

# HIGH COURT OF AUSTRALIA

KIEFEL CJ,  
GAGELER, GORDON, EDELMAN, STEWARD, GLEESON AND JAGOT JJ

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DANIEL MATHEW BRYANT & ORS

APPELLANTS

AND

BADENOCH INTEGRATED LOGGING PTY LTD

RESPONDENT

*Bryant v Badenoch Integrated Logging Pty Ltd*

[2023] HCA 2

*Date of Hearing: 18 October 2022*

*Date of Judgment: 8 February 2023*

A10/2022

## ORDER

1. *The appeal be dismissed.*
2. *Special leave be granted to the respondent to cross-appeal to this Court from part of the judgment and order of the Full Court of the Federal Court of Australia given and made on 24 June 2021.*
3. *The cross-appeal be dismissed.*
4. *The appellants pay the respondent's costs of the appeal and the respondent pay the appellants' costs of the cross-appeal, such costs to be set off against each other.*

On appeal from the Federal Court of Australia

## Representation

B W Walker SC with B M Gibson for the appellants (instructed by Johnson Winter & Slattery)



M G R Gronow KC with R G Morison for the respondent (instructed by Scanlan Carroll Lawyers)

Notice: This copy of the Court's Reasons for Judgment is subject to formal revision prior to publication in the Commonwealth Law Reports.



## CATCHWORDS

### **Bryant v Badenoch Integrated Logging Pty Ltd**

Corporations – Winding up – Insolvency – Voidable transactions – Unfair preferences – Construction of s 588FA(3) of *Corporations Act 2001* (Cth) – Where appellants liquidators of debtor company – Where respondent entered into agreement to supply services to debtor company for harvesting and hauling timber – Where respondent continued to provide services to debtor company despite debtor company's increasing indebtedness – Where liquidators applied to have series of payments made by debtor company to respondent within six-month period ending on relation-back day set aside as unfair preferences – Where liquidators contended that, if "continuing business relationship" existed so as to engage s 588FA(3), liquidators entitled by "peak indebtedness rule" to choose starting date of "single transaction" within relation-back period to prove existence of unfair preference – Whether "peak indebtedness rule" part of or excluded by s 588FA(3) – Proper approach to construction of element of s 588FA(3)(a) that "transaction is, for commercial purposes, an integral part of a continuing business relationship" – Whether payments engaged s 588FA(3)(a).

Words and phrases – "business character of the transaction", "continuing business relationship", "peak indebtedness rule", "running account principle", "unfair preference", "voidable transactions", "winding up".

*Corporations Act 2001* (Cth), Pt 5.7B, ss 588FA, 588FC, 588FE, 588FF, 588FG.



1 KIEFEL CJ. I agree with Jagot J.

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2     GAGELER J. I agree with Jagot J.



3.

3 GORDON J. I agree with Jagot J.

4 EDELMAN J. I agree with Jagot J.

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5 STEWARD J. I agree with Jagot J.

6 GLEESON J. I agree with Jagot J.

7 JAGOT J. Section 588FA(3) of the *Corporations Act 2001* (Cth) is a statutory embodiment of the "running account principle" which has long been a part of insolvency law in Australia<sup>1</sup>. The effect of s 588FA(3) is that if "a transaction is, for commercial purposes, an integral part of a continuing business relationship (for example, a running account)" between a company as debtor and a creditor, then all transactions forming part of that relationship are to be treated as if they together constituted a single transaction in determining if the transaction is an unfair preference given by the company to the creditor, voidable on application by a liquidator<sup>2</sup>.

8 These proceedings raise three questions about the operation of s 588FA(3).

9 The first question is one of statutory construction. The question is whether the so-called "peak indebtedness rule" is part of or is excluded by s 588FA(3) of the *Corporations Act*. The "peak indebtedness rule" permits a liquidator to choose the starting date within the relevantly prescribed statutory period (in this case, the relation-back period of six months prescribed by s 588FE(2)) to prove the existence of an unfair preference given by the company to a creditor<sup>3</sup>.

10 The second question is one of characterisation. What is the proper approach to determining whether a "transaction is, for commercial purposes, an integral part of a continuing business relationship" as referred to in s 588FA(3)(a) of the *Corporations Act*?

11 The third question is one of evaluation of facts. Were certain payments in this case from the debtor (identified below as "Gunns") to the creditor (identified below as "Badenoch"), for commercial purposes, an integral part of a "continuing business relationship" between them within the meaning of s 588FA(3) of the *Corporations Act*? There is also a subsidiary question about the date on which the "continuing business relationship" between Gunns and Badenoch ended.

12 The answer to each question depends on the proper construction of the relevant provisions of Pt 5.7B of the *Corporations Act* and the application of those provisions to the facts of the present case.

### Summary of conclusions

13 First, Pt 5.7B of the *Corporations Act* does not incorporate the "peak indebtedness rule". Rather, the first transaction that can form part of the continuing

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1 *Airservices Australia v Ferrier* (1996) 185 CLR 483 at 501-510.

2 This is referred to as the "doctrine of ultimate effect", eg, *Airservices Australia v Ferrier* (1996) 185 CLR 483 at 502, 504, 505, 507, 509.

3 *Rees v Bank of New South Wales* (1964) 111 CLR 210 at 220-221.

business relationship contemplated by s 588FA(3) is either the first transaction after the beginning of the prescribed period or after the date of insolvency, or (if the relationship started after the beginning of the prescribed period or the date of insolvency) the first transaction after the beginning of the continuing business relationship, whichever is the later.

14 Second, answering the statutory question under s 588FA(3)(a) whether a "transaction is, for commercial purposes, an integral part of a continuing business relationship" involves an objective factual inquiry. What one or both of the parties to the transaction intended (if ascertainable) may be relevant to, but is not determinative of, the statutory question. The task is one of characterisation of the facts, involving an objective ascertainment of the "business character"<sup>4</sup> of the relevant transaction. It is therefore necessary to consider the whole of the evidence of the "actual business" relationship between the parties<sup>5</sup>.

15 Third, the Full Court did not err in concluding that certain payments were transactions forming an integral part of the continuing business relationship between Gunns and Badenoch (defined in these reasons below as payments 1 and 2)<sup>6</sup>. Nor did it err in concluding that other (later) payments were not transactions forming part of the continuing business relationship between Gunns and Badenoch (defined in these reasons below as payments 5 to 11)<sup>7</sup>. It also did not err in concluding that the continuing business relationship did not cease until 10 July 2012 and that, applying s 588FA(1) to the deemed single transaction created by s 588FA(3)(c) and as required by s 588FA(3)(d), there could be no unfair preference given by Gunns to Badenoch<sup>8</sup>.

16 Accordingly, the appeal should be dismissed, the respondent should be granted special leave to cross-appeal, and the cross-appeal should also be dismissed.

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4 *Richardson v The Commercial Banking Co of Sydney Ltd* (1952) 85 CLR 110 at 132 ("Richardson"), quoted in *Airservices Australia v Ferrier* (1996) 185 CLR 483 at 502.

5 *Richardson* (1952) 85 CLR 110 at 132; *Airservices Australia v Ferrier* (1996) 185 CLR 483 at 502; see also *Queensland Bacon Pty Ltd v Rees* (1966) 115 CLR 266 at 286 ("*Queensland Bacon*").

6 *Badenoch Integrated Logging Pty Ltd v Bryant* (2021) 284 FCR 590 at 608 [72].

7 *Badenoch Integrated Logging Pty Ltd v Bryant* (2021) 284 FCR 590 at 609 [79].

8 *Badenoch Integrated Logging Pty Ltd v Bryant, in the matter of Gunns Ltd (in liq) (receivers and managers appointed) [No 2]* [2021] FCAFC 111 at [9], [21] ("*Badenoch Integrated Logging Pty Ltd v Bryant [No 2]*").

### The statutory provisions

17 Division 2 of Pt 5.7B of the *Corporations Act* concerns voidable transactions.

18 Section 9 defines a "transaction" in Pt 5.7B as meaning a transaction to which, relevantly, a body corporate is a party, "for example (but without limitation): ... (d) a payment made by the body".

19 Section 588FF(1) provides that:

"Where, on the application of a company's liquidator, a court is satisfied that a transaction of the company is voidable because of section 588FE, the court may make one or more of the following orders:

..."

20 The orders which may be made include, for example, an order directing a person to pay to the company an amount equal to some or all of the money that the company has paid under the transaction<sup>9</sup>, and an order directing a person to transfer to the company property that the company has transferred under the transaction<sup>10</sup>.

21 Section 588FE(1) provides that, if a company is being wound up, a transaction of the company may be voidable because of any one or more of sub-ss (2) to (6B) of s 588FE. Relevantly for the present case, s 588FE(2) provides that:

"The transaction is voidable if:

- (a) it is an insolvent transaction of the company; and
- (b) it was entered into, or an act was done for the purpose of giving effect to it:
  - (i) during the 6 months ending on the relation-back day; or
  - (ii) after that day but on or before the day when the winding up began."

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9 Section 588FF(1)(a) of the *Corporations Act*.

