SUPREME COURT OF VICTORIA

COURT OF APPEAL

S APCI 2019 0099

ANTHONY ROBERT CANT (in his capacity as liquidator of Eliana Construction and Developing Group Pty Ltd (in liquidation)) — First Applicant

and

ELIANA CONSTRUCTION AND DEVELOPING GROUP (in liquidation) (ACN 132 817 362) — Second Applicant

v

MAD BROTHERS EARTHMOVING PTY LTD (ACN 122 889 007) — Respondent

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JUDGES:	BEACH, McLEISH and HARGRAVE JJA
WHERE HELD:	MELBOURNE
DATE OF HEARING:	13 May 2020
DATE OF JUDGMENT:	5 August 2020
MEDIUM NEUTRAL CITATION:	[2020] VSCA 198
JUDGMENT APPEALED FROM:	[2019] VSC 546 (Robson J)

CORPORATIONS – External administration – Voidable transactions – Whether payment to creditor by related company to debtor company an unfair preference – Whether debtor company a party to transaction between related company and debtor company's creditor – 'Transaction' encompasses interrelated or composite dealings, including authorisation or ratification of third party payment – Whether payment to creditor by related company a payment 'from' the debtor company – Payment 'from the company' must be from money or assets to which debtor company entitled, and have effect of diminishing assets of company available to creditors – Impugned payment involving no diminution of debtor company's assets – Payment not 'from the company' – *Ramsay v National Australia Bank Ltd* [1989] VR 59, *Sheahan v Carrier Air Conditioning Pty Ltd* (1997) 189 CLR 407, *Burness v Supaproducts Pty Ltd* (2009) 259 ALR 339, *Re Emanuel (No 14) Pty Ltd (in liq); Macks v Blacklaw & Shadforth Pty Ltd* (1997) 147 ALR 281, *Re Evolvebuilt Pty Ltd* [2017] NSWSC 901, *Hosking v Extend N Build Pty Ltd* (2018) 357 ALR 795, considered – *Corporations Act 2001* (Cth) ss 588FA(1), 588FE(2), 588FF(1), *Bankruptcy Act 1966* (Cth) s 122 – Appeal dismissed.

CORPORATIONS – External administration – Voidable transactions – Unfair preferences – Good faith – Whether reasonable person in position of creditor had no reasonable grounds for suspecting debtor company insolvent – *White v ACN 153 152 731 Pty Ltd (in liq)* (2018) 53 WAR 234, *Queensland Quarry Group Pty Ltd (in liq) v Cosgrove* [2019] QCA 220, applied – *Corporations Act 2001* (Cth) s 588FG(2).

WORDS AND PHRASES – 'transaction' – 'from the company' – 'by the company'.

APPEARANCES:	Counsel	Solicitors
For the Applicants	Mr M J Galvin QC with Mr C R Brown	White Cleland Pty Ltd
For the Respondents	Mr S V Palmer with Mr L Molesworth	Oakley Thompson & Co Pty Ltd

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BEACH JA
McLEISH JA
HARGRAVE JA:

1 The first applicant is the liquidator of the second applicant, a construction company which it is convenient to call 'Eliana'. He seeks to establish that a payment of $220,000 to a creditor of Eliana was an unfair preference under s 588FA of the *Corporations Act 2001* (Cth) ('the Act'). An unusual feature of the case is that the payment was made to the creditor, not by Eliana, but by a related company called Rock Development & Investments Pty Ltd ('Rock'), using money Rock had borrowed from Nationwide Credit Pty Ltd ('Nationwide').

2 An associate judge found that the payment constituted an unfair preference and was voidable pursuant to s 588FE(2A) of the Act.[1] That decision was reversed on appeal by a judge in the Trial Division.[2] For the reasons that follow, leave to appeal should be granted but the appeal should be dismissed.

Background

3 Between November 2015 and March 2016, Eliana incurred a debt to the respondent ('Mad Brothers') in the amount of $236,952.31 for earthworks conducted at various construction sites, including 7 Ingham Place, Taylors Hill which was land owned by Rock. Of the total debt, $87,256.15 was incurred for earthworks conducted by Mad Brothers at the Taylors Hill site.

4 In April 2016, Mad Brothers served a statutory demand on Eliana in relation to the total debt. Eliana did not satisfy the demand and made no application under s 459G of the Act to set aside or vary it.

5 On 31 May 2016, the Victorian WorkCover Authority ('WorkCover') filed an application in the Supreme Court seeking an order winding Eliana up in

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1 *Re Eliana Construction and Developing Group Pty Ltd (in liq)* (Supreme Court of Victoria, Efthim AsJ, 1 November 2018) ('Associate Judge's Reasons').

2 *Re Eliana Construction and Developing Group Pty Ltd (in liq) [No 2]* [2019] VSC 546 ('Reasons').

insolvency. That application was ultimately dismissed on 20 July 2016. While it remained on foot, on 14 June 2016, Mad Brothers filed its own application in the Supreme Court for an order that Eliana be wound up in insolvency, based on its failure to comply with the statutory demand. An ASIC search in relation to Eliana, which was exhibited to the affidavit filed in support of the application and sworn by Mad Brothers' financial controller, disclosed the WorkCover application. The deponent of the affidavit noticed the reference to the WorkCover application when she swore the affidavit.

6 In August 2016, Eliana ceased trading and suspended its workforce. It was placed into voluntary administration on 11 October 2016 and creditors voted to place it into liquidation on 3 November 2016.

7 In the meantime, on 15 September 2016, Mad Brothers and Eliana executed a settlement agreement pursuant to which Eliana agreed to pay Mad Brothers $220,000 in full and final settlement of the winding up proceeding.

8 On 16 September 2016, the $220,000 amount due under the settlement agreement was paid from a loan facility that Rock had with Nationwide. Rock had applied for finance from Nationwide using its own property as security. At the time of the payment, Mr Magdy Sowiha was the sole director of both Rock and Eliana. The applicants alleged that this justified the inference that Eliana had provided authority to Rock to make the payment.

9 There was conflicting evidence as to the state of the financial relationship between Rock and Eliana at the time of the payment. The applicants contended that this need not be addressed because Eliana had authorised the payment, but they submitted in the alternative that Eliana was a creditor of Rock at the time of the payment and the payment operated to reduce Rock's indebtedness. It will be necessary to return to this matter. However, the first applicant gave evidence that the accounts of Eliana were in a 'mess' and that it was impossible to arrive at an accurate position at any point in time. In addition, Eliana's general ledger showed

Rock as a creditor of Eliana at the time of the payment.

Statutory provisions

10 It is convenient at this point to set out the relevant provisions of the Act. Section 588FA relevantly provides:

> **588FA Unfair preferences**
>
> (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.
>
> …

11 Section 588FE provides for certain transactions to be voidable. It is not in doubt that, if the making of the payment was a transaction which was an unfair preference given by Eliana to Mad Brothers, then it was a voidable transaction.[3] This in turn would, unless a defence was available, attract the power of the Court under s 588FF(1) to make orders, including:

> (a) 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;
>
> (b) an order directing a person to transfer to the company property that the company has transferred under the transaction;
>
> (c) an order requiring a person to pay to the company an amount that, in the court's opinion, fairly represents some or all of the benefits that the person has received because of the transaction.

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[3] See s 588FE (2A)(ii).

…

12 The associate judge made such an order, in the amount of $220,000 together with an order for interest.

13 The relevant 'defence', for present purposes is the 'good faith' provision in s 588FG(2), which provides:

> (2) A court is not to make under section 588FF an order 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 …; 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.

14 Mad Brothers relied on this provision and this formed an alternative basis for the trial judge's decision.

15 The expression 'transaction' which appears in these provisions is defined in s 9 of the Act in the following terms:

> ***transaction***, in Part 5.7B, in relation to a body corporate or Part 5.7 body, means a transaction to which the body is a party, for example (but without limitation):
>
> (a) a conveyance, transfer or other disposition by the body of property of the body; and
>
> (b) a security interest granted by the body in its property …; and
>
> (c) a guarantee given by the body; and
>
> (d) a payment made by the body; and
>
> (e) an obligation incurred by the body; and

(f) a release or waiver by the body; and

(g) a loan to the body;

and includes such a transaction that has been completed or given effect to, or that has terminated.

Proceedings in the Trial Division

16 The associate judge recorded that there was no dispute that there was a transaction under the above definition, that Eliana was insolvent at the time, that Mad Brothers received more than it would have in the liquidation of Eliana, and that Mad Brothers provided valuable consideration in relation to the debt for the purposes of s 588FG(2)(c) of the Act.[4] The main issues, which were related, were whether Eliana was a party to the transaction as required by s 588FA(1)(a) and whether the payment of $220,000 was 'from' Eliana within the meaning of s 588FA(1)(b). If those matters were decided adversely to Mad Brothers, the 'good faith' question arose.

17 By their further amended statement of claim, the applicants alleged as follows:

> In the period 11 April 2016 to 11 October 2016 the Company made a payment to the Defendant in the sum of $220,000.00 ('the Payment').
>
> PARTICULARS
>
> On or about 16 September 2016, the Company authorised an associated entity of the Company, Rock Development and Investments Pty Ltd ('Rock') to make the Payment to the Defendant and Rock made the Payment for and on behalf of the Company.
>
> At the time of the Payment, Rock was a debtor of the Company.

18 At trial and in the succeeding proceedings the applicants' case has been treated as resting on alternative particulars. Their primary case is that Eliana authorised Rock to make the payment and that this suffices to establish that Eliana was a party to the transaction and that the payment was 'from' Eliana within the

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4 Associate Judge's Reasons [10].

meaning of s 588FA(1)(b). Alternatively, it is alleged that the payment was made by Rock in reduction of its indebtedness to Eliana.

