Section 588FA of the Corporations Act – change of wording but no change to meaning?

Tina Hoyer∗

One of the main elements to be established by a liquidator in order to successfully challenge a pre-liquidation transaction known as an unfair preference is contained in s 588FA(1)(b) of the Corporations Act 2001 (Cth). This subsection provides that the transaction must result in the creditor receiving from the company more than the creditor would receive from the company if the transaction was set aside and the creditor was to prove for the debt in a winding up of the company. This wording is substantially different from that of the subsection’s statutory predecessor. It was foreshadowed that despite the differences in the wording, the enactment of s 588FA would cause no fundamental change to the law with respect to unfair preferences. However, this article will demonstrate that there have been subtle, yet significant, changes to the way the court deals with unfair preferences since the enactment of s 588FA.

INTRODUCTION

One of the primary functions of a liquidator is to recover property that has been transferred to others prior to liquidation so as to recoup moneys for the benefit of the liquidated company’s creditors.1 To carry out this function, liquidators most frequently utilise2 s 588FA of the Corporations Act 2001 (Cth) (the Act) which deals with unfair preferences.3 The ability to recover unfair preferences reflects one of the main aims of insolvency law, that is, to ensure that the assets of an insolvent are distributed equally among an insolvent’s creditors and that no one creditor receives preferential treatment unless permitted by law.4

Section 588FA was introduced by the Corporate Law Reform Act 1992 and replaced the previous regime under the bankruptcy legislation.5 It was foreshadowed that despite the differences in the wording of its statutory predecessor, the enactment of s 588FA would cause no fundamental change to the law with respect to unfair preferences.6 However, it is argued here that there has been change as a result of the different wording. Specifically, it will be demonstrated that the following subtle, yet significant, changes have occurred since the enactment of s 588FA:

• the relevant time for determining whether a transaction is an unfair preference is now the actual winding up as opposed to the time of the transaction as it was under the statutory predecessor;7

1 Tina Hoyer is a solicitor, and also a casual lecturer and tutor at the School of Law at James Cook University. The author wishes to thank Dr Colin Anderson of the School of Law at the Queensland University of Technology for helpful comments on earlier drafts of this article. Responsibility for any errors remains with the author.


3 It was noted in the Australian Law Reform Commission in its General Insolvency Inquiry (1988) (known as the Harmer Report) that the evidence produced to it suggested that there was “a lively market in the recovery of preferences”. Keay A, “An Exposition and Assessment of Unfair Preferences” (1994) MULR 545 at 547.


6 Section 565 of the Corporations Law (and its statutory predecessors) engrafted s 122 of the Bankruptcy Act (Cth) (and its statutory predecessor) being the provision dealing with preference payments.


(2010) 18 Insolv LJ 77

77
• the comparison under s 588F A(1)(b) required is between what the creditor received in payment or part-payment of its debt and what it would receive if it were to prove for the same amount of the payment or part-payment in a winding up. Under the statutory predecessor, the comparison was between the creditor’s position with that of the other creditors before and after the transaction; and
• the application of the doctrine of “ultimate effect” has developed and now has a more general application. Historically, the doctrine of ultimate effect predominantly arose in relation to running accounts and considered the ultimate effect of all payments received in a running account as opposed to the immediate effect of each payment received.

This article is divided into four parts: the first part will provide a general background on unfair preferences and the policy justifications for unfair preferences; the second part will examine s 588FA and compare it to its statutory predecessor; the third part will examine the case law as it was prior to the enactment of s 588FA in relation to preferential effect and running accounts; and finally it will consider the changes in the way the court determines and deals with preferential effect under s 588FA. Consideration will also be given to whether these changes are consistent with the policy justifications for unfair preferences.

PART 1 – BACKGROUND

To enable liquidators to recover property for the benefit of a liquidated company’s creditors, the Act provides liquidators with an arsenal of weapons to challenge certain types of pre-liquidation transactions of companies. These provisions are governed by Pt 5.7B, Div 2 of the Act and its purpose was expressed in these terms:

The purpose of the provisions in this proposed Division [Div 2 of Pt 5.7B] is to ensure that unsecured creditors are not prejudiced by the disposition of assets or the incurring of liabilities by a company in a period shortly before the winding up which would have the effect of favouring certain creditors or other persons, and especially related entities. This might occur where a creditor (whether or not that creditor has some connection with the company) was paid out in full rather than having to prove for a proportion of the debt in the winding up.

One type of pre-liquidation transaction which can be challenged by liquidators is an unfair preference under s 588FA of the Act. The ability to have an unfair preference transaction set aside is regarded as a primary weapon of a liquidator in recovering property for the creditors of a company. In general terms, an unfair preference is a payment made or a transfer of property to a particular

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8 Walsh v Natra Pty Ltd (2000) 156 FLR 227; Williams (as liquidator of Scholz Motor Group Pty Ltd) v Peters (2009) 72 ACSR 365.
9 Keay, n 6, p 132.
11 As it is referred to in Air Services v Ferrier (1996) 137 ALR 609, 628. Also referred to as the “entire transaction” doctrine in Re Weiss [1970] ALR 654; the “whole transaction concept” in Richardson v Commercial Banking Co of Sydney Ltd (1952) 85 CLR 110 at 129; the “landlords defence” in Re Discovery Books Pty Ltd (1973) 20 FLR 470.
12 As stated by Wotton J in M & R Jones Shopfitting Co Pty Ltd (in liq) v National Bank of Australasia Ltd (1983) 68 FLR 282; 7 ACLR 445 at 452 – “Where the payment is not in pursuance of some isolated transaction but is integrally bound up with a series of transactions, it is the effect of the total transaction, of all the connected items, that has to be looked at … Although the question usually arises in relation to running accounts, the principle is not so confined…”.
13 Murray, n 1, p 330.
14 Explanatory Memorandum to the Corporate Law Reform Bill 1992.
16 Other types of pre-liquidation transactions which can be challenged by liquidators are uncommercial transactions under s 588FB and unfair loans under s 588D of the Corporations Act 2001 (Cth).
17 Keay, n 2 at 547.
creditor at a time when the company is, or is about to become, insolvent. If certain conditions exist, a court, upon application by a liquidator, may determine that the transaction is voidable and order that it be set aside or varied.\(^\text{18}\)

**The policy basis for unfair preferences**

Company insolvency law in general involves consideration of the position and concerns of the company, its creditors and the general community. As it is commonplace that very little, if any funds are available upon the liquidation of a company, a balancing of these considerations is vital.\(^\text{19}\) Jackson and Kronman suggest that the law on unfair preferences aims to “protect the contractual arrangements fashioned by the bankrupt and his various creditors during the pre-bankruptcy period”\(^\text{20}\) and “to minimize the inevitable social costs associated with bankruptcy by spreading its impact among all classes of creditors”.\(^\text{21}\)

There are three main policy considerations which reflect these considerations and are said to serve as justification for unfair preferences:

- the pari passu principle (also known as the equality principle);
- the deterrence of a race between individual creditors to obtain satisfaction of their debts before a company falls into liquidation; and
- the community of interest between the creditors of a company in the company trading out of its difficulties as opposed to going into liquidation.

