must be attached to payments which come from the debtor himself, as in this case, is shown in *Nunes* v. *Carter* (1). A different view as to the meaning of the expression " in the ordinary course of business " was entertained in the bankruptcy courts prior to *Robertson* v. *Grigg* (2). That view, which appears in cases referred to in *McDonald, Henry & Meek's Australian Bankruptcy Law and Practice*, 2nd ed. (1939), p. 340, should be upheld. At the very worst against the respondent in this case the transaction could not be said to be in the ordinary course of business unless it be a transaction uninfluenced by considerations relating to insolvency or the possibility of insolvency. If it be a transaction entered into by the payee with a view to insolvency then " ordinary course of business " will add nothing to the section. In this case the transaction was influenced by considerations which do not influence business in the ordinary course.

Barwick K.C., in reply. The question is whether in the circumstances as known to the appellant's managing director he had reason to suspect, on either view of the meaning of s. 95 (4), that is, that it means (i) he was in some way conscious of reasons for suspicion, or (ii) objectively, he ought to have had reasons. *Scranton's Trustee* v. *Pearse* (3) lends weight to the submission made on behalf of the appellant as to the width of the doctrine. That case was a particular type of case where the Court went to great pains to show that that particular type of claim was outside the doctrine.

Cur. adv. vult.

Aug. 27.

The following written judgments were delivered :—

LATHAM C.J. This is an appeal from a decree of the Supreme Court of New South Wales in Equity (*Roper* C.J. in Eq.) declaring (1) that a payment by the plaintiff company, the Associated Blue Star Stores Pty. Ltd. (In liquidation), to the defendant company, Downs Distributing Co. Pty. Ltd., was a payment made by the plaintiff which was then unable to pay its debts as they became due from its own money in favour of the defendant, a creditor of the plaintiff, having the effect of giving to the defendant a preference or priority or an advantage over the other creditors of the plaintiff and (2) that, the plaintiff having been wound up within six months

(1) (1866) L.R. 1 P.C. 342, at p. 348.
(2) (1932) 47 C.L.R. 257.
(3) (1922) 2 Ch. 87.

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after such payment, the payment was void. An order was made that the defendant pay the said sum to the plaintiff. The order was made by virtue of s. 95 of the Commonwealth *Bankruptcy Act* 1924-1946, which avoids preferences given to creditors by bankrupts within six months of bankruptcy. That section has been made applicable in the winding up of a company by the *Companies Act* 1936-1940 (N.S.W.), s. 298 (1).

The declaration made brings the challenged transaction within the provisions of s. 95 (1) of the *Bankruptcy Act*. It is not disputed that the company was unable to pay its debts as they became due from its own money at the time (August 1946) when the transaction which has been declared void took place. Section 95 (2) provides that nothing in the section shall affect " (*b*) the rights of a purchaser, payee or encumbrancer in good faith and for valuable consideration and in the ordinary course of business." The defendant company contends that it is entitled to protection under this provision. Section 95 (4) provides :—" For the purposes of this section a creditor shall not be deemed to be a purchaser, payee or encumbrancer in good faith if the conveyance, transfer, charge, payment or obligation were made or incurred under such circumstances as to lead to the inference that the creditor knew or had reason to suspect that the debtor was unable to pay his debts as they became due, and that the effect of the conveyance, transfer, charge, payment or obligation would be to give him a preference, a priority or an advantage over the other creditors." It was contended for the plaintiff that the transaction in question took place under circumstances such as to lead to the inference that, if the creditor did not have the knowledge to which the sub-section refers, at least it had reason to suspect that the debtor company was insolvent and that the challenged transaction had the effect of giving a preference to the defendant company over other creditors. The learned judge held that though the manager (James Mansfield) of the defendant company was an honest man and the manager of the plaintiff company (J. D. Anderson) was not an honest man, the transaction was not in the ordinary course of business and, further, that the defendant company had reason to suspect the insolvency of the plaintiff company, so that the effect of the payment would be to give a preference. The result was that it was held that the defendant company was excluded by s. 95 (4) from the category of purchaser or payee or encumbrancer in good faith. The defendant appellant challenges these findings and further contends that the principle of *Ex parte James* (1) is applicable and

(1) (1874) L.R. 9 Ch. 609.

that to allow the plaintiff company to recover in the present proceedings would be to permit the liquidator, who is an officer of the court, to take advantage of what is alleged to be a dishonest transaction, and that on this ground the Supreme Court should have exercised its discretion by refusing to make a decree in favour of the plaintiff.