19 In answer to a request for further and better particulars of a previous form of this allegation, the applicants had stated that the authority of Eliana to Rock to make the payment 'is inferred by the fact that the sole director and shareholder of Rock at the time of the payment, Magdy Sowiha, was also the sole director and shareholder' of Eliana at that time. In relation to the alleged indebtedness of Rock to Eliana, it was stated that Rock owned various properties for the purpose of development, and Eliana had assisted Rock in their development for Rock's benefit and incurred various costs on behalf of Rock including prior to and around the time of the payment.

20 Mr Sowiha swore in an affidavit relied on before the associate judge that he had directed Nationwide to pay the settlement sum directly into the trust account of Mad Brothers' solicitors, and that Nationwide followed his instruction. However he gave oral evidence that he had not asked Nationwide to pay the sum to Mad Brothers, rather Nationwide had stipulated that as a condition of the loan. He said that he understood the condition to have appeared in the mortgage document or perhaps in the loan offer. The associate judge did not accept that there was any such requirement on the part of Nationwide.[5] Moreover, he rejected a submission of Mad Brothers that, unless there was a debtor/creditor relationship between Eliana and Rock, there was no transaction between Eliana and Mad Brothers.[6] The associate judge relied on an *obiter dictum* of Gordon J in *Burness v Supaproducts Pty Ltd*,[7] to hold that a request or authorisation on the part of Eliana in respect of the payment sufficed to establish that Eliana was a party to the transaction and that the payment was 'from' Eliana, and nothing more was required.[8] It was not in doubt that

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5 Ibid [45].

6 Ibid [53].

7 (2009) 259 ALR 339, 347–8 [45]; [2009] FCA 893 ('*Burness*').

8 Associate Judge's Reasons [53].

Mr Sowiha had directed Nationwide to pay the money to Mad Brothers. The associate judge found in favour of the applicants on the basis that this direction constituted authorisation on the part of Eliana.[9]

21 The associate judge went on to consider whether, in any event, Eliana and Rock were in a debtor/creditor relationship at the time of the payment. He was satisfied on the balance of probabilities that they were. In particular, he found that Eliana was owed $600,000 by Rock and Sentosa Apartments Pty Ltd ('Sentosa') for building works performed by Eliana for those two companies as part of a joint venture. He relied also on general ledger accounts. In the further alternative, the associate judge found that there was an 'interdependent financial relationship' between Eliana and Rock.[10] Among other things, they shared the same bank account.

22 The associate judge also rejected an argument of Mad Brothers that, in respect of the work done at the Taylor's Hill site, Rock was an undisclosed principal and Eliana had engaged Mad Brothers to perform work at that site only as Rock's agent. On that argument, the Nationwide payment was, to the extent of $87,256.15, made by way of discharge of Rock's own indebtedness to Mad Brothers. The associate judge held that there was no evidence supporting the argument, and that it rested on 'mere assertion'.[11]

23 Finally, the associate judge rejected a 'good faith' defence relied on by Mad Brothers. The applicants accepted that Mad Brothers accepted the payment in good faith, but contested the application of s 588FG(2)(b), part of which involves an objective test.[12] In that regard, the associate judge held that a reasonable business person would have no basis to believe that Eliana was solvent at the time of the

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9 Ibid [56].

10 Ibid [58]. The reasons use the term 'independent' which, read in context, is plainly a typographical error.

11 Ibid [60].

12 Ibid [72].

payment. Relevant factors included the fact that Eliana had made offers to pay by instalments, a statutory demand and winding up application had been served and at least one other creditor (WorkCover) had applied to wind up the company.[13]

24 Accordingly, the associate judge found that the payment was made by Eliana and was a preference, voidable pursuant to s 588FE(2).[14] Mad Brothers was ordered to pay the applicants the sum of $220,000, together with interest and costs.

25 Mad Brothers appealed. The grounds of appeal may be summarised as follows:

(a) Eliana did not make the payment to Mad Brothers (grounds 1 to 9);

(b) Rock was not a debtor of Eliana at the time of the payment (grounds 10 and 11);

(c) Rock was liable to pay for the work performed by Mad Brothers at the Taylors Hill site for Rock as an undisclosed principal (ground 12); and

(d) Mad Brothers had a defence under s 588FG(2) (grounds 13 to 17).

26 A judge in the Trial Division upheld the appeal. He held that the question whether or not Rock owed money to Eliana had a bearing on whether or not the payment constituted a payment by or from Eliana within the meaning of ss 9 and 588FA(1) of the Act.[15] In that regard, he held that it had not been established that Rock was a debtor of Eliana at the time of the payment.[16]

27 The judge considered that, on any view, what had taken place in relation to the payment amounted to a transaction within the meaning of s 9. If Rock was not indebted to Eliana, then the transaction involved Eliana incurring an obligation to

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13 Ibid [87].

14 Ibid [92].

15 Reasons [23].

16 Ibid [5], [50].

Rock (paragraph (e) of the definition). If Rock was indebted to Eliana, then the transaction involved a release by Eliana of part of that debt (paragraph (f)).[17]

28 The judge considered the authorities, including *Burness*, and held, in relation to third party payments:

> In my opinion, where the transaction involves a reduction in the debtor's assets which can be measured in money and a consequential discharge of the creditor's debt by that sum, then the transaction can be said to involve a payment by the debtor to the creditor within the meaning of s 588FA(1)(b) of the Act.
>
> Where, however, a payment by the third party which discharges the debtor's debt to the creditor is authorised and ratified by the debtor and only involves the debtor incurring a liability in favour of the third party, and no reduction of assets of the debtor, then, in my opinion, the payment does not, on that ground, constitute a payment by the debtor to the creditor within the meaning of s588FA(1)(b) of the Corporations Act.[18]

29 In reaching these conclusions the judge stated that application of the 'test' articulated by Gordon J could lead to windfall gains, endorsing observations to that effect made by Brereton J in *Re Evolvebuilt Pty Ltd*.[19] The judge concluded:

> On the facts in this case, I have found that there has been no diminution in Eliana's assets by reason of the transaction. I am not satisfied that, in those circumstances, the payment of $220,000 to Mad Brothers was from Eliana within the meaning of s 588FA(1)(b) of the Corporations Act. For the reasons discussed above, I find that the fact that Eliana authorised and ratified the payment by Rock Development is insufficient to constitute a payment by Eliana to Mad Brothers and thus is insufficient to establish that an unfair preference has been given by Eliana to Mad Brothers.[20]

30 It can be seen that the judge expressed himself, more than once, in terms suggesting that the applicants had not established that there was a preference. Strictly speaking, the onus was on Mad Brothers as the appellant to show error on the part of the associate judge. However, nothing was sought to be made of the point in the application in this Court.

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17 Ibid [40].

18 Ibid [75]–[76].

19 [2017] NSWSC 901 ('*Evolvebuilt*').

20 Reasons [78].

31 Next, the judge held that Rock received a benefit of $87,256.15 for work done by Mad Brothers at the Taylors Hill site. He found that the evidence established that Rock owned the Taylor's Hill site and obtained the benefit of the work done on it. No building contract between Rock and Eliana had been produced. He held that Rock was an undisclosed principal and the applicants therefore could not recover that part of the payment of $87,256.15 from Mad Brothers in any event. Accordingly, the judge would have reduced the amount to be disgorged, if he had found an unfair preference, by that sum.[21]

32 The judge went on to consider the good faith defence. He held that the material provided to Mad Brothers and the facts that subsisted when the payment was received were not sufficient to induce a 'positive apprehension' as to 'actual insolvency', and Mad Brothers had established the defence. He found that the associate judge had erred by failing to have proper regard to information provided to Mad Brothers and other events which occurred after the statutory demand was served and the winding-up proceedings commenced, but prior to the payment. Among other things, the judge referred to documents filed by Eliana in the winding-up application directed at establishing its solvency.

33 The judge stated his conclusion as follows:

> I consider that the appellant has established that the facts and matters which were actually appreciated by Mr Maddalon and Ms Haddrell [on behalf of Rock] were insufficient to induce a suspicion as to insolvency in the mind of a reasonable person. A reasonable person could conclude that Mr Sowiha was deciding not to pay, rather than that he could not pay. A reasonable person could conclude that Eliana had access to fairly significant funds, and that persons or entities providing those funds were satisfied as to Eliana's (or its director's or related entity's) ability to repay those loans. A reasonable person would tend to believe the contents of documents which have been filed in this court. A reasonable person inexperienced in questions of solvency and insolvency would rely on legal advice from their advisors as to the adequacy of material filed by the other party.[22]

34 As a result, the judge upheld the appeal and set aside the order of the

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21 Ibid [86]–[87].

22 Ibid [123].

associate judge.

Proposed appeal

35 In this Court, the applicants seek to rely on the following grounds of appeal:

> 1. The learned Judge erred in holding … that the question of whether or not [Rock] owed money to [Eliana] had a bearing on whether or not the payment of $220,000 by Rock to [Mad Brothers] constituted a payment by [Eliana] within the meaning of ss 9 and 588FA(1) of the [Act].
>
> 2. The learned Judge erred in finding … that [Rock] was not indebted to [Eliana] at the time of the said payment.[23]
>
> 3. The learned Judge erred in in holding … that the Payment was not a payment from [Eliana] within the meaning of s 588FA(1)(b) because it did not result in a diminution of [Eliana's] assets.
>
> 4. His Honour erred in finding that Rock was an undisclosed principal in respect of part of the debt to [Mad Brothers] and that, therefore, the Payment was not preferential to that extent.
>
> 5. His Honour erred in [finding] that a reasonable person in [Mad Brothers'] circumstances would have had no reasonable grounds for suspecting that [Eliana] was insolvent at the time of the Payment within the meaning of s 588FG(2)(b)(ii).

36 The respondent in turn filed a notice of contention taking issue with the judge's finding that Eliana was 'a party to the transaction between Nationwide and Rock'. This raises the applicability of the condition in s 588FA(1)(a).