10 Section 588FF(1)(b) of the *Corporations Act*.

22 Sub-sections (2A) to (6B) of s 588FE specify other circumstances in which  
a transaction is voidable. Those circumstances include other prescribed periods  
from 12 months to 10 years ending on the relation-back day.

23 Section 588FC provides relevantly that a "transaction of a company is an  
insolvent transaction of the company if, and only if, it is an unfair preference given  
by the company, or an uncommercial transaction of the company" and the  
transaction is entered into or given effect while the company is insolvent or the  
company becomes insolvent because of, or because of matters including, entering  
into or giving effect to the transaction.

24 Section 588FA deals with unfair preferences. Section 588FB deals with  
uncommercial transactions.

25 Section 588FA provides that:

"(1) A transaction is an unfair preference given by a company to a  
creditor of the company if, and only if:

- (a) the company and the creditor are parties to the transaction  
(even if someone else is also a party); and
- (b) the transaction results in the creditor receiving from the  
company, in respect of an unsecured debt that the company  
owes to the creditor, more than the creditor would receive  
from the company in respect of the debt if the transaction  
were set aside and the creditor were to prove for the debt in a  
winding up of the company;

even if the transaction is entered into, is given effect to, or is required  
to be given effect to, because of an order of an Australian court or a  
direction by an agency.

(2) For the purposes of subsection (1), a secured debt is taken to be  
unsecured to the extent of so much of it (if any) as is not reflected in  
the value of the security.

(3) Where:

- (a) a transaction is, for commercial purposes, an integral part of  
a continuing business relationship (for example, a running  
account) between a company and a creditor of the company  
(including such a relationship to which other persons are  
parties); and
- (b) in the course of the relationship, the level of the company's  
net indebtedness to the creditor is increased and reduced from



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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."

26 It is also relevant that s 588FG(2) provides that a court is not to make an order under s 588FF materially prejudicing a right or interest of a person if the transaction is not an unfair loan to the company, or an unreasonable director-related transaction of the company, and it is proved that:

- "(a) the person became a party to the transaction in good faith; and
- (b) at the time when the person became such a party:
  - (i) the person had no reasonable grounds for suspecting that the company was insolvent at that time or would become insolvent as mentioned in paragraph 588FC(b); and
  - (ii) a reasonable person in the person's circumstances would have had no such grounds for so suspecting; and
- (c) the person has provided valuable consideration under the transaction or has changed his, her or its position in reliance on the transaction."

27 Section 588FG(2) is relevant because it means that an unfair preference under s 588FA concerns transactions entered into or given effect to at a time when either the party to the transaction (that is, the creditor) had reasonable grounds for suspecting that the company was insolvent at that time or would become insolvent as a result of the transaction, or a reasonable person in the creditor's circumstances would have had such grounds for so suspecting.

### **The facts**

28 The appellants are the liquidators of Gunns Limited (in liquidation) (receivers and managers appointed) and its wholly owned subsidiary Auspine Limited (in liquidation) (receivers and managers appointed) (together, "Gunns").

The respondent, Badenoch Integrated Logging Pty Ltd ("Badenoch"), is a creditor of and former supplier of services to Gunns for harvesting and hauling timber to be processed by Gunns.

29        Gunns and Badenoch entered into an agreement in 2003 for Badenoch to supply Gunns with timber. Under the agreement, Badenoch provided timber in a specified quantity per annum. Badenoch was to provide an invoice at the end of each calendar month and payment was due from Gunns on the last working day of the following month. They renewed their agreement in 2008 for the period from 1 January 2008 to June 2013.

30        Gunns suffered significant declines in revenue from 2010. By late 2011, Gunns' parlous financial position was the subject of significant media coverage. On 9 March 2012, Gunns announced a halt in trading of its shares pending the release of an announcement to the market. Despite repeated efforts, Gunns was unable to raise sufficient further capital as required.

31        Badenoch continued to provide services to Gunns during this time, despite Gunns frequently being late in making payments or only making partial payments. Badenoch took steps to protect its position from Gunns' increasing indebtedness and uncertain financial position in various ways, including threatening to cease supply and ceasing supply for short periods, issuing letters of demand, negotiating a payment plan, and seeking a bank guarantee. Ultimately, in August 2012, Badenoch agreed with Gunns to terminate the agreement on the basis that it would continue to supply some services for a further short period to enable "another contractor [to get] up to speed"<sup>11</sup>.

32        On 25 September 2012, and while Badenoch was continuing to supply some services to Gunns, Gunns appointed the liquidators as joint and several administrators. This is the "relation-back day" for the operation of s 588FE, the voidable transactions provision, of the *Corporations Act*<sup>12</sup>.

33        By an application under s 588FF(1) of the *Corporations Act*, the liquidators applied to have a series of payments made by Gunns to Badenoch during the period from 26 March to 25 September 2012 declared to be voidable transactions. This is the period of "the 6 months ending on the relation-back day" prescribed under s 588FE(2)(b) of the *Corporations Act*<sup>13</sup> (the "relation-back period"), on which the

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11    *Badenoch Integrated Logging Pty Ltd v Bryant* (2021) 284 FCR 590 at 609 [78].

12    See s 91 of the *Corporations Act*.

13    By s 588FE(2) of the *Corporations Act*, a transaction is voidable if it is an insolvent transaction of the company and was entered into or given effect, relevantly, during the six months ending on the relation-back day.

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liquidators relied to impugn the transactions during that period as voidable transactions.

34 The transactions between Gunns and Badenoch during this period are identified in the following table<sup>14</sup>:

Date	Invoice	Payment	Balance
26 March 2012		\$322,976.00	\$1,143,940.82
28 March 2012		\$322,975.75	\$820,965.07
30 March 2012		\$410,000.00 ("payment 1")	\$410,965.07
31 March 2012	(\$660,347.78)		\$1,071,312.85
13 (or 16) April 2012		\$410,965.07 ("payment 2")	\$660,347.78
30 April 2012	(\$674,368.12)		\$1,334,715.90
30 April 2012	(\$4,561.51)		\$1,339,277.41
1 (or 2) May 2012		\$660,347.78 ("payment 3")	\$678,929.63
31 May 2012	(\$737,633.68)		\$1,416,563.31
7 (or 8) June 2012		\$678,929.63 ("payment 4")	\$737,633.68
30 June 2012	(\$627,687.34)		\$1,365,321.02
31 July 2012	(\$194,273.06)		\$1,559,594.08
6 (or 8) August 2012		\$300,000.00 ("payment 5")	\$1,259,594.08

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14 *Badenoch Integrated Logging Pty Ltd v Bryant* (2021) 284 FCR 590 at 592-593 [5].

Date	Invoice	Payment	Balance
17 August 2012		\$150,000.00 ("payment 6")	\$1,109,594.08
24 (or 27) August 2012		\$150,000.00 ("payment 7")	\$959,594.08
31 August 2012	(\$129,687.69)		\$1,089,281.77
31 August (or 3 September) 2012		\$150,633.68 ("payment 8")	\$938,648.09
1 September 2012	(\$4,665.04)		\$943,313.13
7 (or 10) September 2012		\$150,000.00 ("payment 9")	\$793,313.13
14 (or 17) September 2012		\$150,000.00 ("payment 10")	\$643,313.13
21 (or 24) September 2012		\$150,000.00 ("payment 11")	\$493,313.13
25 September 2012	(\$76,008.68)		\$569,321.81

35 As has been seen, to be a voidable transaction under s 588FE(2) of the *Corporations Act*, the transaction must be both an insolvent transaction of the company and entered into or given effect, relevantly, during the relation-back period. Accordingly, only a transaction entered into or given effect by a company after the date of insolvency of the company may be a voidable transaction under s 588FE(2).

36 After a separate, contested hearing, the primary judge (Davies J) determined the insolvency date of Gunns to be 30 March 2012<sup>15</sup>. The liquidators

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15 Under s 95A(1) of the *Corporations Act* a "person is solvent if, and only if, the person is able to pay all the person's debts, as and when they become due and payable". Under s 95A(2), a person who is not solvent is insolvent. The date of insolvency of Gunns was determined in *Bryant (Liquidator) v LV Dohnt & Co Pty*

therefore contended that all payments made by Gunns to Badenoch during the period from 30 March to 25 September 2012 were voidable transactions<sup>16</sup>. The payments made on 26 and 28 March 2012 could not be voidable transactions under s 588FE(2) because, when they were made, Gunns was not insolvent.

37 The liquidators also contended that, if there was a "continuing business relationship" between Gunns and Badenoch so as to engage s 588FA(3) of the *Corporations Act*, they were entitled by the "peak indebtedness rule" to choose the starting date within the relation-back period to prove the existence of an unfair preference given by Gunns to Badenoch (it being common ground that the necessary end date would be the end of the "continuing business relationship"). On the basis that the "continuing business relationship" ended by 30 June 2012, the liquidators chose the date of 31 May 2012 as the starting point of the "single transaction" for the application of the unfair preference provision in s 588FA(1)<sup>17</sup>. It can be seen from the table above that, in the period before 30 June 2012, 31 May 2012 is the date on which Gunns' indebtedness to Badenoch peaked at \$1,416,563.31 (due to Badenoch rendering an invoice to Gunns on that date of \$737,633.68). On this basis, Gunns' indebtedness to Badenoch decreased from \$1,416,563.31 (on 31 May 2012) to \$1,365,321.02 (on 30 June 2012), with the difference between the two said by the liquidators to represent the amount of the unfair preference paid by Gunns to Badenoch on the application of s 588FA(1) of the *Corporations Act*.