The culmination of these policy considerations was explained by the High Court of Australia in *G & M Aldridge Pty Ltd v Walsh* (2000) 203 CLR 662 at [30] as follows:

> A primary objective [of the preference provisions] is that of securing equality of distribution among creditors of the same class. The pursuit of that objective has the consequential effect of deterring the “race to the courthouse” and that, in turn, enhances the prospect of enabling debtors to trade out of their difficulties without undue and discriminatory risk to creditors.

However, this is the ideal, and in reality these policy considerations often overlap, and at times, conflict with each other.\(^\text{22}\) Each of these policy considerations will now be examined in turn, the most fundamental being the pari passu principle.

**The pari passu justification**

The pari passu principle is often quoted as a fundamental principle of insolvency law\(^\text{23}\) and is enshrined in s 555 of the Act.\(^\text{24}\) The principle is intended to ensure that the assets of a company which is insolvent are distributed equally among its creditors and that no creditor receives preferential treatment unless permitted by law.\(^\text{25}\) It also recognises that insolvency proceedings are of a collective

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\(^{18}\) In assessing whether a transaction is an unfair preference, aside from s 588FA, consideration must also be given to other sections of the Corporations Act 2001 (Cth), namely ss 588FC, 588FE, 588FF and 588FG. Section 588FC indicates when an unfair preference must be an insolvent transaction and, thereby capable of being classified as a voidable transaction. Section 588FE explains the time zone in which a transaction must occur if it is to be an unfair preference which is voidable. Section 588FF enumerates the orders which may be made by a court if a preference is voidable. Section 588FG specifies, inter alia, the defences which may be available to someone who has received an unfair preference which is voidable.

\(^{19}\) Murray, n 1.


\(^{21}\) Jackson and Kronman, n 20 at 989.

\(^{22}\) Keay, n 6, p 31.


\(^{24}\) Section 555 of the Corporations Act 2001 (Cth) provides: “Except as otherwise provided by this Act, all debts and claims proved in a winding up rank equally and, if the property of the company is insufficient to meet them in full, they must be paid proportionately”.

\(^{25}\) See eg the list of priority creditors in s 556 of the Corporations Act 2001 (Cth).
nature which has the effect of each creditor losing the individual right to pursue separate remedies and must rely on the outcome of collective proceedings.  

However, in reality there are many exceptions to the principle. The main exception being priority debts listed in s 556 of the Act.  

Also, there are a number of exceptions which have been developed by the courts due to competing public policy considerations.  

Thus, it is frequently the situation that there is very little if anything left for unsecured creditors who are the last to receive a dividend in a company liquidation; the majority of funds being distributed to the secured creditors, usually banks and financial institutions, and priority creditors. As a result:

[The pari passu creditors’] lot is not a happy one since experience has shown that the dividends payable to them, after payment of super-priority and priority, is either nil or some small percentage – rarely more than 20 percent and usually much less. This melancholy result demonstrates the emphasis which bankruptcy law in many jurisdictions places upon protecting other prior claimants and also, of course, the low value of the assets of the assets of the failed and broken-up business.  

However, the law in relation to unfair preferences does reflect the pari passu principle in that it allows for recovery from a single creditor in order to benefit the whole group of unsecured creditors and thus there is a pari passu distribution of the company’s property. In this regard, the principle’s aim is to prevent a creditor receiving an advantage as explained by Keay in the following terms:

[When a preference is given by a debtor company, whether motivated by kindness, a sense of duty or some fraudulent intent, the company is, in effect “robbing Peter to pay Paul”, the recipient of the preference obtains an advantage over other creditors in that the preferred creditor is receiving his or her debt (or part thereof) before the other creditors.]

Without the ability of a liquidator to set aside unfair preferences, companies could dissipate assets in favour of whomsoever the insolvent company chose which would lead to many injustices to other creditors as well as the community as a whole.

Race to the courthouse argument

Stemming from the pari passu principle, unfair preferences are also said to deter a race between creditors to obtain satisfaction of their debts before the company goes into liquidation or to ensure that an undignified scramble by creditors over available assets is avoided. This is said to occur because creditors fear imminent liquidation of their debtor company and they wish to improve their position.

This justification for unfair preferences can be traced back to medieval times when there was no provision for a sharing of property so the rule was “first come, first served”. This is an alternative method of distribution that is considered inefficient on the basis that:

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27 Section 556 of the Corporations Act 2001 (Cth) provides for the statutory order of priority among unsecured creditors for example superannuation and wages.
28 Such as cash on delivery transactions and running accounts – discussed further below.
29 Lipton, n 26 at 24.
31 Keay, n 2 at 549.
32 Keay, n 2 at 549.  
33 Keay, n 2 at 550.
34 Keay, n 2, at 549. See also Harmer Report, n 2 at [33] where it was identified that one fundamental aim of insolvency law is to “provide a fair and orderly process for dealing with the financial affairs of insolvent individuals and companies”.
36 Keay, n 2, at 547.
would involve expensive, individually-funded races to assert rights against the insolvent company, as well as incentives to enforce those rights with a speed likely to reduce the value of the estate for distribution as a whole.  

It would also require individual creditors to continually monitor the claims against their debtors to ensure that execution was not being levied upon the debtor’s assets. By providing the creditor with an assurance that their rights will be protected in this type of circumstance, the monitoring costs are reduced and in theory this reduces the cost of obtaining credit for all debtors.

Trading out of difficulties justification

The third policy consideration relevant to unfair preferences is the community of interest between the creditors of a company trading out of its difficulties as opposed to going into liquidation. While clearly related to the race to the courthouse argument, this consideration can conflict with the pari passu principle. The trading out policy consideration developed on the basis that it is believed that creditors who supply goods and services after a company is insolvent, improve the chances of a company trading out of its difficulties which is preferable to the company going into liquidation.

For this reason it is accepted that a post insolvency but pre liquidation payment, for at least the equivalent economic value supplied to a company in the post insolvency period, is not a preference payment. This is on the basis that it does not disadvantage other creditors.

Examples are cash on delivery (COD) transactions, and genuine prepayments. The rationale behind these exceptions is that the company gains goods and services to an equivalent value to that which it pays out to obtain them, so that the existing creditors cannot in theory be prejudiced by the payment. This assumes that there is equivalence between the price and benefit obtained.

Furthermore, in relation to prepayments, the payee is not a creditor and to constitute an unfair preference the person preferred must be a creditor.

This policy consideration is also the justification for the running account exemptions which will be considered more closely in parts two and three of this article.

Accordingly, a creditor who has received an unfair preference from an insolvent company which, prima facie would be voidable and have to be disgorged, could argue that the payment was part of a running account or a COD transaction and on this basis the payment would not have to be disgorged to the liquidator.

In summary, the pari passu principle is not the sole justification for unfair preferences and there are other underlying policies such as the deterrence of the race to the courthouse. These policies can overlap and conflict. The legislature has attempted to accommodate all of these policies which in reality, has resulted in equal distribution being achieved only to a limited extent by the Act. As explained by Keay, the legislature has:

balance the ideal of equality with the interests of the credit economy and the general welfare of the community. Whatever the result, one cannot say that the equality principle applies. The policy appears to be that avoidance provisions exist to ensure that the distributional scheme prescribed by statute occurs.