37 It is convenient to commence with the related questions whether Eliana was a party to the transaction and whether the payment to Mad Brothers was received 'from the company', namely from Eliana. The first question requires applying s 588FA(1)(a) to the facts (the notice of contention). The second involves an examination of the case law regarding the expression 'from the company' in s 588FA(1)(b) (proposed grounds 1 and 3).

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[23] The application for leave to appeal, and the applicants' written case, interchange Rock and Eliana.

Was Eliana a party to the transaction involving Rock and Mad Brothers? — Notice of contention

38 The respondent submitted that, in the face of Mr Sowiha's evidence that he had not asked Nationwide to make the payment directly to Mad Brothers, it could not be said that Eliana had initiated the transaction or asked, directed, requested or authorised the payment. The case rested on inference, which Mr Sowiha had rebutted in unequivocal terms. As a result, it was submitted, it could not be found that Eliana was a party to the transaction.

39 It is relevant, in this context, that the judge appears to have found that Eliana authorised and ratified the payment.[24] In our view, such a finding was plainly open. In the first place, Eliana's general ledger recorded an amount exceeding the payment as having been 'paid off by Rock' to Mad Brothers on 16 September 2016. The applicants contended that it could be seen from other documents that the amount included the payment of $220,000, and this was not contested by the respondent.

40 Secondly, in the context of the common shareholding and directorship of Rock and Eliana, and the interdependence of their financial arrangements, it is not difficult to infer that Mr Sowiha acted on behalf of both companies in undertaking the transaction recorded in the ledger. Mr Sowiha signed the settlement agreement on behalf of Eliana and applied for the finance necessary to perform the agreement. He had Rock borrow the money because it provided the security.

41 Finally, even if Mr Sowiha had not directed Nationwide to make the payment to Mad Brothers, and it was merely a condition imposed by the lender, that does not exclude the possibility that he nonetheless authorised or ratified the payment, as the above considerations suggest.

42 As the judge held, a 'transaction' within the meaning of s 9 is capable of being

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[24] Reasons [78], set out at [29] above.

made up of a series of interrelated or composite dealings.[25] In the context of a person paying a debt owed to the person by a third party, that readily extends to a dealing by which the third party authorises or ratifies that person's conduct in making the payment. The third party is a party to that transaction. It is not necessary to take the further step, which the judge did, of identifying a paragraph of the definition. The judge considered that, on this approach, Eliana incurred an obligation to Rock, bringing the case within paragraph (e). That raises issues more conveniently dealt with in the context of the first and third proposed grounds of appeal, which are dealt with next.

43 It follows that the judge was correct to hold that Eliana was a party to the transaction by which Nationwide paid Mad Brothers the amount of $220,000.

44 For these reasons, the argument in the notice of contention should be rejected. The condition in s 588FA(1)(a) was therefore satisfied.

Payment 'from the company' — proposed grounds 1 and 3

45 Section 588FA(1)(b) presents much greater difficulty. It is not in dispute that the transaction resulted in Mad Brothers receiving more than it would receive if the transaction were set aside and Mad Brothers were to prove for the debt in a winding up of Eliana. The issue is whether the receipt of the payment was a receipt 'from the company' (Eliana). That issue is also reflected in the introductory words of s 588FA(1) 'an unfair preference given by a company'. However, those words do not impose an independent test. They describe the consequences if a transaction satisfies the conditions in paragraphs (a) and (b).

46 It is necessary to review the authorities which bear on the question when a payment made by a third party is received 'from the company' within the meaning of s 588FA(1)(b). Unfortunately, they do not reveal a clear picture.

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[25] Ibid [39], citing *Re Emanuel (No 14) Pty Ltd (in liq); Macks v Blacklaw & Shadforth Pty Ltd* (1997) 147 ALR 281, 288–9 (O'Loughlin, Branson and Finn JJ) ('*Re Emanuel*').

Legislative background

47 It is important to note at the outset that earlier forms of the provision contained language different to that of s 588FA.

48 Before 1993, provision for unfair preferences was made by s 565 of the *Corporations Law* and predecessor provisions to the same effect. Section 565(1) provided as follows:

> A settlement, a conveyance or transfer of property, a charge on property, a payment made, or an obligation incurred … by a company that, if it had been made or incurred by a natural person, would, in the event of his or her becoming a bankrupt, be void as against the trustee in the bankruptcy, is, in the event of the company being would up, void as against the liquidator.

49 This provision, and various others that were in force in like form at different times, requires the payment to have been made 'by a company'. Similarly, it poses the hypothetical question whether, if the payment 'had been made by' a natural person, it would have been a preference. The equivalent language in s 588FA(1) provides that the preference is 'given by the company'. However, as noted earlier, in s 588FA(1) those words are used descriptively: rather than defining what is required to attract the provision, they describe the thing defined. The corresponding, but not identical, requirement in s 588FA(1)(b) is that the payment is received 'from the company'.

50 Until the current provisions were enacted in 1993,[26] s 565 had the effect of applying s 122 of the *Bankruptcy Act 1966* (Cth), which relevantly stated (omitting, among other things, reference to the relation back period):

> (1) A conveyance or transfer of property, a charge on 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 favour of a creditor, having the effect of giving that creditor a preference or advantage over other creditors … is void as against the trustee in the bankruptcy.
>
> (1A) Subsection (1) applies in relation to a conveyance or transfer of property, a charge on property, or a payment made, or an obligation

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[26] See *Corporate Law Reform Act 1992* (Cth) ss 104, 111 (commencing 23 June 1993).

incurred, by the debtor in favour of a creditor:

…

(b) whether or not:

…

(ii) the payment is made out of his own moneys or out of moneys of the debtor and another person or other persons; …

51 It can be seen that s 122(1A)(b)(ii), which was introduced in 1980,[27] made it clear that the payment in question must either be out of the bankrupt's own moneys or out of moneys of the bankrupt and another person or persons. There is no such stipulation expressed in s 588FA. As discussed below, however, such a requirement has been identified by judicial decision.

Case law

52 With that brief legislative background in mind, it is convenient to address the case law regarding third party payments and unfair preferences.

53 In *Re Stevens; Ex parte The Official Receiver v McPhee*,[28] the bankrupt had sold his business to a person named Owler who had been introduced by the respondent, McPhee. Under a scheme promoted and carried out by McPhee, Owler bought the business for £475. This money was not paid to the bankrupt. Instead, Owler gave McPhee a promissory note for £400, covering the bankrupt's debt to McPhee, plus interest. McPhee released the bankrupt from the debt. Owler paid a further £55 to McPhee who settled some outstanding wages and rent for the bankrupt.

54 Judge Moule, sitting in the bankruptcy court,[29] held that the receipt by McPhee of the proceeds of sale of the business was a fraudulent preference within the meaning of s 95 of the *Bankruptcy Act 1924* (Cth).[30]

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27 See *Bankruptcy Amendment Act 1980* (Cth), s 57 (commencing 1 February 1981).

28 (1929) 1 ABC 90 ('*Re Stevens*').

29 See *Bankruptcy Act 1924* (Cth), ss 18(1)(b), 18(2)(a).

30 Section 95 was not relevantly different from s 122 of the *Bankruptcy Act 1966*. Section 95(1)

55 He held that 'the payment which [the bankrupt] should have received he has authorised to be made to the creditor, and it is just the same as if he had received payment himself and had himself handed such payment to McPhee'.[31] As such, there had been a payment within the meaning of the section. McPhee was ordered to give the promissory note into the control of the trustee, leaving the £55 payment unaffected.[32]

56 The judge said:

> To my mind this was a scheme whereby a creditor McPhee introduces a purchaser to take over the whole of his debtor's assets and contrives to get the whole of the purchase money into his possession and control. True it is that McPhee has taken a promissory note in lieu of cash, and it is true that the bankrupt did not himself hand over the purchase money, but he clearly acquiesced in McPhee so obtaining it. I should say that it is clear that the bankrupt authorized Owler to hand over the money, or the equivalent of the money, to McPhee on his behalf. … McPhee has obtained that which represents the whole of the assets of the bankrupt while all the other creditors are left lamenting.[33]

57 While Judge Moule used the term 'acquiesced' in this passage, he also used the language of authority, even contrivance. Plainly, the case involved involvement on the part of the bankrupt that went well beyond mere acquiescence.

58 It is next necessary to refer to a decision of the High Court which has tended to be cited in this area but which in truth has little to do with it. *Robertson v Grigg*[34] concerned an agreement between a debtor and the Main Roads Board, by which the

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provided:

> Every conveyance or transfer of property, or charge thereon made, every payment made, every obligation incurred *and every judicial proceeding taken or suffered*, by any person unable to pay his debts as they become due from his own money, in favour of any creditor *or of any person in trust for any creditor*, having the effect of giving that creditor, *or any surety or guarantor for the debt due to that creditor*, a preference over other creditors shall … be void as against the trustee in bankruptcy. (Emphasis added to identify different language.)

31 *Re Stevens* (1929) 1 ABC 90, 93.

32 The report does not make clear what happened to the remaining £20 of the purchase price, apart from a reference to some 'minor payments in cash': ibid 92.

33 Ibid 93.

34 (1932) 47 CLR 257.

debtor authorised the Main Roads Board to pay direct to the respondent moneys coming due to the debtor under road construction contracts. The respondent lent money to the debtor under successive contracts, and it was these moneys which were repaid by the Main Roads Board. The debtor's trustee sought to recover the amounts paid on the ground that, in authorising the payments, the debtor had given the respondent a preference.