### The primary judge

38 The primary judge held that the "peak indebtedness rule" continued to apply under s 588FA(3), so that the liquidators were entitled to determine the date of the first transaction in the relevant "relationship" for the purpose of the comparison or netting process required by s 588FA(1)(b) of the *Corporations Act* to determine if the transaction was an unfair preference<sup>18</sup> (ie, if "the transaction results in the creditor receiving from the company, in respect of an unsecured debt that the company owes to the creditor, more than the creditor would receive from the

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*Ltd, in the Matter of Gunns Ltd (in liq) (receivers and managers appointed)* [2018] FCA 238.

16 *Badenoch Integrated Logging Pty Ltd v Bryant* (2021) 284 FCR 590 at 592-593 [4]-[5].

17 *Bryant (in their capacities as joint and several liquidators of Gunns Ltd) (in liq) (receivers and managers appointed) v Badenoch Integrated Logging Pty Ltd* (2020) 144 ACSR 423 at 447 [109] ("*Bryant v Badenoch Integrated Logging Pty Ltd*").

18 *Bryant v Badenoch Integrated Logging Pty Ltd* (2020) 144 ACSR 423 at 447 [109].

company in respect of the debt if the transaction were set aside and the creditor were to prove for the debt in a winding up of the company").

39 The primary judge also held that only payments 3 and 4, made in May and June 2012, were subject to s 588FA(3) of the *Corporations Act* in that they were each an integral part of a continuing business relationship involving a running account between Gunns and Badenoch in respect of the supply, and payments for the supply, of timber by Badenoch to Gunns<sup>19</sup>.

40 According to the primary judge, in contrast to payments 3 and 4, payments 1 and 2 and 5 to 11 were made in circumstances where Gunns and Badenoch were "looking backwards rather than forwards; looking to the partial payment of the old debt rather than the provision of continuing services"<sup>20</sup>, so that these transactions were not made as part of a continuing business relationship between Gunns and Badenoch.

### The Full Court

41 In response to an appeal and cross-appeal by Badenoch and the liquidators respectively, the Full Court of the Federal Court of Australia (Middleton, Charlesworth and Jackson JJ) held that the "peak indebtedness rule" is inconsistent with the reasoning in *Airservices Australia v Ferrier*<sup>21</sup> concerning the "running account principle" (and the associated "doctrine of ultimate effect") embodied by s 588FA(3) of the *Corporations Act*<sup>22</sup>. The "doctrine of ultimate effect" is that<sup>23</sup>:

"If a payment is part of a wider transaction or a 'running account' between the debtor and the creditor, the purpose for which the payment was made and received will usually determine whether the payment has the effect of giving the creditor a preference, priority or advantage over other creditors. If the sole purpose of the payment is to discharge an existing debt, the effect of the payment is to give the creditor a preference over other creditors unless the debtor is able to pay all of his or her debts as they fall due. But if the purpose of the payment is to induce the creditor to provide further goods or services as well as to discharge an existing indebtedness,

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19 *Bryant v Badenoch Integrated Logging Pty Ltd* (2020) 144 ACSR 423 at 443 [99].

20 *Bryant v Badenoch Integrated Logging Pty Ltd* (2020) 144 ACSR 423 at 443 [99], citing *Airservices Australia v Ferrier* (1996) 185 CLR 483 at 510.

21 (1996) 185 CLR 483.

22 *Badenoch Integrated Logging Pty Ltd v Bryant* (2021) 284 FCR 590 at 617 [118], 619 [123].

23 *Airservices Australia v Ferrier* (1996) 185 CLR 483 at 501-502 (footnotes omitted).

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. Whether the payment is or is not a preference has to be 'decided not by considering its immediate effect only but by considering what effect it ultimately produced in fact'."

42 The Full Court also held that, if the purpose of a payment is to induce the creditor to provide further goods or services *as well as* to discharge an existing indebtedness, the payment will not be a preference unless the payment exceeds the value of the goods or services acquired<sup>24</sup>. As such, the Full Court said that the principle from *Sutherland (as liquidator of Sydney Appliances Pty Ltd (in liq)) v Eurolinx Pty Ltd*<sup>25</sup>, that a mutual purpose or assumption of a continuation of payment and reciprocal supply "must not come to be subordinated to a predominant purpose of recovering past indebtedness" for a "continuing business relationship" to continue, "should be treated with some caution"<sup>26</sup>.

43 On this basis, the Full Court concluded that, contrary to the conclusion of the primary judge, payments 1 and 2 were made as an integral part of a "continuing business relationship" as provided for in s 588FA(3)<sup>27</sup>. The Full Court agreed with the primary judge, however, that payments 5 to 11 were not part of a "continuing business relationship" between Gunns and Badenoch as, before payment 5 was made, any mutual assumption of such a relationship continuing had ceased<sup>28</sup>.

44 In a subsequent judgment, the Full Court held that the continuing business relationship ended on 10 July 2012 when Badenoch ceased supplying Gunns for the second time<sup>29</sup>. As a result, the Full Court considered that, on the facts, the start date of the relevant relationship did not need to be decided as, whether that date be 26 March 2012 (the start of the period of six months ending on the relation-back day as prescribed by s 588FE(2)(b)(i)) or 30 March 2012 (the date of insolvency), the indebtedness of Gunns to Badenoch increased over the period of the continuing

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24 *Badenoch Integrated Logging Pty Ltd v Bryant* (2021) 284 FCR 590 at 602 [48(c)], applying *Airservices Australia v Ferrier* (1996) 185 CLR 483 at 501-502.

25 (2001) 37 ACSR 477 at 504 [148] ("*Sutherland v Eurolinx Pty Ltd*").

26 *Badenoch Integrated Logging Pty Ltd v Bryant* (2021) 284 FCR 590 at 604-605 [54].

27 *Badenoch Integrated Logging Pty Ltd v Bryant* (2021) 284 FCR 590 at 608 [72].

28 *Badenoch Integrated Logging Pty Ltd v Bryant* (2021) 284 FCR 590 at 609 [78]-[79].

29 *Badenoch Integrated Logging Pty Ltd v Bryant [No 2]* [2021] FCAFC 111 at [9].

business relationship until 10 July 2012 so that the single transaction deemed by s 588FA(3) could not involve any unfair preference under s 588FA(1)(b)<sup>30</sup>.

### The peak indebtedness rule

45 The context of the statutory provisions discloses that it cannot be assumed or inferred that, in incorporating the "running account principle" in s 588FA(3) of the *Corporations Act*, the legislature also intended to incorporate the "peak indebtedness rule".

46 The predecessor to the *Corporations Act*, the *Corporations Act 1989* (Cth), was amended by the *Corporate Law Reform Act 1992* (Cth). The Explanatory Memorandum to the *Corporate Law Reform Bill 1992* (Cth) said that the "Bill implements a number of recommendations of the Harmer Report in relation to claims"<sup>31</sup> in insolvency. The Explanatory Memorandum, after referring to proposed ss 588FA, 588FB, 588FC, 588FD, 588FE, 588FF and 588FG, continued:

#### *"Proposed section 588FA - Unfair preferences"*

1039. Proposed section 588FA defines an 'unfair preference' to be a transaction to which a company and the creditors are parties and which results in the creditor receiving in respect of the debt that the company owes to the creditor more than the creditor would receive in respect of that debt if the transaction had been set aside and the creditor had to prove for the debt in the winding up of the company.

...

1042. Subsection 588FA(2) provides that where a transaction is, for a commercial purpose, an integral part of a continuing business relationship such as a running account between a creditor and the company (including such a relationship to which other persons are parties), it should not be attacked as a preference, but rather the effect of all the transactions which form the relationship between that creditor and the company should be taken into account as though they constituted a single transaction. This provision is aimed at embodying in legislation the principles reflected in the cases of *Queensland Bacon Pty Ltd v Rees* (1967) 115 CLR 266 and *Petagna Nominees Pty Ltd & Anor v A E Ledger* 1 ACSR 547. The effect of these principles is that it is implicit in the circumstances in which payments are made to reduce the outstanding balance in a running account

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30 *Badenoch Integrated Logging Pty Ltd v Bryant [No 2]* [2021] FCAFC 111 at [21].

31 Australia, House of Representatives, *Corporate Law Reform Bill 1992*, Explanatory Memorandum at [32].



between purchaser and supplier that there is a mutual assumption that the relationship of purchaser and supplier would continue as would the relationship of debtor and creditor. The net effect, therefore, is such that payments 'in' are so integrally connected with payments 'out' that the ultimate effect of the course of dealings should be considered to determine whether the payments are preferences."

