

Episode 49: Summary

Episode name: That's Just Unfair! Unfair Preferences in Insolvency Litigation

Guest(s): Nicola Bailey

What area(s) of law does this episode consider?

Recent developments in unfair preferences under section 588FA of the *Corporations Act*.

Why is this topic relevant?

An unfair preference occurs when there is a transaction to which a company and one of its unsecured creditors are parties, and that transaction results in the unsecured creditor receiving from the company more money than if the transaction had not happened and the creditor instead proved in the winding up of the company.

Recent developments in insolvency litigation has seen changes to the calculation of the assets of insolvent companies, the law related to peak indebtedness, and set-off in unfair preference claims.

What legislation is considered in this episode?

Corporations Act 2001 (Cth) ('*Corporations Act*')

Companies Act 1993 (NZ)

What cases are considered in this episode?

Airservices Australia v Ian Douglas Ferrier and Anor [1996] HCA 54

- The liquidators of Compass Airlines (Compass) sought to recover monies paid by Compass to Airservices Australia (then, the Civil Aviation Authority) in the six months prior to its winding up, totalling approximately \$10m. The monies were paid in the form of charges and levies in support of Compass' use Airservices' facilities. The court found that the payments had the effect of preferring Airservices over other creditors.

Cant v Mad Brothers Earthmoving Pty Ltd [2020] VSCA 198

- Mr Sowiha was the sole director of Eliana and Rock. Cant, acting in his capacity as a liquidator of Eliana, sought repayment of monies paid to Mad Brothers under a settlement agreement it had with Eliana, which was paid with funds obtained from a loan facility to Rock. Eliana recorded payment to Mad Brothers in its general ledger as an increase in its debt to Rock. The court found that the payment was not an unfair preference as it had not resulted in a net decrease in the assets of Eliana.

Re Western Port Holdings Proprietary Limited (recs and mgrs apptd) (in liq) [2021] NSWSC 32

- The liquidators of Western Port applied to the court to recover \$2m paid to the ATO in satisfaction of tax debts. Most of the payments were made by Western Port directly, however, some were also made by third parties. All of the transactions were recorded as an increase in Western Port's debt to the respective third party. The court was bound by the decision in *Cant* and, thus, the payments made to the ATO by the third parties were not considered unfair preferences.

Badenoch Integrated Logging Pty Ltd v Bryant [2021] FCAFC 64

- Bryant, liquidator of Gunns, sought to recover payments to Badenoch totalling approximately \$3,360,000. In issue was whether Bryant could choose the point in the six-month relation-back period where debt was highest. The court rejected the peak indebtedness rule, holding that regard should be had instead to the ultimate effect of dealings between the parties.

Morton & Anor v Rexel Electrical Supplies Pty Ltd [2015] QDC 49

- Morton, in his capacity as liquidator of South East Queensland Machinery Manufacturing (SEQMM), sought to recover approximately \$200,000 paid to Rexel as a preference. Rexel submitted that the amount should be set-off against a debt owed by SEQMM to Rexel in the amount of approximately \$92,000. The court held that section 533C of the Corporations Act applied to provide Rexel a set-off in the circumstances.

What are the main points?

- For money to be recovered in an unfair preference claim, it must be determined whether the money comes from the assets of the company. Post *Cant*, this inquiry requires determining whether there was a net decrease in the company's assets. If the payment was made by a third party, the unfair preference claim might fail.
- In *Badenoch Integrated Logging Pty Ltd v Bryant* [2021] FCAFC 64, the full Federal Court rejected the peak indebtedness rule. The court found that the rule was arbitrary and inconsistent with the doctrine of ultimate effect - which is the principle that payments of debts to induce further supply should be examined and evaluated by the ultimate effect that they have on the relationship between the parties, not the effect that they have on the indebtedness of the parties in isolation.
- In *Morton as Liquidator of MJ Woodman Electrical Contractors Pty Ltd v Metal Manufacturers Pty Limited* [2021] FCAFC 228, the full Federal Court held, in answer to a separate question reserved to the court, that section 553C set-off is not available as a defence to an unfair preference claim (this decision was published subsequent to recording of the interview).

What are the practical takeaways?

- Keep on top of recent insolvency cases considering the movement that is currently occurring on critical issues in the space. Knowing the nuances of cases will help you construct arguments that relate to your particular case.
- If unsure about a case or argument being made by opposing counsel, never bluff the court and do not be afraid to request additional time for you to consider a case or an argument.