38 That is, while the company in insolvent but prior to its liquidation.
40 Quo, n 39 at 12.
41 Quo, n 39 at 12.
42 The running account principles were developed by the courts prior to the enactment of s 588FA. The principles are now enshrined in s 588FA(3).
43 Keay, n 6, p 58.
PART 2 – SECTION 588FA OF THE ACT

Section 588FA(1) provides:

1) [Where transaction unfair preference] 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.

In simple terms, “a transaction is an unfair preference if the company and the creditor are parties to the transaction and the transaction results in the creditor receiving from the company, in relation to an unsecured debt owed to the creditor, a greater amount than it would have received in relation to the debt in a winding up of the company”.

To ascertain whether a transaction is voidable and thus recoverable by a liquidator, in addition to s 588FA, consideration must also be given to other sections of the Act namely ss 588FC, 588FE, 588FF and 588FG.

In summary, to succeed in recovering an unfair preference, a liquidator must establish that:

- the transaction was entered into during the six months ending on the relation-back day or after that day but on or before the day when the winding up began;
- the company and the creditor were parties to the transaction;
- the transaction was entered into at a time when the company was insolvent; and
- the transaction resulted in the creditor receiving more than the creditor would receive if the transaction was set aside and the creditor was to prove in a winding up of the company.

The focus of this article is limited to s 588FA of the Act, and particularly s 588FA(1)(b) and the test for preferential effect, being: whether the creditor received more than the creditor would receive if the transaction were set aside and the creditor were to prove in a winding up of the company.

As explained above, this test is based on the pari passu principle in that it aims to ensure that all unsecured creditors are treated equally and that no creditor receives an advantage over other creditors.

This article will also examine s 588FA(3) which has the effect of codifying the principle of the running account. The running account principle was developed by the courts in relation to preferences under the bankruptcy legislation.

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44 Murray, n 1, p 334.

45 Section 588FG(2) provides a defence to creditors on the basis that the creditor entered into the transaction in good faith and had no reasonable grounds for suspecting that the company was insolvent at that time or would become insolvent and a reasonable person in the creditor’s circumstances would have had no such grounds for so suspecting and the person provided valuable consideration under the transaction or changes his, her or its position in reliance on the transaction.

46 Section 9 of the Corporations Act 2001 (Cth) defines “transaction” as one to which the company is a party, eg (but without limitation): (a) a conveyance, transfer or other disposition (b) a charge; (c) a guarantee, (d) a payment made (e) an obligation incurred, (f) a release or waiver (g) a loan and includes such a transaction that has been completed or given effect to, or that has terminated.

47 Sections 513A and 513B of the Corporations Act 2001 (Cth) provides that the “relation-back day” is, in a voluntary liquidation, the day of the commencement of the winding up; or when a winding up order has been made, on the day on which the application for the order was filed.

48 Section 588FE provides for the periods prescribed as relation-back periods. The period is usually six months from the relation-back day. However, it can differ according to the type of voidable transaction, whether there was an intent to defeat creditors or whether an entity related to the company was a party to the transaction.

49 Section 588FA(1)(a) of the.

50 Section 588FC of the Corporations Act 2001 (Cth).

51 Section 588FA(1)(b) of the Corporations Act 2001 (Cth).

52 Murray, n 1, p 338.
services on credit to a debtor and a running account was recorded so that the amount owing to the creditor fluctuated from time to time. If the preference provisions were strictly applied, each one of the payments made by the debtor would be set aside. This was considered as unduly harsh if further credit was given in response to the payment and led to injustices to creditors in that payments made by a company to a creditor in order to maintain a genuine business relationship promised advantages to both the company and the creditor.\footnote{McAloon D, “’Ultimate Effect’ or Maximum Recovery? – Should Liquidators be able to Apply the ‘Peak Indebtedness Rule’ to Running Accounts When Pursuing Unfair Preference Claims?” (2006) 14 Insov LJ 90 at 91.}

Section 588FA(3) of the Act provides:

(3) Where:

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

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

then:

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.

Effectively, this subsection provides that where the parties have an ongoing commercial relationship and the company’s net indebtedness is increased and reduced from time to time as a result of a series of transactions, s 588FA(1) applies in relation to all the transactions forming part of the relationship as if they together constituted a single transaction.\footnote{McAloon, n 53 at 91.}

An example of the application for the subsection is \textit{John Irving & Andre Strazdins as liquidators of Pondermaria Pty Ltd (in liq) v F Laucke Pty Ltd} [2006] SADC 91. In that case, the creditor received nine payments totalling $721,028.72 from the company in liquidation for chicken feed during the relation-back period. Of these payments and pursuant to the s 588FA(3), only $219,190.16 were challenged as being unfair preference payments.\footnote{The nine transactions together formed a single transaction pursuant to s 588FA(3). The liability of $219,190.16 was calculated on the basis that the peak indebtedness of the company in the transaction period was $601,289.18 and the final indebtedness of the company as at the date of the relation-back day was $382,099.02. The “peak indebtedness” rule is explained in part three of this article.}

\section*{The statutory predecessor of s 588FA}

Prior to the enactment of s 588FA, the companies legislation adopted provisions relating to voidable preferences in the bankruptcy legislation, the most recent being s 122 of the \textit{Bankruptcy Act} (Cth) (the \textit{Bankruptcy Act}).\footnote{Prior to the \textit{Corporate Law Reform Act} 1992, the key section of the \textit{Corporations Law} which operated to invalidate transactions entered into by a company prior to its winding up was s 565. Section 565 incorporated ss 120, 121 and 122 of the \textit{Bankruptcy Act} (Cth) as did its predecessor s 451 of the \textit{Companies Code}.} Section 122 of the \textit{Bankruptcy Act} provides as follows:

A conveyance or transfer of property, a charge on a property, or a payment made, or an obligation incurred, by a person who is unable to pay his debts as they become due from his own money (in this section referred to as “the debtor”), in favour of a creditor, being a conveyance, transfer, charge, payment or other obligation executed, made or incurred:

a) within 6 months before the presentation of a petition on which, or by virtue of the presentation of which, the debtor becomes a bankrupt; or

b) on or after the day on which the petition on which, or by virtue of presentation of which, the debtor becomes a bankrupt and before the day on which the debtor becomes a bankrupt; is void as against the trustee in the bankruptcy. (emphasis added)
This wording is very different from the wording of s 588FA. In particular, unlike s 588FA(1)(b), with respect to the requisite preferential effect of a transaction, s 122 of the Bankruptcy Act refers to payments having the effect of giving a creditor a “preference, priority or advantage over other creditors”. In comparison to s 588FA(1)(b), the previous statutory requirement of preference, priority or advantage to the creditor over other creditors, has been replaced by a test of whether the transaction resulted in the creditor receiving from the company in respect of an unsecured debt more than the creditor would receive if a transaction was set aside and the creditor proved for the debt in a winding-up of the company.

On a literal interpretation, it could be argued that consideration of other creditors is not necessary and that all that is required is a comparison between the 100 cents in the dollar that the creditor received and the amount the creditor would have received in a winding up of the company if the impugned transaction was set aside.\(^{57}\) There is no mention of other creditors and it would seem that any payment followed by the result that the creditor would receive less in a winding up would be an unfair preference. Therefore, only in a situation where the result of the winding up was a dividend of 100 cents in a dollar could a creditor argue that the payment did not have a preferential effect.