59 The High Court held unanimously that the payments were not preferences. The judges' reasons differed, but relevantly for present purposes Dixon J (with whom Rich and McTiernan JJ agreed) held that the debtor's agreement to pay the respondent out of the specific fund constituted by moneys due from the Main Roads Board created a valid equitable charge on that fund. Because that charge had been created before the relevant debts arose during the relation back period, the parties were not dealing with each other as debtor and creditor at the time of the charge. Dixon J explained:

> Within the period £1,582 6s. 11d. was lent in various sums. A charge was created in favour of the respondent in respect of each such advance as it was made, but the creation of the charge cannot be a preference within sec. 95 because it did not operate to prefer him in respect of any then existing debt. Upon the terms of sec. 95 the transfer of property or charge thereon made must be in favour of a creditor of the person unable to pay his debts as they became due, and it must have the effect of giving that creditor, or a surety for his debt, a preference. The relationship of debtor and creditor was for long the very foundation of the provisions of the bankruptcy law affecting preference, and, although exceptions have been introduced, the old rule otherwise remains and nothing can amount to a preference unless the person preferred is a creditor. Sec. 95 does not depart from this general principle. In making each separate advance on the faith of the agreement and thereby obtaining a charge in respect of the advance, the respondent did not obtain any benefit or advantage in relation to the past indebtedness. He did not deal with the debtor in his capacity of creditor. No pre-existing debt was better secured or otherwise affected by reason of any subsequent advance. There was, therefore, no preference to him as a creditor.[35]

60 As this passage reveals, the question in the case became whether the parties were in a debtor and creditor relationship when the charge was created. The case

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35 Ibid 271.

was concerned with the character of the recipient of the payment, as creditor or otherwise, at the time of the charge. However, the Court plainly did not consider that the fact that the payment was made by a third party, namely the Main Roads Board, at the direction of the debtor, took the case outside the purview of the preference provisions. In that sense, the case supports the view that a payment made by a third party, with the authority of the debtor, of moneys in the hands of the third party and due to that debtor, is within the scope of those provisions.

61 In *Ramsay v National Australia Bank Ltd*,[36] the Full Court of this Court was required to consider whether a payment made by a third person was to be considered as made by the debtor, for the purpose of s 451(1) of the *Companies (Victoria) Code*. That provision mirrored former s 565 in applying s 122 of the *Bankruptcy Act 1966* to corporations.

62 In *Ramsay*, a company having the same proprietors and directors as the debtor company, and the bank for both entities, were parties to a transaction which the debtor's liquidator alleged amounted to a preference. By the transaction, the related company drew a bill for $50,000. The bank discounted the bill to $47,000, and applied that amount, together with other moneys available to the related company, in reducing the debtor company's indebtedness to the bank. In other words, the related company funded the reduction in the debtor company's debt to the bank.

63 The Court dealt first with the question whether the payment was 'made by' the debtor. The liquidator relied on four cases: *Re Stevens*, *Re Lynch*,[37] *Re Smith*,[38] and *Re Ruwaldt*.[39] In *Re Lynch*, a creditor, with the authority of the debtor, sold one of the debtor's businesses and retained £500 from the proceeds in satisfaction of the debt. The payment was held void as against the trustees in bankruptcy. In *Re Smith*,

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36 [1989] VR 59 ('*Ramsay*').

37 *Re Lynch; Ex parte Hungerford v Lynch* (1937) 9 ABC 210 ('*Re Lynch*').

38 *Re Smith; Ex parte the Trustee v J Bird Pty Ltd* (1933) 6 ABC 49 ('*Re Smith*').

39 *Re Ruwalt; Ex parte Fleetwood Smith v Commercial Bank of Australia Ltd* (1931) 3 ABC 245 ('*Re Ruwalt*').

the debtor sold one of his assets and gave the purchaser a direction to pay the purchase price to a creditor. It was not contested that this amounted to a payment within s 95(1) of the *Bankruptcy Act 1924*, the issue in the case being whether the good faith exception applied. Similarly in *Re Ruwaldt*, a bankrupt farmer sold his crop and directed the purchaser to pay the proceeds in reduction of the farmer's overdraft. Again, this was accepted to constitute a 'payment' by the farmer.

64 The Court in *Ramsay* distinguished these cases on the basis that, in each of them, the amounts concerned were owing by the third party to the debtor, whereas there was no such obligation in the present case.[40] To meet this argument, the liquidator relied on an agreement for sale that the two companies had entered into, whereby the debtor company sold its undertaking for $1, and the related company took over its liabilities and agreed to indemnify the debtor company in respect of them. It was submitted that this meant that, when the related company made the payment to the bank, it was discharging its obligations to the debtor company and the payment was therefore made by that company.

65 The Full Court also rejected this argument, holding that '[b]y no stretch of words' could it be said that the debtor company 'made the payment'.[41] In particular, the Court distinguished the High Court's decision in *Richardson v Commercial Banking Co of Sydney Ltd*.[42] In that case, a solicitor mixed his own money with an office account and a trust account and made payments to a bank in reduction of his overdraft. One payment involved a client's cheque for the balance of the purchase price of a property she had purchased. The solicitor (Price) told the bank he would send the cheque to the bank. The solicitor was arrested before he could do so and he then indicated to the bank that he would not send it. However, the bank officer (Commins) pressed him for the cheque and 'managed to cajole his female clerks into

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40 *Ramsay* [1989] VR 59, 62 (Murphy, Southwell and Phillips JJ).

41 Ibid 63.

42 (1952) 85 CLR 110 ('*Richardson*').

giving it to him'.[43] As to this cheque, the Court said:

> If it had been Price's own money, the effect would have been to give a preference to the respondent bank over other creditors. The question whether such a use of other people's money is within s 95 is not easy. …
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> …
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> On the whole it appears to us that the payment of a cheque representing trust funds into the office account, were it otherwise to operate to give a preference to the bank, would be within s 95. It is within s 95 because, although the same moneys could never but for the misappropriation have been available to the bankrupt's creditors, there would be a preference, priority or advantage effected in favour of the bank as a creditor, in making a payment to it, when other creditors must prove and other creditors suffer the disadvantage of being exposed to the competition upon the assets of the proof of the defrauded owner of the funds.[44]

66 The High Court therefore regarded the proffering of the cheque to the bank as conferring a preference even though the cheque did not belong to the solicitor. It must be noted, however, that the legal title to the cheque was held by the solicitor as trustee. In that sense, the cheque was not simply 'other people's money'.[45] The Court did not decide the question what rights the true owner of the cheque might have against the bank or the Official Receiver.

67 The Court in *Ramsay* held that *Richardson* is not authority for the proposition that a payment such as the one in *Ramsay* was 'made by' the debtor company. The Court noted that Price or perhaps his clerks had given the cheque to the bank, and so made the payment. This was a very different circumstance. The Court summarised its view of the position in these terms:

> We have seen no authority for the proposition that a payment out of his own moneys by B to C, pursuant to a contractual obligation to discharge A's debt to C, an obligation imposed upon B by a contract between A and B, can be said to be a payment made by A to C. The words of s 451 must be given their ordinary, natural meaning. Accordingly we are bound to conclude that the payment by [the related company] to the bank of $54,045.77 on 24 August

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43 Ibid 135 (Dixon, Williams and Fullagar JJ).

44 Ibid 136–7.

45 See generally, *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth* (2019) 93 ALJR 807, 829–30 [83]–[84] (Bell, Gageler and Nettle JJ); [2019] HCA 20; *Boensch v Pascoe* (2019) 94 ALJR 112, 118 [4] (Kiefel CJ, Gageler and Keane JJ); [2019] HCA 49.

> 1984 was not a payment 'made by' [the debtor company] within the meaning of that section.[46]

68 This analysis was criticised by a Full Court of the Federal Court in *Re Emanuel*.[47] In that case, the debtor company engaged a company to build a road. An amount of $322,313.54 became due to the builder under the contract. By deed entered into following litigation between the debtor company and its financier, the financier covenanted to pay that sum to the builder, at the debtor's direction. That direction was duly given and the payment was made. In due course, the liquidator of the debtor company demanded repayment on the ground that the transaction was an unfair preference within s 588FA.[48]

69 The Full Court concluded that a course of dealing initiated by a debtor that is intended to, and does, extinguish a creditor's debt can be a 'transaction' for the purposes of s 588FA even though that end can only be achieved through the participation of a third party in a particular dealing or dealings within the overall transaction, being a dealing or dealings to which the debtor 'is not or may not be a party'. It therefore did not matter that the debtor in this case was not a party to the payment. Nor did it matter that the creditor builder was not party to the deed or the direction. The deed, together with the direction and the payment, constituted a 'composite of dealings' that amounted to a 'transaction'. It sufficed that the debtor and the creditor were parties to the transaction, even though neither was a party to all its component elements.[49]

70 The Court explained:

> We confine our observations for present purposes simply to a course of dealing initiated by a debtor for the purpose of, and having the effect of, extinguishing a debt. It is not apparent to us why it should not be said that, where a debtor so acts and extinguishes a debt, the relevant 'transaction' is the totality of the dealings through which the debtor procures the intended

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46 *Ramsay* [1989] VR 59, 63 (Murphy, Southwell and Phillips JJ).

47 (1997) 147 ALR 281.

48 Ibid 284–5 (O'Loughlin, Branson and Finn JJ).

49 Ibid 289.

> outcome, irrespective of whether one or more of the dealings in the sequence in question does not involve or require the participation of the debtor but does require that of a third party. The transaction, in other words, is the totality of the dealings initiated by the debtor so as to achieve the intended purpose of extinguishing the debt.
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> …
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> We conclude, then, that a course of dealing initiated by a debtor that is intended to, and does, extinguish a creditor's debt can in its totality be a transaction for the purposes of Part 5.7B of the Corporations Law notwithstanding that the achievement of that end can only be realised through the participation of a third party in a particular dealing (or dealings) within the overall transaction, being a particular dealing (or dealings) to which the debtor is not or may not be a party.[50]

71 In light of that finding, the Court found that s 588FA(1)(a) was satisfied. The question for the Court became whether the builder received the money 'from the company' within the meaning of s 588FA(1)(b). The Court held that the builder received the actual benefit of a valuable chose in action owned by the debtor company, in the form of a monetary payment. The Court observed that, if the financier had failed to make the payment as directed, the debtor company could have recovered the agreed sum from the financier directly. As such, although the payment had been received indirectly from the debtor company, the situation was no different to a direct payment.[51]

72 For the proposition that the builder could have sued the financier to enforce the direction, the Court cited *Ashdown v Ingamells*.[52] In *Ramsay*, the Full Court of this Court distinguished that decision on the facts.[53] But it is apparent that the Court in *Re Emanuel* took a contrary view of the law. In the context of deciding whether there was a transaction, the Court referred to this Court's consideration of the words 'a payment made … by' in s 451 of the *Companies (Victoria) Code* as set out at [65] above, and stated:

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50 Ibid 288–9.