The plaintiff company was incorporated in March 1946. It went into liquidation on 21st August 1946. The defendant company was an agent for various suppliers of groceries, and the plaintiff company was engaged in the wholesale grocery trade. In June 1946 an employee of the Blue Star company ordered goods from the defendant company on terms that payment was to be made within seven days after delivery. A representative of the Blue Star company said that there would be no difficulty about payment in seven days. The total purchase price was £3,007 2s. 6d. It was arranged, however, that ten days' credit should be given instead of seven days' credit. The goods were delivered on 3rd July. Payment was not made on the due date and on 12th July a discussion took place between Mansfield and Anderson in the course of which Anderson said that the Blue Star company had overbought and, accordingly, he asked for the time for payment to be extended. He also said that he expected further capital to be obtained for the company. It was then arranged that payment should be made by instalments. Three cheques were given. The first cheque for £1,000 was paid on 15th July. The next cheque, it had been arranged, would be payable on 22nd July, and the final cheque on 29th July. The second cheque, which was due on 22nd July, was dishonoured upon presentation. Anderson said that it would be paid on Thursday, July 25th. Neither the second nor third cheques were paid. Mansfield saw the manager of the bank at which the Blue Star company kept its account, and the manager informed him that this was the first occasion on which a Blue Star company's cheque had been dishonoured. When the cheques were dishonoured Mansfield became concerned and discussed the position with Anderson. Mansfield said in evidence that he was not satisfied with Anderson's statement that further capital would be obtained, and he accepted in cross-examination the suggestion that he was sick of having promises made that were not kept and he wanted his money. Anderson said that he had been negotiating with an insurance company to obtain an advance on goods in the possession of the Blue Star company on paying 2½ per cent for the advance. Mansfield then told Anderson that his company, the Downs Distributing Co., would be prepared to take the stock and make an

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advance of the moneys owing, hold the goods to the order of the Blue Star company, and that the company could take them as and when required, paying cash for them. Anderson agreed to this proposal with a discount of 2½ per cent less than that ordinarily allowed by the defendant company in its list prices. On 3rd August a statement was rendered by the Downs Distributing Co. to the Blue Star company setting out quantities and prices of goods delivered under the arrangement by the Blue Star company, the total value being stated at £2,042 5s. 4d. Of these goods less than £700 worth had been supplied by the Downs Distributing Co. The statement of account was headed "Goods as security from Blue Star Stores Pty. Limited." In the books of the defendant company, however, the Blue Star company was represented in the ledger account as owing the amount already stated, namely, £3,007 2s. 6d., for goods sold to it, was credited with the cheque of £1,000 which had been duly met, and was further credited "By goods £2,007 2s. 6d." Thus the debt of £3,007 2s. 6d. was treated as paid, that is, the goods were taken in satisfaction of the debt. The ledger account further shows that on 12th August the Blue Star company purchased goods to the value of £218 2s. 7d. from the Downs Distributing Co. and paid for them on the same date.

Upon these facts *Roper* C.J. in Eq. held that the substance of the transaction between the defendant and the plaintiff on 3rd August was that "the plaintiff should deliver to the defendant goods of a value slightly in excess of the amount due to the defendant, that the defendant should accept those goods in payment of the debt, who should hold them for a reasonable time and resell them to the plaintiff for cash as and when the plaintiff ordered them." It has been argued for the appellant that the transaction constituted a loan by the Downs Distributing Co. to the Blue Star company of the amount of the latter company's debt, application of the loan money in discharging the debt, and a pledge of the goods as security for repayment of the loan. It is true that the statement to which I have referred represents the goods as being "security," but in my opinion all the facts show that the account of the transaction adopted by *Roper* C.J. in Eq. more accurately describes the substance of the matter.