Such an interpretation would lead to some unjust results which could not have been intended by Parliament. For example, a payment received by a creditor when there were no other creditors would amount to an unfair preference. In this situation, it is difficult to see how any payment received could be preferential.\(^{58}\)

Another substantial change to the statutory predecessor was the inclusion of s 588FA(3) which was intended to codify the running account principles developed by the case law. The running account principles and s 588FA(3) is considered in detail in part three of this article.

**Change of wording but no change of meaning?**

Despite the differences in the wording, it has been held that no substantial change to the law was intended by the legislature\(^{59}\) and it is still necessary for a liquidator to establish the same elements as were necessary under the statutory predecessor.\(^{60}\) As stated by Ormiston JA in *VR Dye v Peninsula Hotels Pty Ltd* (1999) 150 FLR 307 at [33]:

> [T]he new provision should be construed in the same way as the former provision, except to the extent that the language of s 588FA clearly points to a contrary conclusion.

Consequently, … in my opinion it is clear that no change was intended to be made to the nature of a preference under the new legislation, whatever other alterations were made to the law.

Robson J in the Supreme Court of Victoria decision of *Re Centaur Mining & Exploration Ltd* (2008) 221 FLR 217 at 226 was of the same view and stated as follows:

> [I]t is unlikely that parliament intended to materially alter the preference laws with their 1992 amendments. The Explanatory memorandum to the Corporate Law Reform Bill 1992 does not say that parliament so intended. The Harmer Committee decided the policy of the existing law should not be altered. The Harmer Committee did not recommend that any changes be made to the existing principles.

In this regard, the Explanatory Memorandum stated:

\(^{57}\) Austin and Ramsey, n 4, p 1421. By example, a creditor received $10,000 as part payment of a debt; the $10,000 payment is compared to the amount the creditor would receive if the transaction was set aside and the creditor proved in a subsequent winding up; if the creditor would receive 50 cents in a dollar (being $5,000), the would be considered an unfair preference.

\(^{58}\) Note in *Walsh v Natra Pty Ltd* (2000) 156 FLR 227 at 239 states that although the comparison is not to other creditors, there must be at least one other creditor in existence at the time of the transaction which has not received 100 cents in the dollar in any subsequent winding up.


\(^{60}\) Keay, n 2 at 165
Section 588FA of the Corporations Act – change of wording but no change to meaning?

s[ection] 122 [of the Bankruptcy Act] refers at present to a transaction which has the effect of giving to the creditor a “preference, priority or advantage” over other creditors of the company, whereas the new provision specifies quite clearly what that expression means in the context of a corporate winding up.\(^{61}\)

In relation to s 588FA(3) it is clear that it was intended to codify the running account principles. As stated in the Explanatory Memorandum:

This provision is aimed at embodying in legislation the principles reflected in the case of Queensland Bacon Pty Ltd -v- Rees (1967) 115 CLR 266 and Petagna Nominees Pty Ltd & Anor v AE Ledger 1 ACSR 547.\(^{62}\)

Further, the case law in relation to running accounts since the enactment of s 588FA(3) indicates that there was no change intended to be made to the principles.\(^{63}\) It was stated by Burley SCM in Olifent v Australian Wine Industries Pty Ltd (1996) 19 ACSR 285 at 292:

In my opinion, the nature and ambit of the running account defence under the former provision is essentially the same as the defence provided for under the current provisions. The absence of any provision in s 588FA(2) to alter or vary the situation which pertained under the former provisions indicates that the legislature did not intend to alter that position.

In relation to the other exceptions to preferences such as COD transactions and prepayments which applied under the statutory predecessor, Ormiston J in VR Dye & Co v Peninsula Hotels Pty Ltd (in liq) at [32] stated:

the other, formerly existing, apparent exceptions were intended still to apply and, to that extent, the legislative definition must be treated as purposive. In other words the section is still directed against unfair preferences. If that be so, then I would conclude that the new provision should be construed in the same way as the former provision, except to the extent that the language of s 588FA clearly points to a contrary conclusion.

PART 3 – THE LAW PRIOR TO ENACTMENT OF S 588FA

This part of this article will examine the state of the law with respect to preferential effect and the running account principles prior to the enactment of s 588FA more thoroughly and compare it with how s 588FA(1)(b) has been interpreted since its enactment. It is submitted that despite the judicial authority that says otherwise, there has been some subtle yet significant changes in this area. These changes have lead to some outcomes which would not have occurred prior to the enactment of s 588FA.

Preferential effect pre-s 588FA(1)(b)

As outlined above, to establish preferential effect under the statutory predecessor of s 588FA, a liquidator had to prove that the transaction had “the effect of giving to the creditor a preference, priority or advantage over other creditors”.\(^{64}\) The High Court of Australia held that this meant that the effect of the transaction had to be such that if the transaction were allowed to stand, it would “dislocate the statutory order of priorities amongst creditors”.\(^{65}\) In other words, if the transaction was to remain, it would result in the creditor receiving a greater payment than the creditor would receive if the company was wound up.\(^{66}\) Therefore, a comparison was required between what the creditor received from the company as a result of the transaction as opposed to other creditors and what the creditor would have received if the company was wound up as opposed to other creditors.

While this aspect was relatively clear, there was some divergence as to the time of the comparison. That is, was the comparison to be made between the alleged preferred creditor and other

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\(^{64}\) In accordance with the wording of s 122 of the Bankruptcy Act.

\(^{65}\) Burns v Stapleton (1959) 102 CLR 97 at 104.

\(^{66}\) Keay, n 6, p 132.

(2010) 18 Insolv LJ 77 85
creditors who existed at the time of the transaction or with other creditors who proved in the subsequent winding up? The two approaches are different in that one involves the liquidator establishing the financial position of the company at the time of the transaction and the likely return to the creditor in a hypothetical winding up at that time. While the other involves the same determination, however, the comparison is made to the position of the company and the likely return to the creditor at the actual winding up of the company. Depending on which approach is taken, the outcomes could differ.67

The “better and more logical view”68 and the approach taken in the majority of cases69 was that the comparison should be made at the time of the transaction and not the actual winding up. For example, this approach was taken by Menhennitt J in Calzaturificio Zenith Pty Ltd (in liq) v New South Wales Leather & Trading Company Pty Ltd [1970] VR 605:

When one then comes to the … aspect, namely “a preference, a priority or advantage over other creditors”, it seems to me, as a matter of language and common sense … it means “a preference, a priority or an advantage” over other creditors in respect of their debts then due and owing, and that it is a misuse of language to say that … in order to decide whether there was a preference at that particular moment of time you have to take into account debts that ultimately will be provable in bankruptcy.

This view has also been supported by academics70 and in other decisions71 such as Spedley Securities Ltd (in liq) v Western United Ltd (in liq) (1992) 7 ACSR 271 at 274 in which McLelland J stated the following:

A matter of contention in the present proceedings is whether the “other creditors” whose position is to be compared with that of the creditor to which the payment is made, are creditors as at the time of that payment (as the defendant contends) or creditors in the subsequent winding up (as the plaintiffs contend) … As a matter of language, the concept that one creditor being given a preference priority or advantage over other creditors as the effect of a particular transaction, carries the connotation that the “other creditors” are persons having that status at the time of that transaction.