51 Ibid 290–1.

52 (1880) 5 Ex D 280.

53 *Ramsay* [1989] VR 59, 65 (Murphy, Southwell and Phillips JJ).

> We have, with respect, some difficulty with this conclusion. Before a payment made by B to C can be effective to discharge A's debt to C, ordinarily it must be made with A's authorisation or ratification: see Mason and Carter, *Restitution Law in Australia*, para 846, (Butterworths, Sydney, 1995); Goff and Jones, *The Law of Restitution*, p 17, (4th ed, Sweet and Maxwell, London, 1993); and see generally on payment of another's debt, Beatson, *The Use and Abuse of Unjust Enrichment*, Ch 7, (Clarendon Press, Oxford, 1991). Where a payment is so made it can properly be said that it is A's act that makes B's payment efficacious at law to discharge the debt to C. This, of itself, does not provide reason for saying that the payment itself is made by A. Nonetheless where that payment constitutes part of the consideration B furnished and A required in the A-B contract and where, inter alia, that consideration is in the final settlement of the obligations inter se of A and B, then we see no compelling reason for not concluding that A has made the payment to C albeit by using B as its instrument for the purpose. It is, though, unnecessary to consider either this matter or *Ramsay's* case further for reasons we give below.[54]

73 Although the Court regarded it as unnecessary to consider the matter further in the context of the meaning of 'transaction', the above reasoning suggests that the payment was 'made by' the company. However, that point did not need to be decided.

74 Shortly after the decision in *Re Emanuel*, the High Court decided *Sheahan v Carrier Air Conditioning Pty Ltd*.[55] That decision involved a payment made by a receiver, appointed by a secured creditor, to two unsecured creditors of the debtor company. The moneys were paid from the proceeds of realising the company's assets, which were held in the statutory account operated by the receiver.

75 The majority, Dawson, Gaudron and Gummow JJ, approved the contentious passage in *Ramsay* and held that the payments made by the receiver were neither payments made by the debtor company nor payments from the company's own money. The latter requirement was said to emerge, not from the express words but from the purpose of s 122 as applied by s 565, namely to enable the trustee in bankruptcy (here, the liquidator) to recover the money or property concerned and return it to the estate from which it came.[56] In that regard, s 122(1A) of the

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54 *Re Emanuel* (1997) 147 ALR 281, 287–8.

55 (1997) 189 CLR 407 ('*Sheahan*').

56 Ibid 440–1.

Bankruptcy Act 1966 enlarged the scope of the section to include money jointly owned by the bankrupt; it did not remove the requirement that the payment be made from the bankrupt's own money.

76 The majority reasoned that the moneys had been paid by the receiver, out of his statutory account, and this did not cease to be so because the payments significantly affected the contractual relationship between the company and the two creditors. The powers of the receiver were distinguished from cases where a company had given authority for its debts to be paid.

77 The conclusion that the payments had to be from the company's own money did not address the statement of a unanimous High Court in *Octavo Investments Pty Ltd v Knight*,[57] relied on by Brennan CJ and Kirby J in the minority, to the effect that the words 'from his own money' were merely descriptive and did not qualify the operation of s 122.[58] As mentioned, the identified requirement that the payment made by the company be from its own money was treated in *Sheahan* as being inherent in the nature of a preference, in light of the purpose of the provision. Put differently, the nature of a 'preference' can be seen as involving different treatment of creditors in respect of money in which they would, but for the preference, have been entitled to share. This understanding of a preference was supported by Brennan CJ, who referred to the purpose of s 122(1) as being 'to replenish the pool of assets which the creditors … are entitled to share rateably'. (Brennan CJ regarded the payments by the receiver as having been made by the company.) It would seem to follow that, if the payment was not made from the assets of the company, then the money was not money in which the creditors were entitled to share.[59]

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57 (1979) 144 CLR 360, 368–9 (Stephen, Mason, Aickin and Wilson JJ) ('*Octavo*').

58 *Sheahan* (1997) 189 CLR 407, 420 (Brennan CJ), 449 (Kirby J). The dissenting members of the Court also differed as to the construction of s 122(1A): see 421 (Brennan CJ), 450 (Kirby J).

59 Ibid 424. See also *Re Amerind; Commonwealth v Byrnes* (2018) 54 VR 230, 247–9 [71]–[78] (Ferguson CJ, Whelan, Kyrou, McLeish and Dodds-Streeton JJA). Brennan CJ reasoned further that, since the assets of the company would be exhausted in meeting the liabilities owed to the secured creditor, the general creditors were not worse off by the payment to one of their number. This approach was disapproved in *G & M Aldridge Pty Ltd v Walsh* (2001) 203 CLR 662, 671–2 [18]–[22], 673–4 [28] (Gleeson CJ, Gaudron, Gummow, Hayne and Callinan JJ)

78 The majority in *Sheahan* endorsed the decision in *Re Stevens*, recognising that where a debtor directs a third party who holds funds at the direction of the debtor, or is otherwise obliged to the debtor to account to the debtor, not by payment to the debtor but by payment to a creditor of the debtor, that may be a payment 'made by' the debtor within the meaning of s 122(1).[60] However, the Court did not refer to the then very recent decision in *Re Emanuel* which referred also to payments authorised or ratified by the debtor. Indeed, to the extent that the Court approved *Ramsay*, it might be said to have steered a different course to that in *Re Emanuel*. We shall return to this question.

79 The status of *Ramsay* and *Re Emanuel*, in the light of *Sheahan*, was touched upon in an application for summary dismissal in *New Cap Reinsurance Corporation Ltd (in liq) v Somerset Marine Inc*.[61] Refusing the application, Gzell J pointed out that in both *Ramsay* and *Sheahan* the funds in question were not the company's moneys, and that those cases arguably did not preclude a finding of a preference in a case, such as the one at hand, in which the moneys that were paid by the third party were secured by the company. In other words, where the moneys were in effect those of the company, the reasoning in *Re Emanuel* might be available to hold that the payment had been made by the company, using the third party as its instrument for the purpose. This approach was upheld by the New South Wales Court of Appeal in refusing leave to appeal.[62] In a later summary application in the same litigation, Gzell J went further and said that it is 'no part of the proof of an unfair preference to establish an affectation upon the assets of the insolvent company'.[63]

('*G & M Aldridge*'). Instead, there was a preference because the individual creditor's debts were met and those of others were not. This is now reflected in the language of s 588FA(1)(b), which looks to the position of the individual creditor rather than the creditors as a whole.

60 *Sheahan* (1997) 189 CLR 407, 437 (Dawson, Gummow and Gaudron JJ).

61 [2003] NSWSC 540.

62 *Somerset Marine Inc v New Cap Reinsurance Corporation Ltd (in liq)* [2003] NSWCA 338 [22]–[24] (Hodgson JA, Meagher JA agreeing at [1]).

63 *New Cap Reinsurance Corporation Ltd (in liq) v All American Life Insurance Ltd* (2004) 49 ACSR 417, 420 [15]; [2004] NSWSC 366 ('*New Cap*').

80 In the meantime, this Court in *VR Dye & Co v Peninsula Hotels Pty Ltd (in liq)* held that a principle called the 'doctrine of ultimate effect', which the High Court had applied under s 122 of the *Bankruptcy Act 1966*,[64] was also applicable under s 588FA.[65] This requires that a payment said to be a preference be looked at in the context of the wider transaction of which it forms part, and the ultimate effect of that transaction. For example, a payment made in return for the receipt of goods of at least equal value secures the payee no advantage over other creditors and the payment is therefore not a preference.[66]

81 One consequence of the 'ultimate effect' doctrine is that it is relevant to consider the effect of the transaction on the net assets available to creditors. In *Airservices*, Dawson, Gaudron and McHugh JJ stated, in respect of s 565 of the *Corporations Law*:

> a payment made during the six 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 that are available to meet the competing demands of the other creditors.[67]

This passage was relied upon by Ormiston JA in *VR Dye*.[68] It is at the heart of the 'ultimate effect' doctrine.

82 This Court reaffirmed the correctness of this position in *McKern v Minister Administering the Mining Act 1978 (WA)*.[69] In endorsing the 'ultimate effect' doctrine,

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64 *Airservices Australia v Ferrier* (1996) 185 CLR 483, 502–3, 509 (Dawson, Gaudron and McHugh JJ) ('*Airservices*'); see also 491 (Brennan CJ), 516–18 (Toohey J), relying especially on *Richardson* (1952) 85 CLR 110, 132–3.

65 [1999] 3 VR 201, 214–15 [37]–[38] (Ormiston JA, Winneke P and Tadgell JA agreeing at 202 [1], [2]) ('*VR Dye*').

66 *Airservices* (1996) 185 CLR 483, 502 (Dawson, Gaudron and McHugh JJ).

67 (1996) 185 CLR 483, 502, citing *Re Discovery Books Pty Ltd* (1973) 20 FLR 470, 475 (Fox J).

68 *VR Dye* [1999] 3 VR 201, 214 [37] (Ormiston JA).