In my opinion it is unnecessary in this case to determine the precise meaning of the words "in the ordinary course of business" where they appear in s. 95 (2) (*b*) of the *Bankruptcy Act*. Whether that expression is understood in a very general sense or in a sense limited by reference to the particular businesses of the parties concerned, it cannot in my opinion fairly be said that the settlement

of a debt between traders by a transaction involving the redelivery of goods sold together with other goods, subject to an arrangement that the debtor may purchase the goods again for cash, is a transaction in the ordinary course of business. Whether it is regarded as satisfaction of the debt by delivery of the goods (as recorded in the defendant company's books) or as a loan of money followed by payment of the debt and a pledge of the goods, the transaction is of an unusual kind and cannot be said to be in any ordinary course of business.

Further, the circumstances show that Mansfield was anxious about the position and was afraid that his company might not be paid for the goods. He therefore entered into the unusual transaction involving the return of some of the goods sold, together with other goods. In my opinion *Roper* C.J. in Eq. was right in holding that the circumstances were such as to lead to the inference that the Downs Distributing Co. had reason to suspect that the Blue Star company was unable to pay its debts as they became due and that the effect of the transaction would be to give a preference to that company over other creditors. It was argued that the words "the creditor had reason to suspect" meant that the creditor had in his mind some knowledge or belief which to him amounted to reason to suspect; in other words, that the test was a subjective test. In my opinion there is no reason for interpreting the words of the section in this way, and there is every reason for interpreting them as referring to an objective test. The sub-section refers to "such circumstances as to lead to" one or other of two inferences; either first, that the creditor knew certain facts; or secondly, that the creditor had reason to suspect the existence of certain facts. The provision as to the creditor "knowing" adopts a subjective criterion—applied by inference made by the court. The other provision as to the circumstances leading to an inference that the creditor had "reason to suspect" relates in my opinion to what may, by way of comparison, be described as an objective test. It is intended to deal with circumstances such that an inference can fairly be drawn by a court that there was reason to suspect, whether or not in fact the mind of the creditor consciously adverted to the significance with respect to the financial position of the debtor of the matters mentioned in the sub-section. In my opinion a transaction falls within sub-s. (4), so that a creditor is excluded from the category of a creditor dealing in good faith under sub-s. (2) (*b*), if, whatever the creditor may think or believe with respect to the circumstances of a transaction, those circumstances are such as to lead to an inference by the court that there was reason to suspect

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according to the standards of an ordinary reasonable man that the debtor was unable to pay his debts as they became due, and that the effect of the transaction would be to give the creditor a preference over other creditors.

The doctrine of *Ex parte James* (1) was fully examined in *Scranton's Trustee* v. *Pearse* (2) a case which illustrates the difficulties involved in applying a criterion of honest and high-minded conduct. In the present case, however, it appears to me that there are no such difficulties. The argument for the appellant is that the original purchase of the goods by the Blue Star company (not, be it observed, the transaction attacked as a preference) was a fraudulent transaction, and that if the liquidator is allowed to succeed in the present action the result will be that the liquidator will be taking advantage of that fraudulent transaction by obtaining an order for the appellant company to pay the sum of £2,007 2s. 6d. Without going into other matters I am of opinion that the foundation of the appellant's argument fails. No issue of fraud was raised before *Roper* C.J. in Eq. and the evidence was not directed to such an issue. There is no finding of fraud by the learned trial judge. Before fraud is found the issue must be clearly raised and the evidence must be convincing. The evidence is as consistent with hopeful optimism on the part of the Blue Star company as with fraud. It would, in my opinion, be quite wrong for a court of appeal, which has not seen the witnesses, to base a decision upon a new finding by it that a transaction was fraudulent. There may possibly be very exceptional circumstances in which such a course might properly be adopted, but this case cannot be held to present any circumstances which would exclude what, in my opinion, should be the general rule. There are other suggested replies to the attempt to apply *Ex parte James* (1) with which it is not necessary to deal. Accordingly, in my opinion the decision of the Supreme Court was right and the appeal should be dismissed.