Notwithstanding the support for this view, there were some authorities referring to a requirement that the comparison be made with the general body of creditors who proved in the actual bankruptcy.72 McLelland J in Harkness v Potts (1993) 10 ACSR 517 at 521 stated the following:

[T]he phrase “preference, priority or advantage over other creditors” requires a comparison to be made between (i) the position of the recipient as a result of the challenged payment (and any sufficiently connected transactions) and (ii) the position of other creditors, in relation to the subsequent winding up.

This approach is known as the “ultimate effect doctrine” and stems from a Federal Court decision of Fox J in Re Discovery Books Pty Ltd (1972) 20 FLR 470 when interpreting the description of the requisite effect in the High Court decision of Richardson v Commercial Banking Co of Sydney Ltd (1952) 85 CLR 110, he stated:

What I understand from the passage cited is that the effect of a payment is to be judged after bankruptcy, with due regard for events occurring after the payment was made, and that one must

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67 For example, the creditors could vary at the beginning of the relation-back period to those in existence at the actual winding up of the company. It is more likely that the return to a creditor at the actual winding up would be less than up to six months prior to the actual winding up. An example is in Walsh v Natra Pty Ltd (2000) 156 FLR 227 – at the time of the transaction, there were no other creditors; whereas at the actual winding up there were two creditors. Although Natra had paid its trade creditors, the Commissioner of Taxation was owed sales tax due for December 1992 and January 1993 (but did not lodge a proof of debt until nearly three years after the winding up order) and the employee, Mullally, was owed long service leave over a 25-year period (this claim was discharged by another company).


69 Keay, n 6, p 132.


ultimately come back to considering whether by reason of the payment, or dealing, there is less money available for the general body of creditors than otherwise might have been expected to be the case.\(^{73}\)

In other words, Fox J was of the view that ultimately preferential effect is concerned with the effect of the transaction on the general body of creditors in the actual winding up.\(^{74}\)

The approach of examining the ultimate effect has been criticised as confusing preferential effect with the policy justification for preference payments (ie the pari passu principle).\(^{75}\) That is, preferential effect should be established to ascertain whether a creditor has received an advantage at the time of the transaction and not to ascertain whether the transaction has lead to adverse consequences for creditors in a subsequent winding up. This proposition was succinctly stated by Bennetts as follows:

> to determine preferential effect by reference to creditors in the actual winding up competing for assets as a result of the challenged transaction confuses the policy justification for preference recoveries with preferential effect. For, although it is appropriate to recognize that preference recoveries are ultimately justified by reference to the need to prevent individual creditors from improving their position when winding up is imminent, leaving those creditors who remain in the winding up to compete for limited assets, such policy recognition has nothing to do with the determination of preferential effect … [E]stablishing preferential effect is best perceived in terms of satisfying the operation of the preference avoidance provisions … which … are concerned with the circumstances of the transaction under review and its consequences at the time when the transaction is entered into.\(^{76}\)

It could be argued that legislature’s omission of any reference to other creditors in s 588FA was intended to clarify this position. By omitting reference to “other creditors”, the focus is directed to whether the creditor has received an advantage as opposed to consideration of other creditors which is what is required if the doctrine of ultimate effect is adopted. This may be what was meant by the following statement in the Explanatory Memorandum:

> s[ection] 122 [of the Bankruptcy Act] refers at present to a transaction which has the effect of giving to the creditor a “preference, priority or advantage” over other creditors of the company, whereas the new provision specifies quite clearly what that expression means in the context of a corporate winding up.\(^{77}\)

In the next part of this article, the running account principles and the doctrine of ultimate effect and its development since the enactment of s 588FA will be examined. It is argued that traditionally, the doctrine of ultimate effect was predominantly only considered in the context of running accounts.\(^{78}\) Since the enactment of s 588FA, application of the doctrine of ultimate effect has broadened.

### Running account principles

The running account principles were well established prior to the enactment of s 588FA. The principles arose out of a line of authority in relation to preferences, such as Richardson v The Commercial Banking Co of Sydney (1952) 85 CLR 110, Queensland Bacon Pty Ltd v Rees (1966) 115 CLR 266 and continued to be endorsed by a majority of the High Court of Australia in Airservices Australia v Ferrier (1996) 185 CLR 483 prior to the enactment of s 588FA(3).

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\(^{73}\) Re Discovery Books Pty Ltd (1972) 20 FLR 470 at 475.

\(^{74}\) Bennetts, n 68 at 177.

\(^{75}\) Bennetts, n 68 at 177; Keay, n 6, p 133-134.

\(^{76}\) Bennetts, n 68 at 177-178.

\(^{77}\) Explanatory Memorandum of Corporate Law Reform Bill 1992, 1040.

\(^{78}\) Richardson v Commercial Banking Co of Sydney Ltd (1952) 85 CLR 110; Queensland Bacon Pty Ltd v Rees (1966) 115 CLR 266; and Petagna Nominees Pty Ltd v AE Ledger (in liq) (1989) 1 ACSR 547. However, Wotton J in M & R Jones Shopfitting Co Pty Ltd (in liq) v The National Bank of Australasia Ltd (1983) 7 ACLR 445 at 452 stated that “although the question usually arises in relation to running accounts, the principle is not so confined”. Also, in Airservices Australia v Ferrier (1996) 137 ALR 609 at 623 the doctrine of ultimate effect was referred to as being applicable to an isolated payment.
The running account principles are intended to prevent injustices to creditors in the situations where there is a running account between the debtor and creditor. For example, where a supplier of goods supplies goods on credit to a customer and the price of the goods supplied and payments received are recorded on a running account statement; or where a bank provides an overdraft facility and drawings and payments are continually made. In these situations, the payments could be related to existing indebtedness, such as for goods received, and therefore could amount to an unfair preference. However, the payments could also be for future goods, and to induce further supplies and therefore would not amount to an unfair preference.

For the running account principles to apply, the creditor had to demonstrate that a payment was an inseparable part of some wider set of transactions and was not an isolated payment. If this could be established, the court would treat all of the transactions as a “single transaction” and then examine the effect of the transaction on the net value of the assets available to the creditors in the actual winding up.

To create the “single transaction”, the approach taken by the courts was to treat the six month relation-back period (or that portion of the period during which a running account existed) as the single transaction. Using this approach, if a creditor had a net benefit at the end of this period when compared with the level of indebtedness at the beginning of the period, the creditor would have received an unfair preference to the extent of that net benefit. However, the courts allowed liquidators to choose any point during the period to serve as the beginning of the single transaction in respect of which an unfair reference was said to arise. This would undoubtedly always be the point of peak indebtedness thus allowing a liquidator to recover the maximum amount as an unfair preference for the benefit of the general body of creditors. This is known as the “peak indebtedness rule” and is considered a strategic advantage to liquidators.

Upon the determination of the “single transaction”, the court would then consider the purpose of the payment. If the sole purpose of the payment was to discharge an existing debt, the payment would be considered a preference. However, if the purpose of the payment, whether explicit or implicit, was to induce the creditor to provide further goods and services as well as discharge existing indebtedness, the payment would not be an unfair preference unless it exceeded the value of goods or services acquired. This was referred to as the “ultimate effect doctrine”. As stated in the High Court of Australia decision of Airservices Australia v Ferrier:

In such a case a court, exercising jurisdiction under s 122 of the Bankruptcy Act, looks to the ultimate effect of the transaction. Whether the payment is or is not a preference has to be decided not by considering its immediate effect only but by considering what effect it ultimately produced in fact.