69 (2010) 28 VR 1, 6–10 [14]–[27] (Nettle JA), 39–41 [114]–[118] (Mandie JA, Beach AJA agreeing at [141]) ('*McKern*').

Nettle JA disapproved the statement of Gzell J in *New Cap* that 'it is no part of the proof of an unfair preference to establish an affectation upon the assets of the insolvent company'.[70]

83 These cases are relevant because one aspect of the 'receiving from the company' question that was argued before us was whether or not it is necessary, in order for there to be a preference, for the assets of the debtor company to have been diminished by the payment. In *Federal Commissioner of Taxation v Kassem*, and in *Hosking v Extend N Build Pty Ltd*, the Full Court of the Federal Court and the New South Wales Court of Appeal respectively left open the question whether what was said on this point in *Airservices* applied to the regime in s 588FA.[71]

84 In a decision which is central to the present case, Gordon J was called upon to consider third party payments in *Burness*. The facts were very similar to those in *Ramsay*. The creditor company had sold and hired building products to the debtor for several years. The directors of the debtor company were a father and son. During the relation back period, and while the creditor was pressing for payment, the son informed the creditor that, due to his father's imminent retirement, he was establishing a new company, in which his father would have no interest, to take over the business. He said that the creditor should transfer the debtor company's account to the new company. The creditor received a payment from the new company after this conversation, and a second payment, also from the new company, after the son had formally advised the creditor that the debtor company had ceased business and that the new company was now carrying on that business. The creditor's records were amended accordingly and the judge accepted that the debt had been transferred to the new company as of the date of this advice.

85 The judge found that the second payment was not a preference because, when

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70 Ibid 7–8 [16]–[18].

71 (2012) 205 FCR 156, 164 [58]–[61] (Jacobson, Siopis and Murphy JJ) ('*Kassem*'); (2018) 357 ALR 795; [2018] NSWCA 149 ('*Hosking*').

it was made, the debt was owed by the new company and not by the insolvent company. The first payment, made before the transfer of the debt, was found to be a preference (albeit that the good faith exception was found to apply).[72]

86 Gordon J first considered whether there was a transaction to which the debtor was a party. She found that there was, on two alternative bases. First, the debtor company had initiated a course of dealing that was intended to, and did, extinguish its debt. Secondly, the debtor company had acquiesced in the payment of its debt by the new company (which possibly gave a right in the new company in the form of a claim for money paid).[73] In reaching both conclusions, Gordon J applied *Re Emanuel*. The case makes no reference to *Ramsay*, in particular the passage approved in *Sheahan* and disapproved in *Re Emanuel*, and it will be necessary to consider whether this is significant later in these reasons.

87 In a passage relied on by the applicants in the present case, Gordon J declined to endorse a narrow view of what was decided in *Re Emanuel*:

> I do not accept that *Re Emanuel (No 14)* is authority for the proposition that before a payment by a third party can be taken to be a payment 'accepted' or 'made' by the debtor there must be evidence of an arrangement between the debtor and the third party whereby at the direction of the debtor, the third party made a payment to the creditor in discharge of an obligation owed by the third party to the debtor. That is not what the authorities establish. Where a payment made by a third party to a creditor is authorised by the debtor, nothing more is required. The debt is discharged by the third party at the request of or with the acceptance of the debtor.
>
> On the other hand, if a debt is discharged by a third party payment which is unauthorised, the debt is not necessarily discharged. The debtor has a choice – to accept or not to accept the payment. If the debtor ratifies or accepts the unauthorised payment by the third party, the debtor will be liable to the third party who made the payment. In other words, the 'acceptance' will give the third party a claim for money paid for and at the request of the debtor or, as it is sometimes put, impose upon the debtor a duty of restitution. If the debtor does not ratify the payment, the original debt it owed to the creditor remains outstanding.[74]

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72 (2009) 259 ALR 339, 349 [49]–[50].

73 Ibid 348 [47].

74 Ibid 347–8 [45]–[46] (citations omitted).

88 It is clear that, in this passage, Gordon J considers that, where actions of a debtor have the effect of causing a payment made by a third party to discharge the debtor's debt, that is capable of constituting a transaction to which the debtor is a party, so as to satisfy s 588FA(1)(a).

89 Gordon J then turned to consider whether the payment amounted to a preference within the meaning of s 588FA(1)(b). She held that it did. In doing so, she put to one side a submission that there could be no preferential effect without a diminution in the assets of the debtor. It was unnecessary to decide whether the new company received consideration, or had a claim against the debtor, arising from the transaction. That was because the return to unsecured creditors was close to zero, which was less than the creditor received by way of the payment.[75] Gordon J did not specifically address the question whether the payment was received 'from the company'.

90 The next decision was particularly relied on by the respondent. In *Evolvebuilt*, the insolvent company was subcontracted to perform interior work on a large building project. Payments to secondary subcontractors performing that work, made by the head contractor rather than by the insolvent company, were alleged to be preferences. The head contract entitled the head contractor to pay secondary subcontractors at the insolvent company's request and claim the amounts paid as a debt from the insolvent company. Such a request was made in general terms, but the amounts in issue were paid after the contract had been terminated, at the behest of a union which had become involved after the insolvent company stopped making payments itself. Brereton J found that the general request under the contract was therefore irrelevant.[76] The issues were whether the insolvent company was a party to the transaction and whether the payments were made by and received from that company (which Brereton J appears to have treated as synonymous concepts) rather

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75 Ibid 349 [49].

76 [2017] NSWSC 901 [49].

than the head contractor.

91 Brereton J concentrated on the latter question. He analysed the Full Court's reasons in *Re Emanuel* and observed that they treated the two above questions separately. *Re Emanuel* had recognised that the conferral on a creditor of the benefit of an asset of the company could amount to receipt of a preference 'from the company'. The direction of the debtor company was significant to bringing about that conferral.

92 Brereton J then went on to consider the judgment of Gordon J. He took issue with it in several respects. First, in so far as Gordon J relied on *Re Emanuel* for the proposition that a course of dealing initiated by a debtor and intended to extinguish a creditor's debt could be a preference, that part of the reasons in *Re Emanuel* did not concern the question whether the money was received from the company, only the question whether there was a transaction to which the debtor was a party.[77]

93 Secondly, Brereton J considered that, in stating that nothing more than authorisation by the debtor was required, Gordon J elided the question what is required to extinguish a debt and the question whether the payment is received from the company.[78]

94 Thirdly, Brereton J held that Gordon J had not addressed that latter question. However, the decision could be reconciled with *Re Emanuel* because it could be inferred that, in *Burness*, the transfer of the business to the new company included an undertaking by the new company to pay the insolvent company's debts. As such, the payments to the creditor were of money to the benefit of which the debtor company was legally entitled and the creditor could be said to have received that benefit from the insolvent company.[79]

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77 Ibid [33], [37].

78 Ibid [40].

79 Ibid [43].

95 Brereton J concluded:

> In those circumstances, although it may well be that the payments by Built had the effect of discharging Evolvebuilt's indebtedness – either because Evolvebuilt assented to them, or because the liquidators subsequently did so – it does not follow that they were made by or received from Evolvebuilt. The payments were made out of Built's assets, and not out of any asset to the benefit of which Evolvebuilt was otherwise entitled. Thus they were made by, and received by the defendants from, Built and not Evolvebuilt. This is so, even if making the payment gave Built some right to restitution against Evolvebuilt. If it were otherwise, then the satisfaction of a creditor's debt by the debtor's guarantor would constitute a payment on behalf of the debtor and be liable to be avoided as a preference.
>
> Such a result is entirely consistent with the policy and purpose of the preference provisions. The effect on Evolvebuilt's position – and that of the general body of its unsecured creditors – is at worst neutral. While it is known that Built has lodged a proof in the liquidation, the evidence does not reveal whether it includes the amounts paid to the defendants. At the highest, Built may have acquired a restitutionary claim against Evolvebuilt for the amount it paid to discharge Evolvebuilt's debts, but that claim would not exceed the debts which it discharged. If Built did not acquire a restitutionary claim, then the result is positive.
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> To set aside the impugned payments and order their 'repayment' to the company, which had never been entitled to them, would confer on the company and the general body of unsecured creditors a windfall which they would not have received had Built not chosen – unconstrained by any legal obligation to do so – to make them. This feature is not present in any of the cases on which the liquidators rely.
>
> In my view, therefore, it cannot be said in any sensible way that the impugned payments … were received from, or made by, Evolvebuilt. They therefore do not fall within s 588FA(1), or s 588FF(1)(a).[80]

96 The analysis of Brereton J can be reduced to this, for present purposes. Gordon J in *Burness* did not address the question whether the payment was received from the company. It can be inferred, for the same reasons as in *Re Emanuel*, that it was. The analysis of Gordon J regarding direction, authorisation and ratification bears only on the question whether the debtor is a party to the transaction, and not on the 'from the company' question.

97 In our view, these observations are correct. They are borne out by the fact that the relevant discussion in Gordon J's reasons appears in paragraphs leading to her

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[80] Ibid [51]–[54].

conclusion under s 588FA(1)(a), before she turns to s 588FA(1)(b).[81]

98 The decision of Brereton J was the subject of an appeal, in *Hosking v Extend N Build Pty Ltd*.[82] Bathurst CJ, with whom Beazley P and Gleeson JA agreed, found that the liquidator had not established that Evolvebuilt was a party to the transaction as a result of which the head contractor made the payments. In light of that finding, the 'from the company' issue did not arise. Bathurst CJ concluded:

> In these circumstances, it is not necessary to consider whether a creditor receives 'from the company' a payment in respect of an unsecured debt for the purposes of s 588FA(1)(b) where, as part of a 'transaction', the payment is received from a third party and the debtor company authorised or acquiesced in the payment being made on its behalf so as to give rise to a 'restitutionary' claim against it in favour of the third party. I am inclined to the view that, if the 'restitutionary' claim resulted from a 'transaction' to which the debtor company was a party, then the payment could be said to have been received 'from the company'. This is consistent with the reasoning of Gordon J expressed in *Burness* at [46]-[47]. However, it is unnecessary to reach a final conclusion on this issue or on whether Built would have such a 'restitutionary' claim in the present case. Nor is it necessary to determine the question left open by the Full Court in *Kassem* at [59] of whether it is necessary for there to be a diminution in the debtor company's assets for a transaction to constitute an 'unfair preference' under s 588FA(1).[83]

Parties' submissions

99 Against that background, the submissions of the parties can be stated relatively briefly.

100 The applicants submitted that, in accordance with *Burness*, it was sufficient to establish a payment from Eliana that Eliana had authorised or acquiesced in the payment made by Rock to Mad Brothers. Gordon J held that this sufficed to give rise to a restitutionary claim against the debtor company. It was said that the judge had found that there was the necessary authorisation or acquiescence,[84] and that this was plain, in any event, from Mr Sowiha's evidence that he had arranged the payment so

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81 *Burness* (2009) 259 ALR 339, 348 [48].