RICH J. I agree that the appeal should be dismissed. As was pointed out in *Burns* v. *McFarlane* (3) the issues in sub-s. 2 (*b*) of s. 95 of the *Bankruptcy Act* 1924-1933 are " (1) good faith; (2) valuable consideration; and (3) ordinary course of business." This last expression it was said " does not require an investigation of the course pursued in any particular trade or vocation and it does not refer to what is normal or usual in the business of the debtor or that of the creditor." It is an additional requirement and is

(1) (1874) L.R. 9 Ch. 609.
(2) (1922) 2 Ch. 87.
(3) (1940) 64 C.L.R. 108, at p. 125.

cumulative upon good faith and valuable consideration. It is, therefore, not so much a question of fairness and absence of symptoms of bankruptcy as of the everyday usual or normal character of the transaction. The provision does not require that the transaction shall be in the course of any particular trade, vocation or business. It speaks of the course of business in general. But it does suppose that according to the ordinary and common flow of transactions in affairs of business there is a course, an ordinary course. It means that the transaction must fall into place as part of the undistinguished common flow of business done, that it should form part of the ordinary course of business as carried on, calling for no remark and arising out of no special or particular situation.

The evidence in the case supports the findings that the transaction was not made in good faith or in the ordinary course of business.

WILLIAMS J. This is an appeal by the defendant from a decree made by *Roper* C.J. in Eq. sitting as the Supreme Court of New South Wales in Equity, whereby it was declared that the payment by the plaintiff to the defendant of the sum of £2,007 2s. 6d. on 1st August 1946 was a payment made by the plaintiff which was then unable to pay its debts as they became due from its own money in favour of the defendant, a creditor of the plaintiff, having the effect of giving to the defendant a preference, a priority or an advantage over the other creditors of the plaintiff, and that, the plaintiff having been wound up within six months thereafter, such payment was void.

The plaintiff had a short and for the most part an insolvent life. It was incorporated on 27th March 1946 but found it necessary as soon after as 21st August 1946 to hold a general meeting and pass an extraordinary resolution that it could not by reason of its liabilities continue its business, and that it should be wound up voluntarily. The genesis of the payment was the sale and delivery of goods by the defendant to the plaintiff on 3rd July 1946 for prices which after deducting 10 per cent totalled £3,007 2s. 6d. This was the first transaction between the companies. Prior to the sale the managing director of the defendant told the agent of the plaintiff that all the defendant's goods were sold strictly on seven days payment and the agent said there would be no difficulty whatever about such payment. But there was a difficulty at the very beginning because the agent said that the plaintiff would not be able to pay for the whole of the goods in seven days, and at his request the goods were divided into two parcels, the first parcel comprising goods priced at £2,176 17s. 6d., payment to be made on

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10th July 1946 and the second parcel priced at £830 5s., payment to be made on 15th July 1946. The £2,176 17s. 6d. was not paid on 10th July 1946, whereupon the managing director of the defendant telephoned the plaintiff, and on 12th July had a discussion with its managing director. The latter told the former that his company had over bought stocks of goods on a cash basis which they were finding a little difficult to sell, and that it would be necessary to delay payment for the defendant's goods for a few days. He also said that the financial position of the plaintiff would be greatly improved because the Treasury had approved of the sale of shares in the company, and he was confident the plaintiff would be able to dispose of considerable numbers of its shares to retail shopkeepers and this would mean a considerable increase in the capital of the company. The latter replied that the defendant was not interested in the details of the plaintiff's financial position and wanted to be paid. Finally he agreed that payment of both amounts of purchase money should be made by three post-dated cheques, the first for £1,000 payable on 15th July, the second for £1,000 payable on 22nd July and the third for £1,007 2s. 6d. payable on 29th July.

The first cheque was presented and paid on 15th July. The second cheque was presented on 22nd July and dishonoured; it was re-presented on 24th July and again dishonoured. The managing director of the plaintiff then requested the managing director of the defendant to allow this cheque to stand over until after the presentation and payment of the third cheque. The third cheque was presented on 29th July and dishonoured. The managing director of the plaintiff repeated his previous statement that the plaintiff was finding it difficult to sell goods paid for in cash as an excuse for the failure to honour these cheques. He again mentioned that the company hoped to raise fresh capital by the sale of its shares, and referred to £7,000 to be provided by a mysterious person in Siam which had been delayed in transit. The managing director of the defendant also made enquiries from the manager of his bank, which was also the bank of the plaintiff, and got satisfactory answers, and inspected the plaintiff's warehouse where he saw large quantities of goods which he knew from his knowledge of the trade could only have been purchased for cash. It was in these circumstances that the transaction took place which *Roper* C.J. in Eq. has held to be a preference.