As a consequence, a payment made during the 6 month period cannot be viewed in isolation from the general course of dealing between the creditor and the debtor before, during and after that period. Resort must be had to the business purpose and context of the payment to determine whether it gives the creditor a preference over other creditors. To have the effect of giving the creditor a preference, priority or advantage over other creditors, the payment must ultimately result in a decrease in the net value of the assets.
Prior to the enactment of s 588FA, the doctrine of ultimate effect was predominantly applied to running accounts and the majority of the authorities in relation to the doctrine of ultimate effect involved running accounts. For example:

- **Richardson v Commercial Banking Co of Sydney Ltd** dealt with a succession of deposits and withdrawals from an overdrawn bank account.
- **Re Discovery Books Pty Ltd** involved several rental payments – consequently the doctrine of ultimate effect is also known as the “landlord’s defence”.
- **Airservices Australia v Ferrier** involved nine payments for services to an airline company for services with respect to terminal and en route navigation, meteorological information, rescues and fire-fighting.

**PART 4 – HAS THE LAW IN RELATION TO PREFERENCES CHANGED SINCE THE ENACTMENT OF S 588FA?**

Despite the legislative intention and the case law authorities suggesting that no change was intended to the law in this area, it is clear that there have been some subtle yet significant changes.

First, the time for consideration of whether the transaction had the requisite preferential effect is not apparent in the wording of s 588FA. Given the legislative intention the relevant time ought to be at the time of the transaction as it was with respect to the case law relating to the statutory predecessor. However, as will be discussed in this part, the Victorian Court of Appeal decision of **Walsh v Natra Pty Ltd** (2000) 156 FLR 227 has held that the time for consideration of preferential effect is the time of the actual winding up as opposed to the time of the relevant transaction.

Secondly, the decision of **Walsh v Natra Pty Ltd** dealt with part payments by creditors in a way which it is submitted could not have been intended by the legislature. This approach was recently endorsed in the Queensland Court of Appeal decision of **Williams v Peters** (2009) 232 FLR 98; 72 ACSR 365.

Thirdly, and perhaps linked to the first point, is that since the enactment of s 588FA, the application of the doctrine of ultimate effect has a more general application. There have been several decisions since the enactment of s 588FA, not involving running accounts, which have applied the doctrine of ultimate effect.

**The relevant time to consider**

As outlined in part three of this article, s 588FA(1)(b) requires a comparison of what a creditor received with what it would receive if the transaction were set aside and the creditor were to prove for the debt in a winding up of the company. An issue arising in relation to this is whether the amount received by the creditor should be compared with what would be received in the actual winding up or what would have been received had there been a winding up at the time of the transaction. The wording of s 588FA(1)(b) is silent on this issue.

The authorities under the statutory predecessor favoured the comparison to be made at the time of the transaction and not at a subsequent winding up. This was often referred to as a hypothetical

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84 However, Wotton J in **M & R Jones Shopfitting Co Pty Ltd (in liq) v The National Bank of Australiasia Ltd** (1983) 68 FLR 282; 7 ACLR 445 at 452 stated that “although the question usually arises in relation to running accounts, the principle is not so confined”. Also, in **Airservices Australia v Ferrier** (1996) 137 ALR 609 at 623 the doctrine of ultimate effect was referred to as being applicable to an isolated payment.


87 There were some authorities in which the relevant time considered was at the time of the actual winding up – **Re RHD Power Services Pty Ltd (in liq)** (1991) 9 ALC 27 at 29; **Harkness v Potts** (1993) 10 ACSR 517 at 521; **Re Discovery Books Pty Ltd** (1973) 20 FLR 470 at 575; **Richardson v Commercial Banking Co of Sydney Ltd** (1952) 85 CLR 110.
bankruptcy at the time of the impugned transaction. Therefore, if it is the case that the legislature intended that there be no change to the law as has been suggested, this should have remained the same.

Furthermore, there are the following indirect references within s 588FA and other provisions of Pt 2, Div 5.7B of the Act, which indicate that the relevant time for consideration should be at the time of the transaction:

- Section 588FA(1)(b) refers to “a winding up” as opposed to “the winding up”.
- There are several other provisions that use the words “the winding up” when referring to the actual winding up of a company. Therefore, if the intention was that the actual winding up should be the relevant time for consideration, s 588FA(1)(b) would have referred to “the winding up”.
- The section also uses the word “would” referring to the amount the creditor would hypothetically receive if the transaction were to be set aside and the creditor were to prove for the debt.
- Section 588FC of the Act provides that the time for consideration of when the company was insolvent is at the time of the transaction is entered into or becomes insolvent as a result of the transaction. It is therefore logical that the time for consideration of preferential effect should also be at the time of the transaction.
- The defence provision in s 588FG(2), refers to certain circumstances existing at the time of the transaction. Again, it would be logical that the time for considering preferential effect should be the time of the transaction as it is for consideration of whether the statutory defence is available to a creditor.

However, despite these compelling indicators, the unanimous decision of the Victorian Court of Appeal of Walsh v Natra Pty Ltd held that s 588FA(1)(b) refers to the actual subsequent winding up.

In Walsh v Natra Pty Ltd, the liquidator of Mooney Pty Ltd sought to recover 11 part payments totaling $51,000 made by Mooney Pty Ltd to Natra Pty Ltd (towards a total unsecured debt of $83,000) during the relation-back period on the basis that the payments were unfair preferences under s 588FA. At the outset, it should be noted that the running account principles were not considered in this case.

One of the arguments raised by Natra Pty Ltd was that it was necessary to consider what it would have received in a notional winding up on each of the 11 dates. At first instance, the trial judge dismissed the liquidator’s claim on the basis that:

- the comparison was between what the creditor received from each part payment of the debt and what it would receive by proving for the whole debt; and
- there was insufficient evidence to establish that the creditor would have received less of a dividend in a hypothetical wind up on the date of each of the payments than what it actually received.

On appeal, Phillips and Charles JJA held that:

- section 588FA(1)(b) does not require a consideration of a hypothetical winding-up as at the date of the payment which is impugned. The comparison it requires is between the amount the creditor receives by way of the impugned payment and the probable return to the creditor if that transaction were set aside and the creditor proves instead in the winding-up; and
- a liquidator can rely on the probable return to the unsecured creditor in the action winding-up for the purpose of establishing the comparison required under section 588FA(1)(b).90

Notwithstanding his observation that VR Dye & Co v Peninsula Hotels Pty Ltd held that the “new Div 2 was not intended to make great change”, 91 Phillips JA stated the following in relation to the case authorities on this issue with respect to the statutory predecessor:

88 For example, s 588FE(6) of the Act.
89 Bennetts, n 68 at 173.
90 Walsh v Natra Pty Ltd (2000) 156 FLR 227 at [31] and [33].
Under the former law, … the notion of a hypothetical bankruptcy at the date of the impugned transactions is at best misleading. What had to be established was that the creditor who was party to the impugned transaction gained a benefit amounting to a “preference, priority or advantage” over other creditors in existence at that time, but the benefits accruing to those other creditors could be determined according to their fate in the subsequent winding up. If then they received less than 100 cents in the dollar on their debts but the creditor who was party to the impugned transaction received 100 cents in the dollar, the necessary preference, priority or advantage was established.92

In support of his view, Phillips JA predominantly relied upon Richardson v Commercial Co of Sydney Ltd which, as outlined in part two of this article, concerned the running account principles.93

This view that the relevant time to consider is the actual wind up has been followed in subsequent decisions.94 For example in the Federal Court decision of Tolcher (in liq) v Capital Finance Australia Ltd (2006) 60 ACSR 584 Tamberlin J stated that “the ‘winding up’ as referred to in the statute is the actual winding up, and not a hypothetical winding up or series of windings-up as at the date of each payment”.95

As outlined in part three of the article, considering the time of the actual winding up as opposed to the time of the transaction, confuses preferential effect with the policy justification for unfair preferences as argued by Bennetts96 and Keay.97 Furthermore, the relevant time for consideration with respect to insolvency is the time of the transaction and on this basis, from a practical prospective, only one point of time should be considered.