82 (2018) 357 ALR 795; [2018] NSWCA 149.

83 Ibid 822 [111].

84 Reasons [78], [79].

as to avoid Eliana being wound up.

101 The applicants submitted that *Evolvebuilt* was distinguishable because it involved a true third party payment that had not been initiated, approved or ratified by the debtor company. However, it was further submitted that Brereton J had erred in placing weight on the question whether there had been a disposition of the company's assets. The policy underlying s 588FA was said to be to ensure the equal treatment of creditors, not to avoid the disposal of assets of the company. The latter was said to be the policy underlying different provisions, directed to uncommercial and fraudulent transactions and voidable settlements.

102 The trial judge was said to have fallen into the same error by finding that setting aside the present payment would amount to a windfall gain to creditors. This consideration was said to be irrelevant to s 588FA.[85] On the same basis, the fact that there was an effective substitution of creditors (Rock taking the place of Mad Brothers) was also irrelevant. The applicants submitted that, for the same reason, a payment made by a company to one of its creditors, funded by increasing its bank overdraft, could be an unfair preference even though that creditor was replaced as creditor by the bank, to the extent of the payment. Likewise, the making of any payment to a creditor from the assets of the company will be offset by a corresponding reduction in the company's liabilities. This confirms that s 588FA is not directed to preventing the diminution of the company's assets and does not require proof of such diminution.

103 The applicants contended that the observation of Bathurst CJ in *Hosking* leant support to their case and cast doubt on the reasoning of Brereton J. They also relied on the following passage in the reasons of the High Court in *G & M Aldridge*:

> even if, as is the case in the present matters, a payment is made by the company, the question is not whether the payment was 'at the expense of other general creditors'. The question is whether the payment gave the

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[85] Reasons [48].

recipient a preference, priority or advantage.[86]

104 For these reasons, the applicants submitted, the judge was in error in finding that the question whether there was an unfair preference turned on whether Rock owed money to Eliana. That was not a necessary step along the path to the conclusion that the money was a payment from Eliana. The reasoning in *Burness* offered an alternative path. When that path was taken, the question whether there had been a diminution in Eliana's assets was a distraction.

105 The respondent submitted that the applicants had run their case at trial on the basis that Rock had owed money to Eliana and that Eliana had directed Rock to pay Mad Brothers, in partial reduction of Rock's debt to Eliana. There was no evidence that Eliana had directed, requested or authorised the payment by Nationwide. The pleaded case was that Eliana's authority was to be inferred. However, Mr Sowiha gave evidence that Nationwide insisted that the payment be made to Mad Brothers directly. The respondent submitted that Eliana was not a party to the transaction between Rock and Nationwide, and no specific loan was alleged between Rock and Eliana. The judge did not find that a debtor/creditor relationship between Rock and Eliana was essential to there being an unfair preference. He was simply addressing Eliana's case as it was run.

106 The respondent submitted that the reasoning of Gordon J in *Burness* did not assist the applicants. If Eliana was not a party to the transaction between Rock and Nationwide, it was unnecessary to decide whether Rock had a claim in restitution against Eliana. In any event, no such claim had ever been made in the present case. The existence of such a claim would still not address the difficulty for the applicants that the payment needed to be 'from' Eliana. To the contrary, if Rock had a claim against Eliana, that showed that the payment was made by Rock, not by Eliana.

107 The respondent submitted that the payment was not made from Eliana's

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86 (2001) 203 CLR 662, 672 [22] (Gleeson CJ, Gaudron, Gummow, Hayne and Callinan JJ) (citations omitted).

assets and Mad Brothers did not receive any money from Eliana. In deciding whether there had been a payment from the debtor company, it was necessary, or at least relevant, to ask whether the assets of the company had been diminished. As a matter of logic, it was said, money cannot be said to have come from someone unless there had been a diminution in that person's assets. But the judge did no more than take this into account in considering whether the payment was received from Eliana.

Analysis

108 In considering what is required in order to be able to identify a payment as having been received 'from' an insolvent company, it is necessary to start with the text of s 588FA itself. The requirement is that something be 'received from the company'. This is similar to the former requirement that the payment (etc) be made 'by' the company. But there is a difference. The making of a payment 'by' someone connotes agency. Asking whether a payment is made by a person involves identifying the actor responsible for the payment. In contrast, receiving a payment 'from' somebody connotes a movement or transfer. Asking whether a payment is received from a person involves identifying the source of the payment.

109 This tends to suggest that s 588FA requires that the payment be received from the company's assets. But in any event, it is quite clear from the 'ultimate effect' doctrine and the authorities that the previous provisions were seen as requiring that a payment, in order to amount to a preference, be made from the company's own money, and not simply be 'made by' the company. So much was clear from *Airservices* even before it was expressly decided in *Sheahan*. In the light of that history, it would be surprising if the change in language from 'by' to 'from' were thought to have discarded the requirement that the payment be from the company's own money. To the contrary, this Court's decisions in *VR Dye* and *McKern* are authority for the proposition that the introduction of the present regime was not intended to effect fundamental change. This history strongly suggests that the words 'from the company' are intended to convey that the payment be made out of moneys or assets to which the company is entitled.

110 That conclusion is also supported by the scope of relief available in s 588FF. The section does not provide for orders that a person pay money or transfer property to a third person, only to the company itself. If s 588FA were thought to permit a payment made by a third person, other than from the company's assets, to be classed as an unfair preference, it would have been expected that corresponding relief, in the form of an order that the payment be restored to the third person, would have been provided for in s 588FF. Conversely, it would be perverse to order that money belonging to a third person be paid to the company. That would not undo the unfair preference, but provide for a windfall to creditors at the expense of the third party.

111 In our view, the applicants' reliance on the different purposes served by various voidable disposition provisions does not assist them. It may readily be accepted that the purpose of s 588FA, unlike related provisions, is to ensure that creditors share rateably in such property of the company as is available for distribution on a winding up. The fact that other provisions have the purpose of ensuring that this property is not dissipated does not mean that s 588FA treats dissipation of the assets available to creditors as irrelevant, or that such dissipation is not a necessary aspect of the unfair treatment at which s 588FA is directed.

112 The applicants also submitted that transactions that are plainly unfair preferences may involve no diminution in the company's net assets, but merely the substitution of one creditor for another. The paying of a creditor using company funds drawn down from a bank overdraft was given as an example. It is true that such a transaction may leave the company's balance sheet unchanged. At least where the overdraft is secured, however, the transaction will result in a diminution of the assets available to unsecured creditors, replacing an unsecured creditor with a secured one. In cases where the loan is not secured, it might be debated whether the payment is anything more than a rearrangement among creditors, whose treatment remains equal among themselves. After all, every payment by a company to a creditor has the effect of reducing the company's liabilities and can therefore be said to cause no net diminution in assets. Partial payment in return for forgiveness of a

debt will cause an increase in net assets. Yet either could constitute a preference. Consideration of the net asset position is therefore a distraction. The more pertinent issue is whether the assets available for distribution among creditors have been reduced. It is unnecessary and undesirable to attempt to say more about hypothetical analogies.

113 The applicants placed reliance on the decision of the Supreme Court of New Zealand in *Robt Jones Holdings Ltd v McCullagh*.[87] In particular, the Court held in that case that, because s 292(2) of the *Companies Act 1993* (NZ) reflected the policy intention of creditor equality and s 296 provided protection for creditors acting in good faith, it was 'unnecessary to also have as a restraint on the scope of the voidable transactions regime a requirement that, in order to trigger the avoidance power, there must be a diminution in the assets available to creditors'.[88] However, the statutory regime in New Zealand is relevantly different. Section 292(1) provides that 'insolvent transactions' entered into during a specified period are voidable. A 'transaction' means certain steps taken 'by the company'. An 'insolvent transaction' is defined in s 292(2) as a transaction by a company entered into when the company is unable to pay its debts and which 'enables another person to receive more towards the satisfaction of a debt owed by the company than the person would receive' in the company's liquidation. The critical words 'receiving from the company' are absent. The position in New Zealand therefore does not assist in addressing the present issue.

114 While s 588FA, for the above reasons, retains the need for a payment to have been received from money or other assets to which the company is entitled, comparison with its predecessors reveals that it differs in a related respect. The omission of the requirement that the payment be made 'by' the company means that some of the analysis in previous cases may no longer be applicable. (As we have

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87 [2019] NZSC 86.

88 Ibid [64] (Glazebrook, O'Regan, Ellen France, Arnold and Kós JJ).

noted already, the expression 'given by a company' in the opening words of s 588FA(1) is descriptive and does not form part of the defining criteria.)

115 With this understanding of what is conveyed by 'receiving from the company', it is useful to return briefly to the main authorities in order to consider the significance of an authorisation by the company to a third party to make a payment. The cases of direction, in which a company directs the payment of moneys to which it is entitled, can be put to one side. Such moneys are plainly received from the company because they are moneys to which the company is entitled and the benefit of which is received by the creditor from the company, by its direction.