It is described in the declaration in the decree as the payment of £2,007 2s. 6d. but I doubt whether this is an adequate description of the transaction. Its true nature appears to have been that the

defendant advanced the plaintiff the sum of £2,007 2s. 6d. to enable the plaintiff to pay the defendant for the goods. The advance was secured by the plaintiff depositing with the defendant goods consisting partly of some of the goods sold by the defendant to the plaintiff and partly of other goods, prices being placed against such goods which after deducting 7½ per cent totalled £2,042 5s. 4d. The plaintiff was to be entitled to redeem these goods at these prices. The result was that for the accommodation provided the defendant was to receive the difference between £2,007 2s. 6d. and £2,042 5s. 4d., that is to say, £35 2s. 10d. Instead of being an unsecured creditor of the plaintiff for £2,007 2s. 6d., representing the purchase money of goods sold and delivered by the defendant to the plaintiff, the defendant became a secured creditor of the plaintiff for £2,042 5s. 4d. representing money lent by the defendant to the plaintiff, the balance of £35 2s. 10d. representing the consideration for the loan. There is evidence that the managing director of the plaintiff had first suggested that he would raise the money to pay the defendant by pledging goods with an insurance company and that this led the managing director of the defendant to offer on behalf of his company to lend the money instead. There is also evidence that the defendant had lent money on the security of goods before, but this was the first occasion it had lent money to an existing debtor.

His Honour accepted the managing director of the defendant as an astute business man and an honest witness. He was satisfied that the witness was misled despite his astuteness by the greater astuteness and persuasiveness of the managing director of the plaintiff into accepting the latter's assurance that the financial embarrassment of the plaintiff was temporary and would shortly be overcome. But the onus was on the defendant to prove that the transaction was in good faith and for valuable consideration and in the ordinary course of business, and his Honour was not satisfied that the transaction was in good faith or in the ordinary course of business. He held that the defendant had reason to suspect that the plaintiff was unable to pay its debts as they became due and that the effect of the payment would be to give it a preference, priority or an advantage over the other creditors.

I entirely agree with these findings. The meaning of the expression in the ordinary course of business in s. 95 (2) of the *Bankruptcy Act* was discussed by this Court in *Robertson* v. *Grigg* (1), and *Burns* v. *McFarlane* (2). In the later case (3) it was said in the

(1) (1932) 47 C.L.R. 257.
(2) (1940) 64 C.L.R. 108.
(3) (1940) 64 C.L.R., at p. 125.

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joint judgment of *Rich* J., *Dixon* J. and *McTiernan* J. that the expression does not require an investigation of the course pursued in any particular trade or vocation, and that it does not refer to what is normal or usual in the business of the debtor or that of the creditor. It seems to me, therefore, that the expression refers to a transaction into which it would be usual for a creditor and debtor to enter as a matter of business in the circumstances of the particular case uninfluenced by any belief on the part of the creditor that the debtor might be insolvent. In my opinion the transaction impeached was not of this nature. The defendant was pressing for payment in cash for the goods it had sold and delivered to the plaintiff. The transaction did not result in any immediate cash payment. Cash could only be obtained by the plaintiff selling its stock on hand or raising fresh capital. It could not assist the plaintiff to sell its goods or to raise fresh capital to have its goods deposited not in its own warehouse but in that of the defendant. The transaction was not in any sense an ordinary loan. There was no proper rate of interest and no time fixed for repayment. The purpose of the transaction was to convert the defendant from an unsecured creditor into a secured creditor, and thereby give the defendant a preference over the other unsecured creditors of the plaintiff. I agree with his Honour that a short extension of credit would have been all that was necessary to meet the situation in the ordinary course of business if the defendant had not had a possible insolvency of the plaintiff in view.