47 The reference in the Explanatory Memorandum to s 588FA(2) should be read as a reference to the current s 588FA(3).

48 These parts of the Explanatory Memorandum reflect the recommendation in the Law Reform Commission's 1988 General Insolvency Inquiry ("the Harmer Report")<sup>32</sup> that there "should be a statutory provision which allows the court to have regard to the relationship between the parties and, if appropriate, the history of transactions between them to determine if there has been a preferential transaction or transactions"<sup>33</sup>. The Harmer Report, as explained in *Fortress Credit Corporation (Australia) II Pty Ltd v Fletcher*<sup>34</sup>, recommended the continuation of the policy that "transactions by which an insolvent individual or company disposed of property within a relevant period prior to the actual commencement of the formal insolvency in circumstances that are unfair to the general body of unsecured creditors" be voided<sup>35</sup>.

49 *Queensland Bacon Pty Ltd v Rees*<sup>36</sup>, referred to in the Explanatory Memorandum, concerned, in part, the determination of a preference to a creditor where there is a "running account" between the debtor and creditor with "an expectation that further debits and credits will be recorded" and where, "[o]rdinarily, a payment, although often matching an earlier debit, is credited against the balance owing in the account"<sup>37</sup>.

50 In *Richardson v The Commercial Banking Co of Sydney Ltd*, it was held that "where the payment forms an integral, an inseparable, part of an entire transaction its effect as a preference involves a consideration of the whole

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32 Law Reform Commission, *General Insolvency Inquiry*, Report No 45 (1988).

33 Harmer Report, Summary of Report at 43 [131].

34 (2015) 254 CLR 489 at 500 [11].

35 Harmer Report, vol 1 at 266 [629].

36 (1966) 115 CLR 266.

37 *Airservices Australia v Ferrier* (1996) 185 CLR 483 at 504-505.

transaction"<sup>38</sup>. By reference to this principle, Barwick CJ in *Queensland Bacon* concluded that<sup>39</sup>:

"it is enough if, on the facts of any case, the court can feel confident that implicit in the circumstances in which the payment is made is a mutual assumption by the parties that there will be a continuance of the relationship of buyer and seller with resultant continuance of the relation of debtor and creditor in the running account, so that, to use the expressions employed in *Richardson's Case*, 'it is impossible' – I interpolate, in a business sense – 'to pause at any payment into the account and treat it as having produced an immediate effect to be considered independently of what followed ...'."

51 In *Petagna Nominees Pty Ltd v A E Ledger Liquidator of Linun Pty Ltd (in liq)*<sup>40</sup>, also referred to in the Explanatory Memorandum, Wallace and Franklyn JJ each referred<sup>41</sup> to the statement in *The Law of Company Liquidation*<sup>42</sup> that:

"Genuine payments made by the company to reduce a general debit as it stands from day to day and in order to maintain a genuine business relationship that promises advantages to both the company and its creditor are not preferences. This is because there is a mutual assumption by the parties that the business relationship of buyer and seller will continue with the result that the relationship of debtor and creditor will continue in the running account between the parties. There is no attempt to terminate this relationship but rather to ensure its continuance to the mutual benefit of the parties. In these circumstances payments made by the company to its supplier should not be viewed in isolation and attacked as preferences."

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38 (1952) 85 CLR 110 at 129.

39 (1966) 115 CLR 266 at 286 (footnote omitted).

40 (1989) 1 ACSR 547 ("*Petagna Nominees*").

41 (1989) 1 ACSR 547 at 552-553 per Wallace J, 563 per Franklyn J (Malcolm CJ agreeing at 549).

42 McPherson, *The Law of Company Liquidation*, 3rd ed (1987) at 319 (footnotes omitted).

52 Franklyn J also reproduced<sup>43</sup> a summary of principles developed by Wootten J in *M & R Jones Shopfitting Co Pty Ltd (in liq) v The National Bank of Australasia Ltd*, including the proposition that<sup>44</sup>:

"The mere fact that a payment is made on a running account does not protect it from scrutiny and if a point comes where payments are made with a view to terminating the running account, or greatly reducing the level of credit granted on the account, the effect of these payments may be a preference. It follows 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. However, this does not mean that the connection between such a payment and dealings prior to the chosen date is to be ignored."

53 Other than in respect of the first sentence, this summary is not straightforward. It does not follow from the "running account principle" that a liquidator may choose the point during the prescribed period from which to identify a preference. Further, if the liquidator can do so, then the connection between that payment and earlier payments would be ignored, at least for the application of the "running account principle".

54 The relevant point to be drawn from this discussion is that the focus of the two cases referred to in the Explanatory Memorandum, *Queensland Bacon* and *Petagna Nominees*, is the "running account principle", not the "peak indebtedness rule".

55 The original source of the "peak indebtedness rule", the judgment of Barwick CJ in *Rees v Bank of New South Wales*<sup>45</sup>, was a case in which the liquidator had chosen a date representing the point at which the bank overdraft was at its highest as the start of the notional single transaction required to be assumed by the "running account principle". The bank claimed the defence of good faith (that it had no reason to suspect insolvency), that the date the liquidator selected was arbitrary, and that to determine whether there had been any preference it was necessary to consider the ultimate effect of all transactions within the entire prescribed six-month period ending on the relation-back day<sup>46</sup>. The High Court rejected the good faith defence. In response to the argument about the date selected by the liquidator, having said that it was "sufficient in the circumstances of this

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43 *Petagna Nominees* (1989) 1 ACSR 547 at 564.

44 (1983) 68 FLR 282 at 290.

45 (1964) 111 CLR 210.

46 *Rees v Bank of New South Wales* (1964) 111 CLR 210 at 214-216.

case to take the overall effect of the deposits and the withdrawals in the period"<sup>47</sup>, Barwick CJ continued<sup>48</sup>:

"It was also said in argument for the bank that it was not permissible for the liquidator to choose a date within the period of six months and to make a comparison of the state of the overdrawn account at that date and its state at the date of the commencement of the winding up. It was submitted that the proper comparison was between the debit in the account at the commencement of the statutory period of six months and the debit at the commencement of the liquidation – a comparison which in this case would result in a materially lesser figure than that reached by taking the liquidator's comparison. In my opinion 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 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."

56 It should be inferred from their reasons that Kitto and Taylor JJ accepted this obiter dictum, albeit without analysis<sup>49</sup>.

57 It may be accepted that, as the liquidators stressed in this Court, in *Queensland Bacon* Barwick CJ referred to related transactions "from the date of the first impugned payment" and "the first payment which is impugned"<sup>50</sup>. It may also be assumed that his Honour had in mind in this regard his statement in *Rees v Bank of New South Wales*<sup>51</sup> which is the source of the "peak indebtedness rule". The rule, if it may be called such, merely reflects that a liquidator discharging their functions and powers under ss 477 and 478 of the *Corporations Act* to collect the assets of a company in liquidation would seek to identify any unfair preference in the prescribed period ending on the relation-back day in the context of a running account by comparing the position at the end of that period with the position at the point of peak indebtedness; the effect of so doing will be to maximise both the

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47 *Rees v Bank of New South Wales* (1964) 111 CLR 210 at 220.

48 *Rees v Bank of New South Wales* (1964) 111 CLR 210 at 220-221.

49 See *Rees v Bank of New South Wales* (1964) 111 CLR 210 at 221-222 per Kitto J; see also at 229 per Taylor J ("... at the material time, which I take to be on and after 1st December 1960 ...", 1 December 1960 being the date of the first payment selected by the liquidator).

50 (1966) 115 CLR 266 at 282.

51 (1964) 111 CLR 210 at 220-221.

likelihood of ascertaining an unfair preference and the amount of any unfair preference.

58 What is more difficult to accept is that, in referring to *Queensland Bacon* and *Petagna Nominees*, the Explanatory Memorandum contemplated that the "peak indebtedness rule" formed part of the "running account principle". The context of the relevant discussion in the Explanatory Memorandum is the inclusion of the "running account principle" in the *Corporate Law Reform Bill 1992*. The Explanatory Memorandum explains (in part) the rationale underlying the "running account principle". No rationale is to be found in the Explanatory Memorandum for the "peak indebtedness rule". The rule also remains unexplained in the decisions which embody it, other than that it is obvious that if the relevant "relationship" between debtor and creditor is taken to start at the first transaction between them, there could never be an unfair preference because the account will stand at zero at that time. It may be inferred that it is for this reason that, in *Rees v Bank of New South Wales*, Barwick CJ conceived of the possible starting points for the relevant "relationship" to be either the date on which the prescribed period ending on the relation-back day commenced or the date selected by the liquidator<sup>52</sup>.

59 This context to the inclusion of s 588FA(3) (as s 588FA(2)) in the *Corporations Act 1989* is relevant because it indicates that approaching Pt 5.7B on the assumption that the legislature intended to give effect to the "peak indebtedness rule" as a part of the existing law is fraught. This is not a case in which Parliament has repeated in a statute words the meaning of which has been judicially determined<sup>53</sup>. It is a case in which Parliament has given effect to the "running account principle".