Also, the circumstances at the date of the winding up can be significantly impacted upon be a range of factors such as the outcome of other voidable transaction recoveries. This was a factor considered by Dr Morrison98 when expressing the following view:

The most certain and seemingly fairest calculation is one made at the time of the transaction since the very definition of a preference and the extent of a preference must surely be obtained at the date of the impugned transaction, rather then some future time. There must be a preferential effect at the time of giving the preference.

However, as pointed out by Dr Morrison, this is not view of the decided case and until a higher court considers this issue or there is legislative change, the view that the actual winding up is the relevant time to consider will stand.

The treatment of part payments in Walsh v Natra

Aside from the argument in relation to the relevant time for consideration, another argument put forward by Natra Pty Ltd in Walsh v Natra Pty Ltd was that the comparison required was not between the amount of the payment received by it and the amount which it would have received if it had proved for that amount in a winding up; but between the amount received and the amount it would have received if it had proved in the winding up for the full amount of its unsecured debt. It was held by Phillips JA, with whose reasons the other members of the court agreed, that one had to compare “like with like”. The basis of this was expressed as follows:

In a case like the present, it can fairly be said that the creditor received 100 cents in the dollar in respect of an unsecured debt, being a portion only of a total unsecured debt of $83,000. In respect of $40,000

92 Walsh v Natra Pty Ltd (2000) 156 FLR 227 at [38].
93 Richardson v Commercial Co of Sydney Ltd (1952) 85 CLR 110; Walsh v Natra Pty Ltd (2000) 156 FLR 227 at [37].
94 McVeigh, Re JAG Plastering & Carpentry Pty Ltd (in liq) v Commissioner of Taxation [2004] FCA 653; New Cap Reinsurance Corp Ltd v All American Life Insurance Co (2004) 49 ACSR 417. Also it was referred to in the Queensland Court of Appeal decision of Williams (as liquidator of Scholtz Motor Group Pty Ltd) v Peters (2009) 72 ACSR 365. However, the point in relation to the relevant time was not fully argued and therefore it was not properly considered.
95 Tolcher (in liq) v Capital Finance Australia Ltd (2006) 60 ACSR 584; [2006] FCA 1804 at [40].
96 Bennetts, n 68 at 177.
97 Keay, n 6, p133-134.
of that debt, the creditor received $40,000: and the comparison which is sought by para (b) is between
that payment of $40,000 and the probable return to the creditor in a winding up if that payment of
$40,000 were set aside and the creditor were to prove for that $40,000 (being its resuscitated debt) in
that winding up. In a case like the present, the question becomes this: is 100 cents in the dollar (which
was received for the relevant part of the total unsecured debt) more than the probable dividend on proof
for the like sum in a winding up, supposing that the impugned transaction were first set aside?99

The outcomes are substantially different depending on which approach is taken as demonstrated
in the following tables using the figures from Walsh v Natra Pty Ltd (on the date of the first payment
of $40,000, Natra was an unsecured creditor for $83,000; the dividend was 50%):

<table>
<thead>
<tr>
<th>Approach taken by the court</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount received (first payment)</td>
</tr>
<tr>
<td>$40,000</td>
</tr>
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</table>

It is clear that using this method, any payment received would amount to a preference unless there
was a surplus in the winding up after the payment of all creditors.

If the approach argued by Natra was used there would be no preferential effect because the
creditor would have received more if the transaction were set aside and he proved in the wind up.

<table>
<thead>
<tr>
<th>Approach argued by Natra</th>
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<tbody>
<tr>
<td>Amount received</td>
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<tr>
<td>$40,000</td>
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Walsh v Natra Pty Ltd was recently applied in the Queensland Court of Appeal decision of
Williams v Peters. In this case Scholz Motor Group Pty Ltd (“he Company”) operated a motor vehicle
dealership. Peters paid the sum of $165,000 into the Company’s overdraft account, being the purchase
price of a Mercedes Benz. Peters later sought finance for the vehicle and as a result the Company was
paid a further $165,000 by Peters’ financier. Peters sought to recover the $165,000 he had paid from
his own funds. Peters was given a cheque in the sum of $165,000 from the Company, however, it was
dishonoured. The Company later paid Peters $10,000 and gave him two vehicles as security for the
balance amount owing. The vehicles were later sold for $50,000 and $35,000. The liquidator
commenced proceedings to recover the three transactions of $10,000, $50,000 and $35,000 on the
basis that the transactions were unfair preferences.

One of the arguments put forward by Peters was that the comparison should be between the
benefit received by the transaction, that is $95,000, and the amount which would have been received
had the transactions been set aside and he proved for the full amount owing of $165,000. If this
method was adopted, there would be no preferential effect as the dividend to creditors in this case was
70%. Therefore, the $95,000 received by Peters would be compared with $115,500 being 70% of
$165,000). However, the court in the first instance adopted the approach taken in Walsh v Natra Pty
Ltd and held that the transactions constituted unfair preferences.

On appeal, it was pointed out to the court that the approach in Walsh v Natra Pty Ltd leads to “the
absurd consequence” that the creditor would always be held to have received 100 cents in the dollar
where part payments were concerned.100 However, McMurdo P was not persuaded and stated the fol-

100 Williams v Peters (2009) 72 ACSR 365 at [13].
We were not taken to any decision which questioned … the reasoning of the result. The case has now stood for some nine years as an authority on the construction of s 588F A(1). In my opinion the construction placed on paragraph (b) of s 588F A(1) does no violence to the language of the provision and achieves a result which conforms with the likely legislative intention that the provision accommodate, in a practical way, part payments of unsecured debts as well as payments in full.

This court should not depart from the construction of the subject provision determined in Walsh v Natra Pty Ltd unless of opinion that the decision is clearly wrong and in my respectful opinion that is not the case.

Perhaps from a policy perspective, the approach is sound in that any part payment would undoubtedly be considered a preference payment unless there was a surplus in the winding up. However, as suggested by Bennetts\textsuperscript{101} and Keay,\textsuperscript{102} this approach confuses preferential effect with the policy justification for preferences. That is, the approach focuses on the outcome to other creditors as opposed to whether the creditor received an advantage. This in turn leads to harsh consequences to creditors which could not have been intended by the legislature.