His Honour was also not satisfied that the defendant was a purchaser, payee or encumbrancer in good faith. Section 95 (4) defines two instances in which a creditor shall not be deemed to be a purchaser, payee or encumbrancer in good faith. The first case is where the circumstances are such as to lead to the inference that the creditor knew that the debtor was unable to pay his debts as they became due and that the effect of the transaction would be to give him a preference, priority or advantage over the other creditors. The second case is where the circumstances are such as to lead to the inference that the creditor had reason to suspect these matters. His Honour found that the circumstances were such as to lead to the inference that the managing director of the defendant had reason to suspect these matters. It was contended for the appellant that in drawing such an inference the Court should have regard to the mentality of the particular creditor. But, in my opinion, the circumstances to which the sub-section refers are such circumstances as would lead a reasonable business man to suspect these matters.

In the present case there was ample evidence to lead to the inference in question. A part of the original debt should have been paid on 10th July but it was not paid. The plaintiff had to ask for time to pay. It was unable to pay the second cheque on 22nd July or the third cheque on 29th July. Section 95 (1) of the *Bankruptcy Act* refers to a person being unable to pay his debts as they become due from his own money. Section 95 (4) refers to a person being unable to pay his debts as they become due, so that it does not contain the words from his own money, but the expression must have the same meaning in both sub-sections. In the leading case of *Bank of Australasia* v. *Hall* (1), *Isaacs* J. said that a debtor is able to pay his debts as they become due from his own money "if the debtor can by sale or mortgage of property which he owns at the time . . . change the form of the property into cash wholly or partly but sufficient for the purpose of paying his debts as they become due" (2).

Any reasonable business man in the position of the managing director of the defendant must have suspected that the plaintiff was unable to pay its debts as they became due out of its existing resources and would only be able to do so if it could obtain additional capital. The managing director knew that there were other creditors, so that any reasonable business man in his position must have suspected that to convert an unsecured into a secured debt would give the defendant a preference over the other unsecured creditors.

There remains for consideration a ground not taken before his Honour, namely, the contention that the transaction impeached is protected by the rule in *Ex parte James*; *Re Condon* (3). In that case the proceeds of an execution had been paid by the execution creditor to the trustee in bankruptcy under the mistaken belief that the trustee was legally entitled to the moneys. It was held that the Court had jurisdiction to relieve against the mistake of law and to order the trustee to repay the moneys to the execution creditor. *James* L.J. said: "I am of opinion that a trustee in bankruptcy is an officer of the Court. He has inquisitorial powers given him by the Court, and the Court regards him as its officer, and he is to hold money in his hands upon trust for its equitable distribution among the creditors. The Court, then, finding that he has in his hands money which in equity belongs to some one else, ought to set an example to the world by paying it to the person really entitled to it. In my opinion the Court of Bankruptcy ought

(1) (1907) 4 C.L.R. 1514.
(2) (1907) 4 C.L.R., at p. 1543.
(3) (1874) L.R. 9 Ch. 609.

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to be as honest as other people " (1). The rule in *Ex parte James* (2) has been invoked in many subsequent cases, on some occasions with, but more often without, success. In *In re Tyler* (3), *Farwell* L.J. said that the rule applied to the administration of all estates, whether in Chancery, Bankruptcy, or the winding up of companies where the Court itself by its officer often found itself in the position of a *quasi* litigant. In the same case *Buckley* L.J. said that in *Ex parte James* (1), *James* L.J., when he spoke of money which in equity belonged to some one else, meant money " which in point of moral justice and honest dealing belongs to some one else. He was using the words in a popular sense, and not in the sense of money which in a Court of Equity would belong to some one else . . . assuming that he (the officer) has a right enforceable in a Court of Justice, the Court of Bankruptcy or the Court for the administration of estates in Chancery will not take advantage of that right if to do so would be inconsistent with natural justice and that which an honest man would do " (4). These words of *Buckley* L.J. were approved by *Atkin* L.J. in *In re Thellusson* (5). In *Re Gozzett* (6), *Romer* L.J. said that the principle is applicable only when an officer of the Court, if he acted in strict accordance with his legal rights, would be doing something dishonourable. There is a useful collection of the cases up to 1922 in the report of *Scranton's Trustee* v. *Pearse* (7). The scope of the rule is discussed in the judgments of the Court of Appeal in that case and *Williams* on *Bankruptcy* 15th ed. (1937), pp. 239 et seq. Since *Scranton's Case* (8) the rule has again been before the Court of Appeal in *Re Gozzett* (9). In *In re Thellusson*, *Atkin* L.J. said that " it can make no difference whether the trustee himself has acquired the property by unworthy means, or whether there is vested in him by operation of law property which has been acquired by the debtor by unworthy means. If it would be dishonourable of the debtor to use the money to pay his creditors, it is equally dishonourable for the officer of the Court, knowing the full facts, to use the money to pay his creditors " (10). But the cases as a whole appear to show that it is only in exceptional cases that the rule would be applied where the officer or his predecessor in office has not been personally concerned in the transaction. *In re Thellusson* (11) is an exceptional case. There a creditor who had agreed to lend the debtor money to pay