60 As other cases have also made clear, s 588FA(3) of the *Corporations Act* is to be read as embodying the "running account principle" and its associated requirement to determine the question of an unfair preference by reference to the ultimate effect of the transactions during the relevant prescribed period in the running account as a whole<sup>54</sup>.

61 As noted, sub-ss (2) to (6B) of s 588FE identify the circumstances in which a transaction is voidable. The circumstances require an "insolvent transaction" (s 588FE(2)), an "uncommercial transaction", an "unfair preference", an "unfair loan", or an "unreasonable director-related transaction" (s 588FE(2A) to (2D)), or

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52 (1964) 111 CLR 210 at 221.

53 *Re Alcan Australia Ltd; Ex parte Federation of Industrial, Manufacturing and Engineering Employees* (1994) 181 CLR 96 at 106.

54 See, eg, *Airservices Australia v Ferrier* (1996) 185 CLR 483; *VR Dye & Co v Peninsula Hotels Pty Ltd (in liq)* [1999] 3 VR 201.

a combination of such or other prescribed circumstances (s 588FE(3) to (6B)). In each case, the time of the entry into or of the giving of effect to the transaction is a part of the identified circumstances. The time must be within the period prescribed for each relevant kind of transaction. That period is identified as starting from or ending at the relation-back day or after that day but on or before the day the winding-up began.

62 It follows that s 588FC, concerning insolvent transactions (which, on the terms of that section, requires the transaction to be an unfair preference or an uncommercial transaction), is capable of operating only in respect of transactions within the relevantly prescribed period in sub-ss (2) to (6B) of s 588FE. This context frames the operation of s 588FA. Section 588FA pre-supposes the existence of s 588FE and, in particular, the prescribed period within which, if a transaction has been entered into or given effect, the transaction may be determined by a court to be a voidable transaction. Section 588FA also pre-supposes the existence of s 588FC, which, critically, only applies relevantly where a transaction is entered into when a company is insolvent or the transaction has the effect of causing the company to become insolvent. This context cannot be ignored in giving meaning to s 588FA(3).

63 Paragraphs (a) and (b) of s 588FA(3) are the gateway provisions to the operative provision in s 588FA(3)(c). Paragraphs (a) and (b) identify both the required kind of transaction (a transaction which is, for commercial purposes, an integral part of a specified kind of relationship) and the required kind of relationship (a continuing business relationship such as a running account) in which the level of the company's net indebtedness to the creditor is increased and reduced as a result of a series of transactions forming part of the relationship.

64 "[A] continuing business relationship" in s 588FA(3)(a) may start either before or during the prescribed period. "[T]he relationship" twice appearing in s 588FA(3)(b) is the "continuing business relationship" referred to in s 588FA(3)(a). But neither provision is concerned with "a continuing business relationship" at any time. Both provisions are functionally tethered to s 588FA(3)(c) and (d). Paragraphs (c) and (d) of s 588FA(3) provide how s 588FA(1), concerning unfair preferences – which are necessarily transactions in a period prescribed by s 588FE(2) to (6B) and which are entered into when a company is insolvent or have the effect of causing the company to become insolvent – applies to transactions of the kind made as an integral part of a continuing business relationship of the kind identified in s 588FA(3)(a) and (b). Section 588FA(3)(c), in providing that s 588FA(1) applies "in relation to all the transactions forming part of the relationship as if they together constituted a single transaction", cannot mean all the transactions forming part of the relationship from the first transaction which started the relationship, if the relationship started before the prescribed period. It cannot mean this because the function of s 588FA(3)(c) is to dictate how s 588FA(1) applies and the operation of that provision is confined to the relevant period prescribed by s 588FE(2) to (6B) and to the premise of

insolvency under s 588FC. That is, where the relationship started before the prescribed period, the relevant transactions forming part of the relationship for the purpose of s 588FA(3)(c) must be transactions within the prescribed period and which are entered into when a company is insolvent or have the effect of causing the company to become insolvent.

65 The natural and ordinary meaning of s 588FA(3)(c) of the *Corporations Act* is that "all the transactions forming part of the relationship" means "all the transactions forming part of the relationship" which are within the relevant period prescribed by s 588FE(2) to (6B) and which were entered into when the company was insolvent or the effect of which was to cause the company to become insolvent. Such transactions, as a result, might be an unfair preference on the application of s 588FA(1) (and assuming the other relevant requirements of s 588FE, as applicable, are satisfied). This does not involve reading any additional words into s 588FA(3)(c). Rather, it gives the language of s 588FA(3)(c) its ordinary and natural meaning in its full context. Section 588FA(3)(d) then operates by reference to that deemed "single transaction".

66 The power of a court under s 588FF(1) of the *Corporations Act* to make orders if it is satisfied that a transaction of a company is voidable is engaged "on the application of a company's liquidator". This reflects the liquidator's functions and powers under ss 477 and 478 of the *Corporations Act*. It also reflects that it is for the liquidator (at least in the first instance) to decide what the liquidator's statutory and fiduciary duties to the company require in the circumstances<sup>55</sup>. This underlies the fact that a court's power under s 588FF is conditioned on an application by a liquidator and, in this sense, depends on a choice or election of a liquidator to impugn the transaction<sup>56</sup>.

67 The effect of the liquidators' arguments is that, in deciding if it is satisfied that a transaction is voidable because of s 588FE, a court is bound by the decision of the liquidator as to the first transaction forming part of the "relationship" for the purpose of the deemed "single transaction" in s 588FA(3)(c). This would be the effect of the "peak indebtedness rule" if embodied in s 588FA(3)(c) read with s 588FF(1). But, as discussed, while there can be no doubt that s 588FA(3) is a statutory embodiment of the "running account principle", the same conclusion cannot be drawn from the statutory context in respect of the "peak indebtedness rule".

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55 eg, *Pace v Antlers Pty Ltd (in liq)* (1998) 80 FCR 485 at 497.

56 eg, *Williams v Lloyd* (1934) 50 CLR 341 at 373-374; *Brady v Stapleton* (1952) 88 CLR 322 at 333; *N A Kratzmann Pty Ltd (in liq) v Tucker [No 1]* (1966) 123 CLR 257 at 277.

68 The fact that the liquidator determines which transaction is to be the subject of an application under s 588FF(1) does not enable the liquidator to determine the first transaction forming part of "the relationship" for the purpose of the deemed "single transaction" in s 588FA(3)(c). That date is dictated by the operation of s 588FA(3)(c). This is consistent with the fact that it is for the court, not the liquidator, to determine if it is satisfied that a transaction is voidable "because of" s 588FE, which, insofar as an "insolvent transaction" is concerned, relevantly requires the transaction to be an unfair preference as provided for in ss 588FC and 588FA. In the context of a transaction which is an integral part of a continuing business relationship as provided for in s 588FA(3)(a) and (b), an insolvent transaction is only voidable as an unfair preference "because of" s 588FE if that is so by application of s 588FA(1) to all the transactions forming part of the relationship within the period prescribed by s 588FE. This construction gives the language of the provisions its natural and ordinary meaning, without reading in words, and accords with the policy choice underlying the statutory embodiment of the "running account principle" in s 588FA(3) of the *Corporations Act*. That principle, as embodied in s 588FA(3) of the *Corporations Act*, unavoidably qualifies the object of Pt 5.7B to ensure "equality of distribution amongst creditors of the same class"<sup>57</sup>.

69 Contrary to the arguments for the liquidators, their proposed construction giving effect to the "peak indebtedness rule" is not open on the language of s 588FA.

70 Nor, for the reasons given, can it be said that s 588FA was intended to embody the "peak indebtedness rule". It may be accepted that the statutory choice of confining the relevant transactions forming part of the relationship to the period prescribed by s 588FE(2) to (6B) and on the premise of insolvency is arbitrary, but that results from the legislative choice made. The arbitrariness that would result from the liquidators' proposed construction arises from the choice made by a liquidator. It is also not the case that the liquidators' construction serves the purpose of the "running account principle", whereas the construction determined to be correct above defeats that purpose. The purpose of the "running account principle" is not to maximise the potential for the claw-back of money and assets from a creditor, but that is the effect of the "peak indebtedness rule". The "running account principle" recognises that a creditor who continues to supply a company on a running account in circumstances of suspected or potential insolvency enables the company to continue to trade to the likely benefit of all creditors. The prescription of periods within which *all* transactions in a continuing business relationship are deemed to be a "single transaction" and, accordingly, may be netted off against each other to determine any unfair preference serves this purpose.

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57 *G & M Aldridge Pty Ltd v Walsh* (2001) 203 CLR 662 at 675 [30].



71 The reasoning in *Airservices Australia v Ferrier* also does not support the liquidators' arguments. Dawson, Gaudron and McHugh JJ there explained that<sup>58</sup>:

"If at the end of a series of dealings, the creditor has supplied goods to a greater value than the payments made to it during that period, the general body of creditors are not disadvantaged by the transaction – they may even be better off. The supplying creditor, therefore, has received no preference. Consequently, a debtor does not prefer a creditor merely because it makes irregular payments under an express or tacit arrangement with the creditor that, while the debtor makes payments, the creditor will continue to supply goods. In such a situation, the court does not regard the individual payments as preferences even though they were unrelated to any specific delivery of goods or services and may ultimately have had the effect of reducing the amount of indebtedness of the debtor at the beginning of the six-month period. If the effect of the payments is to reduce the initial indebtedness, only the amount of the reduction will be regarded as a preferential payment."