However, until a higher court considers the issue, or there is legislative intervention,\textsuperscript{103} the decisions of Walsh v Natra Pty Ltd and Williams v Peters stand. This may be the situation for some time given the view of the High Court that intermediate appellate courts should not depart from decisions of their counterparts unless these decisions are plainly wrong.\textsuperscript{104}

The application of the ultimate effect doctrine pre-s 588FA

The doctrine of ultimate effect stemmed from a line of cases concerning running accounts and appeared to be confined to running accounts as the majority of cases when dealing with a single transaction did not refer to the ultimate effect and confined consideration of the effect of the transaction to the time of the transaction. However, since the decisions of VR Dye & Co v Peninsula Hotels Pty Ltd and Beveridge v Whitten, it seems that the doctrine of ultimate effect has a more general application and is not confined to running accounts.\textsuperscript{105}

In VR Dye & Co v Peninsula Hotels Pty Ltd, the Victorian Court of Appeal held that a payment by an insolvent company to an accountant for professional fees was not an unfair preference pursuant to section 588FA. The payment had been paid into the accountant’s trust account and withdrawn after the services were provided.

In contrast to this decision, the Full Court of the Federal Court decision of Higgins v GS Enterprises Pty Ltd (in liq) (1989) 7 ACLC 410 involved almost identical facts except that it concerned a solicitor and it was decided under s 122 of the Bankruptcy Act prior to the enactment of s 588FA. In Higgins v GS Enterprises Pty Ltd, the payment was held to be a preference payment. This case has been criticised as being flawed:

\begin{itemize}
  \item first, on that basis that it was a prepayment and at the time of the payment there was no creditor debtor relationship and therefore could not be an unfair preference; and
  \item secondly, as an alternative, it was similar to a COD transaction which could also not be an unfair preference.\textsuperscript{106}
\end{itemize}

Accordingly, it would appear that the outcome in VR Dye & Co v Peninsula Hotels Pty Ltd was correct. However, it is submitted that the basis of the decision was not correct. The outcome was reached on the basis of the doctrine of ultimate effect. Ormiston JA was of the view that the

\begin{itemize}
  \item Bennett, n 68.
  \item Keay, n 6 p 132.
  \item Morrison, n 98 at 32: “legislative intervention is desirable to clarify the position”.
  \item Morrison, n 98 at 32 and 37 referring to Farah Constructions Pty Ltd v Say-Dee Pty Ltd (2007) 230 CLR 89.
  \item However, Wotton J in M & R Jones Shopfitting Co Pty Ltd (in liq) v The National Bank of Australasia Ltd (1983) 7 ACLR 445 at 452 stated that “although the question usually arises in relation to running accounts, the principle is not so confined”. Also, in Airservices Australia v Ferrier (1996) 137 ALR 609 at 623 the doctrine of ultimate effect was referred to as being applicable to an isolated payment.
  \item Quo, n 39 at 10.
\end{itemize}
transaction involved several stages: first, the professional engagement upon condition that the funds were paid into the trust account; secondly, the giving of the cheque by the company to Dye; and thirdly, the drawing down of the funds. He said that if viewed in isolation, the third stage could be viewed as an unfair preference. However, all three stages were to be viewed in totality. In other words, Ormiston JA interpreted the approach set out in *Air Services Australia v Ferrier* broadly and relied on the courts reference to “a wider transaction” as justification for the application of the doctrine of ultimate effect.

He specifically discounted the proposition that the transactions amounted to a running account and stated that s 588FA(3) was not relevant. It is submitted that Ormiston JA was correct in this regard and that the relevant transaction did not amount to a running account as it did not predicate a continuing relationship of debtor and creditor.

It is submitted that it was not necessary to apply the doctrine of ultimate effect and the same result could have been reached in *VR Dye & Co v Peninsula Hotels Pty Ltd* if the relevant time considered was the time of the payment. At that time, there was no creditor debtor relationship and the purpose of the payment was to induce services and not pay a debt.

It has been said that the decision was decided on policy grounds and if such payments were considered unfair preferences, insolvents would be hard pressed to get any professional assistance for fear that payment would be clawed back by a liquidator. In support of this proposition is the following statement made by Ormiston JA in the decision:

> a matter of principle it is said to arise in relation to insolvent companies engaging and payment of accountants and other professional persons to assist them in their dying days.

*VR Dye & Co v Peninsula Hotels Pty Ltd* was followed by the NSW Court of Appeal in *Beveridge v Whitton* which also took the doctrine of ultimate effect outside the running account context.

In *Beveridge v Whitton*, the defendant was an accountant who provided professional services to the company prior to its liquidation and while he was experiencing financial difficulties. The facts were different from *VR Dye & Co v Peninsula Hotels Pty Ltd* in that there were no monies held in trust. The terms of engagement were that the fees would be due for payment within seven days of issue of a memoranda of fees. The liquidator argued that the services provided did not result in any quantifiable addition to turnover or inventory.

In relation to the liquidator’s argument, the Court of Appeal held that the doctrine of ultimate effect did not depend on an evaluation of whether the overall result of the impugned transaction was to improve or worsen the company’s position. On the facts there was no deliberate over-servicing and no overcharging therefore the services provided had been provided to the company which equaled the value of the fees paid. Accordingly, there was no unfair preference.

As with *VR Dye & Co v Peninsula Hotels Pty Ltd*, the decision may be justified on policy grounds in that if the liquidator’s argument was correct, then no person would assist a company in financial difficulties.

The approach in *VR Dye & Co v Peninsula Hotels Pty Ltd* and *Beveridge v Whitton* was approved and the ultimate effect doctrine applied in *McKern v Minister Administering the Mining Act 1978; Re Centaur Mining and Exploration Ltd*. In this case, payments of royalties and rental for mining tenements which were transferred for millions of dollars were not unfair preferences because of the doctrine of ultimate effect. If the payments were not made the tenements would have been forfeited and transfers of the leases not permitted. The payment of the royalties increased the value of the tenements by an equivalent amount.

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107 *Air Services Australia v Ferrier* (1996) 137 ALR 609.
109 Therefore, it could not be argued that it was a prepayment.
110 Therefore, there was no argument available that it was a COD transaction as the payment was not contemporaneous with the supply.
111 Quo, n 39 at 15.
These decisions clearly circumvent the pari passu principle. The transactions were held to not be unfair preferences on the basis that there was no preferential effect because an equivalent benefit was received by the company. This could be said of any creditor who supplies goods or services to a company. As pointed out by Hammerschlag J in Sims v ABC Tissue Products Pty Ltd [2008] NSWSC 192 when considering an argument resembling the ultimate effect doctrine:112

If the submissions were correct no payment of any purchase price could ever be an unfair preference if it reflected the true value of the performance by the seller. This needs only to be stated to be rejected.

CONCLUSION
This article has raised three aspects in relation to preferential effect which has changed since the enactment of s 588FA of the Act. While these changes are subtle, they lead to different outcomes and possibly outcomes which could not have been intended by the legislature. All three of these changes are as a result of the court focusing on the actual winding up of the company as opposed to the time of the transaction in determining whether the transaction has the requisite preferential effect. It appears that the true nature of preferential effect has been forgotten and confused with its policy justification.

112 There was clearly a lack of authorities referred to in this case. However, it was argued that because each payment was for the price of goods delivered, the company obtained the benefit equivalent to the value of each payment.