(1) (1874) L.R. 9 Ch., at p. 614.
(2) (1874) L.R. 9 Ch. 609.
(3) (1907) 1 K.B., at p. 871.
(4) (1907) 1 K.B., at p. 873.
(5) (1919) 2 K.B., at p. 762.
(6) (1936) 1 All E.R. 79, at p. 88.
(7) (1922) 2 Ch., at p. 116.
(8) (1922) 2 Ch. 87.
(9) (1936) 1 All E.R. 79.
(10) (1919) 2 K.B., at p. 764.
(11) (1919) 2 K.B. 735.

a pressing debt paid the money into the bank account of the debtor in ignorance of the fact that a receiving order had been made against him. Out of the money paid in, the bank recouped itself for the amount of an overdraft leaving a balance in the account. The balance vested in the Official Receiver by operation of law. The money was paid into a bank account over which the Official Receiver had control, so that the payment was very much akin to a payment to him personally. In *Re Gozzett* (1), Lord *Wright* M.R. said that the payment was very analogous to a payment under mistake of fact and it was not therefore a matter of astonishment that the Court held that the rule should apply. In his judgment in *In re Wigzell* (2), *Younger* L.J. set out the exceptional circumstances that existed in *In re Thellusson* (3). He referred to the essential difference between applying the rule to "a transaction initiated by the bankrupt himself, not presumably in every case a person of the highest commercial morality, and a transaction initiated either by the trustee or the Court" (4). He pointed out that in the case of transactions initiated by the bankrupt himself "it is not obvious that a creditor with whom that transaction has been carried out and is complete, even one who in relation to it may have been tricked by the bankrupt, has any equity at all as against the other creditors of the same bankrupt, who may all have been equally tricked, merely because in his case the proceeds of the transaction can be traced amongst the bankrupt's assets, and in the other cases they cannot" (5).

The trickery alleged in the present case is that the defendant was induced to give credit by the fraudulent representation of the agent of the plaintiff that there would be no difficulty whatsoever in paying for the goods, whereas the agent well knew that the plaintiff was insolvent and would be unable to pay for the goods. This is an allegation of fraud, and fraud should be strictly pleaded and proved. Fraud was not raised before *Roper* C.J. in Eq., and it is apparent that on such an issue further evidence might have been tendered. But it is unnecessary to pursue the matter because the trickery, if any, was the trickery of the plaintiff whilst it was a going concern, and it was not trickery in which the liquidator was in any sense involved. It may be that some of the goods sold and delivered by the defendant to the plaintiff or their proceeds of sale could be traced into the possession of the liquidator, but the mere fact that the assets available for the unsecured creditors are thereby

(1) (1936) 1 All E.R., at p. 88.
(2) (1921) 2 K.B., at pp. 868, 869.
(3) (1919) 2 K.B. 735.
(4) (1921) 2 K.B., at p. 869.
(5) (1921) 2 K.B., at pp. 869, 870.

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increased would not give the defendant any equity to be paid in full. A person who sells his goods on credit without security has only himself to thank if he finds himself an unsecured creditor on the bankruptcy of his debtor: *Re Gozzett* (1). If as in the present case he takes a security too late he cannot complain of any hardship caused by the operation of the bankruptcy law: *In re Hall* (2); *In re Wigzell* (3).

In my opinion the appeal should be dismissed.

Appeal dismissed with costs.

Solicitors for the appellant, *Frank C. Kirkpatrick & Co.*

Solicitors for the respondent, *Manning, Riddle & Co.*

J. B.

(1) (1936) 1 All E.R. 79.
(2) (1907) 1 K.B. 875.
(3) (1921) 2 K.B. 835.