72 The reference to "the beginning of the six-month period" in this statement should not go unnoticed. The facts in *Airservices Australia v Ferrier* did not require consideration of the "peak indebtedness rule" as the liquidators had applied to recover nine payments within the prescribed period of six months ending on the relation-back day.

73 Construing s 588FA(3) to exclude the operation of the "peak indebtedness rule" also does not suffer from "two fundamental difficulties" the liquidators identified.

74 The first proposed difficulty, that a company may become insolvent after the relation-back day (so that, in theory, a transaction that is not an "insolvent transaction" under s 588FC might be an integral part of a "continuing business relationship" and therefore part of the deemed "single transaction" under s 588FA(3)), is no difficulty at all. The statutory provisions work together. To be a voidable transaction, all requirements specified in one or more of s 588FE(2) to (6B) must be satisfied. Where there is a requirement that the transaction be an "insolvent transaction" (s 588FE(2), (3), (4), and (5)), that requirement must also be satisfied. By s 588FC, a transaction is only an insolvent transaction if it is, amongst other things, an unfair preference in accordance with s 588FA. It follows from the same reasoning as set out above concerning the purpose of s 588FA (to identify voidable transactions) that "all the transactions forming part of the relationship" for the purpose of the deemed "single transaction" in s 588FA(3)(c) must mean "the relationship" starting at the beginning of the prescribed period, or the date of insolvency, or (if the relationship started after the beginning of the

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58 (1996) 185 CLR 483 at 503-504 (footnotes omitted).

prescribed period or the date of insolvency) the beginning of the continuing business relationship, whichever is the later. These objective facts determine the operation of the provisions, not the choice made by a liquidator in the application under s 588FF. Again, this is not to read words into s 588FA(3), but to give meaning to the provision in its overall context as part of an integrated scheme directed at the identification of voidable transactions.

75 The second proposed difficulty, that fixing the start of the deemed single transaction as 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, also does not arise. The longer prescribed periods in sub-ss (4) and (5) of s 588FE, for example, do not operate in isolation. They also require that the transaction be an insolvent transaction with a related entity (s 588FE(4)(b)) or an insolvent transaction for, amongst other things, the purpose of defeating creditors (s 588FE(5)(b)). The overall interaction of these longer prescribed periods with the operation of s 588FA(3) in the event of transactions forming an integral part of a continuing business relationship will be fact dependent.

76 Accordingly, the cases which concluded that the "peak indebtedness rule" is to be read into s 588FA(3) of the *Corporations Act* wrongly assumed that the "running account principle" included the "peak indebtedness rule"<sup>59</sup>, did not involve full argument on or reasoning about the issue<sup>60</sup>, or must now be considered to be wrong in that respect<sup>61</sup>.

77 It is also not the case that the "peak indebtedness rule" is irreconcilable with the "running account principle" and the associated need to consider the ultimate effect of the transactions forming part of the relevant continuing business

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59 eg, *Rothmans Exports Pty Ltd v Mistmorn Pty Ltd (in liq)* (1994) 125 ALR 442 at 453; *CSR Ltd v Starkey* (1994) 13 ACSR 321 at 325. See also, to the contrary, *Timberworld Ltd v Levin* [2015] 3 NZLR 365 at 382 [52], 384 [61], 386 [69], [71], 388 [80]-[81] (especially at 388 [80] fn 72), 390-391 [86]-[90], 391 [93]-[94], in which the New Zealand Court of Appeal, in considering the provision in the *Companies Act 1993* (NZ) modelled on s 588FA of the *Corporations Act*, concluded that the "peak indebtedness rule" is not part of the law in New Zealand.

60 *Sutherland v Eurolinx Pty Ltd* (2001) 37 ACSR 477 at 503 [140]; *Sutherland v Lofthouse* (2007) 214 FLR 157 at 171 [50], 172 [53], [54]; *Clifton (as liquidator of Adelaide Fibrous Plasterboard Linings Pty Ltd (in liq)) v CSR Building Products Pty Ltd* [2011] SASC 103 at [13].

61 *Olifent v Australian Wine Industries Pty Ltd* (1996) 130 FLR 195.

relationship<sup>62</sup>. Once it is accepted that the first transaction in the continuing business relationship cannot be the first transaction between the creditor and debtor if that occurred before the prescribed period, but must be a later transaction, then (leaving aside a case in which the continuing business relationship itself starts during the prescribed period and after the date of insolvency) there was (and is) a policy choice available between two starting points. Barwick CJ recognised that this was the choice in *Rees v Bank of New South Wales* and saw no reason why the choice should not be that of the liquidator<sup>63</sup>. The first choice, selecting the time of peak indebtedness within the prescribed period when a transaction may be voidable, maximises the potential for there to be an unfair preference and the amount of any unfair preference. The second choice, by not selecting the time of peak indebtedness, permits the facts as they exist to dictate if there is an unfair preference and the amount of any unfair preference. Both choices are reconcilable with the "running account principle", but in enacting Div 2 of Pt 5.7B of the *Corporations Act* Parliament's language fixed upon the first transaction in the relationship capable of being a voidable transaction and, accordingly, made the second choice.

78 For these reasons, the date of the first transaction in the relevant relationship between Gunns and Badenoch in accordance with s 588FA(3) of the *Corporations Act* is 30 March 2012, being the later of the date of the start of the prescribed period under s 588FE(2)(b) (26 March 2012, the relation-back day being 25 September 2012 when the liquidators were appointed as administrators of Gunns) and the date of insolvency (30 March 2012), the continuing business relationship having started years before the prescribed period.

### **Continuing business relationship**

79 The second question arising in this appeal concerns the proper approach to determining whether 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". This is the statutory question mandated by s 588FA(3)(a). It is a question of objectively ascertained fact. This factual question is not to be decided by applying one or more of the ways in which judges have explained their decision about that question in other cases concerned with different facts. To do so would be to substitute words of judicial explanation for the language of the statute.

80 Argument was directed to issues about the assumptions or purposes of the debtor and creditor and whether the "sole" or "dominant" assumption or purpose

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62 cf *Timberworld Ltd v Levin* [2015] 3 NZLR 365 at 388 [80]-[81]; *Badenoch Integrated Logging Pty Ltd v Bryant* (2021) 284 FCR 590 at 617 [118].

63 (1964) 111 CLR 210 at 220-221.

of one or both of the parties in making and receiving an impugned payment was to continue the business relationship between them. This debate reflects a misunderstanding, and misapplication, of what was said in *Richardson*<sup>64</sup>, *Queensland Bacon*<sup>65</sup>, and *Airservices Australia v Ferrier*<sup>66</sup> as to the relevance of parties' purposes and assumptions when determining if a continuing business relationship has continued or ceased. Those cases speak of a search for a "business purpose common to both parties"<sup>67</sup>, a "mutual assumption"<sup>68</sup>, or a consideration of the "business purpose and context of the payment"<sup>69</sup>. Those statements should be understood to mean no more than that the task is one of characterisation of the facts, involving an objective ascertainment of the "business character"<sup>70</sup> of the relevant transaction – whether "a transaction is, for commercial purposes, an integral part of a continuing business relationship".

- 81        The concept of the "mutual assumption" or common business "purpose" of the parties in relation to the transaction may be useful, but only to the extent that it serves as a description of the objective ascertainment of the "business character" of the transaction which is required to answer the statutory question. To parse the terms "mutual assumption" or common business "purpose", searching for their metes and bounds as if they were the language of a statute, is impermissibly to divert attention from that statutory question. What one or both of the parties intended (if ascertainable) may be relevant to, but is not determinative of, the statutory question. There must be a continuing business relationship and the transaction must, for commercial purposes, be an integral part of that continuing business relationship. In objectively characterising those matters – whether, on all the facts, there is a continuing business relationship (and the transaction is, for commercial purposes, an integral part of that continuing business relationship), there is no longer such a relationship, or that relationship has ended and been

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64    (1952) 85 CLR 110 at 133.

65    (1966) 115 CLR 266 at 286.

66    (1996) 185 CLR 483 at 502-506.

67    *Richardson* (1952) 85 CLR 110 at 133.

68    *Queensland Bacon* (1966) 115 CLR 266 at 286.

69    *Airservices Australia v Ferrier* (1996) 185 CLR 483 at 502.

70    *Richardson* (1952) 85 CLR 110 at 132, quoted in *Airservices Australia v Ferrier* (1996) 185 CLR 483 at 502.

replaced by another (as occurred in this case) – it is necessary to consider the whole of the evidence of the "actual business" relationship between the parties<sup>71</sup>.

82 For example, in *Airservices Australia v Ferrier*, only the last of several payments was held to constitute an unfair preference. The decisive conclusion for the other payments was that they formed part of the continuing business relationship, "which contemplated further debits and credits", so that the payments "were intended to continue and not determine that relationship". As such, those payments were "so connected with the continuing provision of services, that it is the ultimate and not the immediate effect of each payment on the relationship ... that is relevant"<sup>72</sup>. Further, Dawson, Gaudron and McHugh JJ said that the "appropriation of a payment to a past debt will generally have no bearing on the issue of preference", as<sup>73</sup>:

"Where the relationship appears to be a continuing one, the fact that the parties agree to appropriate the payment to the oldest debt is neither unusual nor surprising. In that context, it can seldom, if ever, provide any ground for concluding that the payment was not connected with the future supply of goods or services."

83 To adopt their Honours' words<sup>74</sup>:

"the whole point of the doctrine emanating from *Richardson, Queensland Bacon* and *Rees* ... is designed to ensure that the effect of a payment that induces the further supply of goods and services is evaluated by the ultimate effect that it has on the financial relationship of the parties."

84 The different conclusion in respect of the last payment in *Airservices Australia v Ferrier* resulted from the fact that, although the creditor believed it would continue to supply services to the debtor and in fact did so after the last payment, that payment was made "looking backwards rather than forwards; looking to the partial payment of the old debt rather than the provision of continuing services"<sup>75</sup>. In so concluding, Dawson, Gaudron and McHugh JJ were not suggesting that a subjective intention of a creditor to reduce past indebtedness meant that the continuing business relationship would cease (clearly not, given the

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71 *Richardson* (1952) 85 CLR 110 at 132; *Airservices Australia v Ferrier* (1996) 185 CLR 483 at 502; see also *Queensland Bacon* (1966) 115 CLR 266 at 286.

72 *Airservices Australia v Ferrier* (1996) 185 CLR 483 at 507-508.

73 *Airservices Australia v Ferrier* (1996) 185 CLR 483 at 508.

74 *Airservices Australia v Ferrier* (1996) 185 CLR 483 at 509.

75 (1996) 185 CLR 483 at 510.

treatment of the earlier eight payments). They were saying that, on the whole of the evidence, the objectively inferred character of the payment was to reduce past indebtedness, and not to induce the continuation of supply. On this basis, the whole of the last payment was to be characterised as an unfair preference.

85 It follows that it is not the case that a continuing business relationship necessarily continues unless and until it can be inferred that the *sole* mutual assumption or purpose of the creditor and debtor in respect of the transaction is the reduction of indebtedness. That is not what was being said in *Airservices Australia v Ferrier*<sup>76</sup>. The statutory task remains one of characterisation of the facts involving an objective ascertainment, on the whole of the evidence, of the business character (for commercial purposes) of the transaction in issue.

### **Payments 1 and 2 and 5 to 11**

86 The dispute about payments 1 and 2 and 5 to 11 exposes the operation of the discussion above. For this reason, Badenoch's proposed cross-appeal in respect of payments 5 to 11 should be the subject of a grant of special leave to appeal to this Court.

87 There is no dispute that Badenoch and Gunns were in a continuing business relationship from 2003. As noted, from 2010 onwards, Gunns was regularly late in making payments and often made payments that were only in partial satisfaction of invoiced amounts such that, by the end of February 2012, Gunns owed Badenoch approximately \$1.64 million<sup>77</sup>.

### *Payments 1 and 2*

88 Before payments 1 and 2 were made on 30 March and 13 (or 16<sup>78</sup>) April 2012 respectively, Badenoch had issued a letter of demand in respect of Gunns' indebtedness, ceased supplying Gunns with timber for 10 days despite Gunns being Badenoch's sole customer, and demanded a bank guarantee of \$1 million to secure supply. Gunns proposed a progressive payment plan in response<sup>79</sup>. Badenoch accepted this proposal on the basis that if Gunns' indebtedness exceeded

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76 (1996) 185 CLR 483 at 501-502.

77 *Badenoch Integrated Logging Pty Ltd v Bryant* (2021) 284 FCR 590 at 606 [58].

78 There was some uncertainty about the actual dates of the impugned payments: see *Badenoch Integrated Logging Pty Ltd v Bryant* (2021) 284 FCR 590 at 593 [7].

79 *Bryant v Badenoch Integrated Logging Pty Ltd* (2020) 144 ACSR 423 at 434 [48].

\$1 million Badenoch would immediately cease supply<sup>80</sup>. Badenoch also reserved the right to enforce its contract immediately<sup>81</sup>. Gunns made payments 1 and 2 to Badenoch to "get deliveries back on track" and Badenoch continued to supply timber<sup>82</sup>.

89 The necessary focus is on the "actual business" relationship<sup>83</sup>, "in a business sense"<sup>84</sup>. The issue is whether it is possible to treat payments 1 and 2, "for commercial purposes", as an integral part of the "continuing business relationship" or as so unconnected from the subsequent debits to the account to enable treating them "as having produced an immediate effect to be considered independently of what followed"<sup>85</sup>. What followed in the present case was payments 3 and 4 on 1 (or 2) May 2012 and 7 (or 8) June 2012 respectively, and supplies of timber.

90 The actual business relationship, evaluated in its commercial context, is critical. In the present case, Gunns had often made only partial payments of Badenoch's invoices since 2010, but the agreement and the business relationship continued. The controlling minds of Badenoch believed that Gunns would ultimately be in a position to pay all of Badenoch's outstanding invoices<sup>86</sup>. The temporary cessation of supply and negotiation of additional credit terms in March 2012 did not cause Gunns or Badenoch to consider that their business relationship was coming to an end. To the contrary, they were working towards their business relationship continuing and believed it would do so (and, indeed, it did do so)<sup>87</sup>. The mere change in credit terms between Gunns and Badenoch in March 2012 did not operate to bring their continuing business relationship to an end. Nor is the fact

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80 *Bryant v Badenoch Integrated Logging Pty Ltd* (2020) 144 ACSR 423 at 434-435 [49].

81 *Bryant v Badenoch Integrated Logging Pty Ltd* (2020) 144 ACSR 423 at 435 [49].

82 *Badenoch Integrated Logging Pty Ltd v Bryant* (2021) 284 FCR 590 at 606-607 [65]; *Bryant v Badenoch Integrated Logging Pty Ltd* (2020) 144 ACSR 423 at 434 [48], 435 [54].

83 *Richardson* (1952) 85 CLR 110 at 132; *Airservices Australia v Ferrier* (1996) 185 CLR 483 at 502; see also *Queensland Bacon* (1966) 115 CLR 266 at 286.

84 *Queensland Bacon* (1966) 115 CLR 266 at 286.

85 *Richardson* (1952) 85 CLR 110 at 133.

86 *Badenoch Integrated Logging Pty Ltd v Bryant* (2021) 284 FCR 590 at 606 [59], 607 [70].

87 *Badenoch Integrated Logging Pty Ltd v Bryant* (2021) 284 FCR 590 at 606 [65], 607 [67]-[68], 608 [73].

that Badenoch and Gunns *also* wanted to reduce Gunns' past indebtedness determinative<sup>88</sup>.

91 The mutual assumption or purpose as between Gunns and Badenoch that should be inferred as a matter of objective fact from all of the circumstances in the present case is that payments 1 and 2 were made to induce further supply. Their mutual intention that the payments would also reduce Gunns' past indebtedness, in the context of the actual business relationship as a whole, was not such as to characterise the payments as having been made to reduce past indebtedness, *rather than*<sup>89</sup> to induce the continuation of supply. To conclude otherwise would be to "ignore the practical relationship between the payments and the subsequent supply of services and the ultimate effect of the dealings between the parties [and] would not advance the purpose for which"<sup>90</sup> s 588FA(3) of the *Corporations Act* was enacted.

92 The Full Court's conclusion to the same effect<sup>91</sup> is correct.

#### *Payments 5 to 11*

93 Payments 5 to 11 were made between 6 (or 8) August and 21 (or 24) September 2012<sup>92</sup>. By early July 2012 Badenoch had again decided to cease supplying Gunns due to its inability to obtain payment<sup>93</sup>. Badenoch's lawyers wrote to Gunns on 3 July 2012 demanding payment, threatening to commence legal proceedings to recover a debt of \$737,633.68, and saying that once Badenoch had "finalised those services which have been agreed to between it and your Regional Management", Badenoch would cease to provide any further services to Gunns until non-payment was rectified<sup>94</sup>. On 10 July 2012, Badenoch ceased to provide services to Gunns<sup>95</sup>. On 11 July 2012, Gunns proposed a payment plan in response to the letter from Badenoch's lawyers. On 31 July 2012, Badenoch wrote to Gunns

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88 *Airservices Australia v Ferrier* (1996) 185 CLR 483 at 502.

89 *Airservices Australia v Ferrier* (1996) 185 CLR 483 at 510.

90 *Airservices Australia v Ferrier* (1996) 185 CLR 483 at 509.

91 *Badenoch Integrated Logging Pty Ltd v Bryant* (2021) 284 FCR 590 at 608 [72].

92 *Badenoch Integrated Logging Pty Ltd v Bryant* (2021) 284 FCR 590 at 592-593 [5].

93 *Bryant v Badenoch Integrated Logging Pty Ltd* (2020) 144 ACSR 423 at 435-436 [58]-[59].

94 *Bryant v Badenoch Integrated Logging Pty Ltd* (2020) 144 ACSR 423 at 436 [63].

95 *Bryant v Badenoch Integrated Logging Pty Ltd* (2020) 144 ACSR 423 at 437 [64].



saying that Badenoch was owed \$1.36 million and the non-payment was a breach of a fundamental term of the contract, amounting to a repudiation of the agreement. The letter continued<sup>96</sup>:

"Before we accept Auspines [sic] repudiation, we propose to investigate the opportunity for a transition to a mutually acceptable termination of the agreement at the end of three or four months.

We understand that you would regard it as helpful if we were to supply logs. Subject to the following arrangements, we are willing to meet this need in the short term with a gradual tapering off while another contractor gets up to speed."

94 Badenoch proposed termination of the agreement for supply between it and Gunns "on the basis of a payment plan comprising an immediate payment of \$300,000 and weekly instalments of \$150,000 until all outstanding debt was paid. In the meantime, Badenoch would not take action in respect of the current debt whilst instalments were paid and would cooperate with Gunns to meet timber supply requirements in the course of a structured handover to another contractor."<sup>97</sup> Gunns accepted this proposal on 2 August 2012<sup>98</sup>. Payment 5 was the first payment under and in accordance with the new agreement reached on 2 August 2012.

95 In these circumstances, Badenoch's submission that the Full Court erred in finding that the change in the business relationship between Gunns and Badenoch meant that payments 5 to 11 were not made as part of that relationship<sup>99</sup> must be rejected. Badenoch's argument is that the agreement reached on 2 August 2012 was that the business relationship would cease once another contractor had been appointed<sup>100</sup>. According to Badenoch, this did not mean that the business relationship between Badenoch and Gunns ceased by 2 August 2012, given that Badenoch continued to supply to Gunns until September 2012<sup>101</sup>. Badenoch submitted that it could readily be inferred that payments 5 to 11 were made to induce the provision of future services, with the expectation by both parties that

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96 *Bryant v Badenoch Integrated Logging Pty Ltd* (2020) 144 ACSR 423 at 439 [77].

97 *Bryant v Badenoch Integrated Logging Pty Ltd* (2020) 144 ACSR 423 at 439 [77].

98 *Bryant v Badenoch Integrated Logging Pty Ltd* (2020) 144 ACSR 423 at 439 [79].

99 *Badenoch Integrated Logging Pty Ltd v Bryant* (2021) 284 FCR 590 at 609 [79].

100 See the letter referred to in [93] above: "... we are willing to meet this need in the short term with a gradual tapering off while another contractor gets up to speed".

101 *Bryant v Badenoch Integrated Logging Pty Ltd* (2020) 144 ACSR 423 at 440 [93].

future credits and debits would be recorded, albeit also with the intention that at some point in the future that relationship would come to an end.

96 These submissions are disconnected from the actual business relationship between Gunns and Badenoch, at least by 2 August 2012. By that time, in a practical "business sense"<sup>102</sup>, the pre-existing business relationship between Gunns and Badenoch had ceased. They had agreed that their agreement would cease and also agreed a transition plan towards the cessation of supply. Badenoch was intent on supplying for the purpose of maximising the reduction of Gunns' debt to it before the handover to another contractor<sup>103</sup>. Gunns knew from Badenoch's letter of 31 July 2012 it would need to find another contractor<sup>104</sup>. As a result, the fact that some supply continued after the 2 August 2012 agreement is immaterial. That supply was not provided pursuant to the pre-existing business relationship. It was provided pursuant to the agreed transition plan to another contractor. The continuing business relationship between Gunns and Badenoch had ceased by no later than 2 August 2012, before payment 5 was made.

97 For these reasons, the Full Court's conclusion to the same effect<sup>105</sup> is correct.

### **The end of the continuing business relationship**

98 The liquidators submitted that the Full Court correctly concluded in its first judgment that the continuing business relationship ceased by the end of June 2012, but then found in its second judgment that the continuing business relationship did not cease until 10 July 2012.

99 The Full Court did not find that the continuing business relationship ceased by or on 30 June 2012 in its first judgment. It considered that the primary judge had so found and concluded that it "is clear that the continuing business relationship continued throughout this period up to the end of June 2012, and that payments 3 and 4 (which were referable to the March and April invoices) formed an integral part of that relationship"<sup>106</sup>. In so concluding, the Full Court was not embracing the primary judge's finding about the cessation of the continuing business relationship by or on 30 June 2012. Their Honours were agreeing with the primary judge that payments 3 and 4 were part of that continuing business relationship. As those payments were made on or before 8 June 2012, the 30 June

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102 *Queensland Bacon* (1966) 115 CLR 266 at 286.

103 *Bryant v Badenoch Integrated Logging Pty Ltd* (2020) 144 ACSR 423 at 439 [77].

104 *Bryant v Badenoch Integrated Logging Pty Ltd* (2020) 144 ACSR 423 at 439 [77].

105 *Badenoch Integrated Logging Pty Ltd v Bryant* (2021) 284 FCR 590 at 609 [79].

106 *Badenoch Integrated Logging Pty Ltd v Bryant* (2021) 284 FCR 590 at 608 [75].

2012 date had no significance for the Full Court in its first judgment. This also follows from the fact that in its first judgment the Full Court said that payments 5 to 11, "being payments made after 31 July 2012, were not a part of a continuing business relationship"<sup>107</sup>.

100 By the second judgment, it was apparent that the start and end date of the continuing business relationship in accordance with s 588FA(3) mattered because of the changing state of Gunns' indebtedness<sup>108</sup>. As determined above, the date of the first transaction in the relationship in accordance with s 588FA(3) is 30 March 2012. At that time, Gunns' debt to Badenoch was \$410,965.07<sup>109</sup>.

101 On 31 July 2012, Badenoch rendered an invoice in the sum of \$194,273.06<sup>110</sup>. This is after the date on which the primary judge had found the continuing business relationship ceased<sup>111</sup>. In its second judgment the Full Court concluded that the continuing business relationship ceased on 10 July 2012, being the date on which Badenoch ceased supply for the second time<sup>112</sup>. While the invoice of 31 July 2012 was rendered after this date, it related to supply by Badenoch before this date. The Full Court, accordingly, concluded that the 31 July 2012 invoice was a transaction forming part of the continuing business relationship<sup>113</sup>.

102 The rendering of the 31 July 2012 invoice gave rise to an obligation on the part of Gunns to pay as and when required. The rendering of the invoice, accordingly, is a "transaction" within the meaning of s 9 of the *Corporations Act*. The (undisputed) fact that the invoice related to work before 10 July 2012 means that the obligation to pay which arose on 31 July 2012 would be an integral part of the continuing business relationship if the relationship continued until 10 July 2012. The Full Court did not err in so concluding. On 3 July 2012, Gunns and Badenoch were still contemplating supply being continued under the agreement as modified in March if the non-payment was rectified. Further, at that time,

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107 *Badenoch Integrated Logging Pty Ltd v Bryant* (2021) 284 FCR 590 at 609 [79].

108 *Badenoch Integrated Logging Pty Ltd v Bryant [No 2]* [2021] FCAFC 111 at [3]-[4].

109 *Badenoch Integrated Logging Pty Ltd v Bryant* (2021) 284 FCR 590 at 592 [5].

110 *Badenoch Integrated Logging Pty Ltd v Bryant [No 2]* [2021] FCAFC 111 at [3]; *Badenoch Integrated Logging Pty Ltd v Bryant* (2021) 284 FCR 590 at 592 [5].

111 *Bryant v Badenoch Integrated Logging Pty Ltd* (2020) 144 ACSR 423 at 447 [109].

112 *Badenoch Integrated Logging Pty Ltd v Bryant [No 2]* [2021] FCAFC 111 at [9].

113 *Badenoch Integrated Logging Pty Ltd v Bryant [No 2]* [2021] FCAFC 111 at [9].

Badenoch was merely contemplating termination of the agreement if Gunns did not rectify the non-payment<sup>114</sup>. This is sufficient to conclude that the continuing business relationship did not cease before 10 July 2012 when Badenoch ceased supply. The Full Court's conclusion that, as the net indebtedness of Gunns to Badenoch increased from 30 March 2012 (\$410,965.07) to 31 July 2012 (relating back to supply provided before 10 July 2012) (\$1,559,594.08), there could be no unfair preference relating to the single transaction deemed by s 588FA(3), and its application of s 588FA(1) to that deemed single transaction as required by s 588FA(3)(c) and (d), are correct.

## Orders

103 The orders which should be made are:

- (1) The appeal be dismissed.
- (2) Special leave be granted to the respondent to cross-appeal to this Court from part of the judgment and order of the Full Court of the Federal Court of Australia given and made on 24 June 2021.
- (3) The cross-appeal be dismissed.
- (4) The appellants pay the respondent's costs of the appeal and the respondent pay the appellants' costs of the cross-appeal, such costs to be set off against each other.

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<sup>114</sup> *Bryant v Badenoch Integrated Logging Pty Ltd* (2020) 144 ACSR 423 at 436 [63].