116 Several points may be made about the cases already referred to. First, the observations in *Ramsay* which were queried in *Re Emanuel* but endorsed in *Sheahan* were directed to the inquiry whether a payment was 'made by' the company, which is no longer the statutory expression. There is therefore no need to decide whether the criticism in *Re Emanuel*, which (unlike both *Ramsay* and *Sheahan*) was a case decided under s 588FA, were apt. Nor, for the same reason, does it matter that Gordon J did not refer to *Ramsay*.

117 Secondly, the pertinent discussion in the judgment of Gordon J in *Burness* appears in a section of the reasons addressing the 'transaction' question in s 588FA(1)(a), the issue having been defined as 'what is the conduct or dealing engaged in by [the debtor company] which effected a change in the rights, liabilities or property' of the company.[89] That formulation, while confirming the need for the transaction to affect the assets of the company, looks to the role played by the company by which it might be concluded that it was a party to the relevant transaction. The reasons are not directed to the 'from' the company question, and that issue is not mentioned.

118 In that context, the judge's consideration of whether the company's debt was

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[89] *Burness* (2009) 259 ALR 339, 345 [37].

discharged by the dealing is confined to asking what actions by a company will have that effect. Nothing is said as to the separate question, arising under s 588FA(1)(b), whether the payment is from the company. Accordingly, when Gordon J states that, when the debtor authorises the payment, 'nothing more is required', she is saying that the company is a party to the transaction. This is made clear by the immediately following sentence: 'The debt is discharged by the third party at the request of or with the acceptance of the debtor'.[90] Consistently with this understanding, Gordon J states subsequently that: '[a]ll that has been established is that a debt … has been discharged and that … a payment was made to the defendant under s 588FA(1)(a).'[91]

119 Thirdly, to the extent that Brereton J in *Evolvebuilt* stated that Gordon J 'elided' what is required for a third party payment to discharge a debt with whether it can be said that the payment is made by the debtor (taking that to mean 'from' the debtor in this context), we respectfully disagree, for the above reasons.[92] Gordon J did not need to consider the 'from the company' issue. It also follows that, to the extent to which the New South Wales Court of Appeal considered, albeit tentatively, that Gordon J's reasoning supported a wider view of 'from the company', we again respectfully disagree, for the above reasons.[93]

120 Our conclusions can be stated as follows:

(a) The words 'given by a company' in s 588FA(1) do not form part of the definition of an unfair preference. They are descriptive of the position when the elements of the definition in paragraphs (a) and (b) are met.

(b) A company may be a party to a transaction for the purposes of s 588FA(1)(a) as a result of giving a third party a direction as to the making of a payment to

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90 Ibid 348 [45].

91 Ibid 348 [48].

92 *Evolvebuilt* [2017] NSWSC 901 [41].

93 *Hosking* (2018) 357 ALR 795, 822 [111] (Bathurst CJ, Beazley P and Gleeson JA agreeing at [123] and [124]).

a creditor, or by authorising or ratifying such a payment. However, this does not necessarily mean that the payment is received 'from the company'.

(c) The words 'from the company' in s 588FA(1)(b) have the effect of retaining the requirement under the previous law that the preference be received from the company's own money, meaning money or assets to which the company is entitled.

(d) It is necessary, in order for a preference to be 'from the company' that the receipt of it by the creditor has the effect of diminishing the assets of the company available to creditors.

(e) On the other hand, a payment by a third party which does not have the effect of diminishing the assets of the company available to creditors is not a payment received 'from the company' and is therefore not an unfair preference.

Conclusion as to grounds 1 and 3

121 The foregoing analysis is broadly to the same effect as that of the judge in the present case. The judge found that here had been no diminution in Eliana's assets as a result of the transaction. Bearing in mind that the judge had also declined to find that Rock was a debtor of Eliana, this sufficed to uphold the appeal.

122 For these reasons, we reject grounds 1 and 3. The existence or otherwise of a debtor/creditor relationship between Rock and Eliana was a matter of significance, and the diminution in assets point was critical.

Ground 2 — Was Rock indebted to Eliana?

123 It is then necessary to consider whether the judge erred in finding that it had not been shown that Rock was indebted to Eliana. Such indebtedness would, of course, have meant that the payment made by Rock reduced its debt to Eliana and gave Mad Brothers the benefit of moneys to which Eliana was entitled. The payment

would therefore have reduced the value of the asset constituted by the debt and amounted to a payment from Eliana.

124 The applicants' case under this proposed ground depended on the obligations said to have arisen from the project involving Eliana, Rock and Sentosa. The applicants pointed to evidence that Eliana had been engaged as the builder in a joint venture between Rock and Sentosa in April 2014, and was owed unpaid progress payments for that work. Sentosa had deducted $600,000 from the first payment made to Eliana to offset an unpaid equity payment due from Rock to Sentosa. In this context, it was said that Eliana, through Mr Sowiha, directed Rock to make the $220,000 payment to Mad Brothers and Eliana recorded that payment in its general ledger against Rock's loan account.

125 The respondent submitted that the liquidator gave evidence that Eliana's accounts were incomplete and not properly reconciled, and accurate accounts could not be produced. This was partly because a number of related entities including Rock used Eliana's bank account. In addition, Eliana's general ledger showed Rock as a creditor, not a debtor, of Eliana at the time of the $220,000 payment. It submitted that the judge had rightly found that a letter from Sentosa's lawyers, in which Rock's obligation to pay $600,000 to Sentosa was alleged, did not establish that Rock was indebted to Eliana. The letter in fact recorded that the joint venturers denied owing any money to Eliana. The letter referred to offsetting claims. Further, the entitlement of Eliana to progress claims under the contract was contested and the liquidator had stated that he had not examined the progress payment claims.

126 In our view, this ground is not made out. The solicitor's letter upon which the applicants rely afforded some evidence that Eliana had foregone part of a progress payment in order to fund Rock's outstanding equity contribution of $600,000. However, Eliana's general ledger showed Eliana as having been indebted to Rock, not the other way around. Although the liquidator gave evidence that he considered the ledger to be incomplete and that he considered Rock to be a debtor rather than a creditor, principally on the basis of progress payment claims due under the Sentosa

joint venture contract, he conceded that it was difficult to be definitive of Eliana's financial position at any point of time due to the incomplete and inaccurate state of its books and records. The liquidator had not looked into the $600,000 claim but relied on the solicitor's letter.

127 The judge held that the evidence was inadequate to establish the claimed indebtedness on the part of Rock, and emphasised that the solicitor's letter also disputed that the joint venture owed anything to Eliana. The basis for this was that extensive offsetting claims were made by the joint venturers against Eliana. The liquidator had not investigated these claims. They were larger in amount than the claimed unpaid progress payments.

128 In our opinion the applicants failed to establish that Rock was indebted to Eliana in the manner claimed. Assuming that the solicitor's letter was accepted as evidencing the creation of a debt in the amount of $600,000, more was required to show that the debt remained outstanding when the $220,000 payment was made. The company's records did not support such a conclusion. They suggested that Eliana was in debt to Rock. The liquidator had not investigated the $600,000 debt, but relied on the letter. Nor had he evaluated the strength of the offsetting claims. Accordingly, even if the outstanding progress payment claims were taken into account, it had not been shown that they would not themselves be offset. In our view, the evidence fell short of showing that Rock was indebted to Eliana at the time of the contested payment.

129 We therefore reject ground 2.

Ground 4 — Undisclosed principal

130 The above conclusions mean that the appeal must be dismissed. It is desirable, however, to address the remaining grounds.

131 The judge held that, even if the payment made by Nationwide to Mad Brothers was properly characterised as an unfair preference on the basis contended

for in the first three grounds, Rock was an undisclosed principal of Eliana in respect of part of the debt to Mad Brothers, reflecting the value to Rock of work done by Mad Brothers on the Taylor's Hill site ($87,256.15). To that extent, the judge held, the payment could not be a preference in any event.

132 The applicants submitted that the associate judge had been correct to take the opposite view. He had observed that there was no building contract between Rock, which owned the Taylors Hill land, and Eliana, and that the relevant invoices were directed to Eliana. The associate judge regarded the agency claim as 'mere assertion'.[94] The applicants said that, in any event, even if Rock initially incurred the debt as an undisclosed principal for Eliana, the settlement agreement still created a debt between Eliana and Mad Brothers, independently of Rock.

133 The respondent submitted that the trial judge's finding was open on the evidence. It said that the alternative submission of the applicants had not been made before the judge and should not now be permitted. In any event, Rock's primary indebtedness was said not to merge in the settlement agreement.

134 We would not uphold this ground. Rock owned the Taylor's Hill land and obtained the benefit of the work done by Mad Brothers on it. There was no building contract, which might have shown that Eliana had commissioned the work on its own account. Eliana operated a bank account which was also used by Rock. In the circumstances, it was open to the judge to infer that, although Eliana was billed for the work, the undisclosed principal was Rock, as owner of the land. As such, had Eliana paid the debt, it would have done so on behalf of Rock.

135 The judge did not address, because it was not raised, the relevance of the fact that the deed of settlement intervened before the payment was made. The applicants now contend that, in any event, Eliana was indebted to Mad Brothers by virtue of the deed of settlement, and it is that obligation, rather than any debt owing by Rock, that

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94 Associate Judge's Reasons [59]–[60].

was paid. But the interposition of the deed does not necessarily make any debt owing by Rock irrelevant. That depends on whether Eliana entered into or performed the settlement agreement entirely on its own account. Those were issues that, had they been raised at trial, could have been the subject of evidence. In particular, evidence could have been led as to whether in entering into and/or performing the settlement agreement, Eliana was acting, to the extent of the debt arising from work on the Taylor's Hill site, as agent for Rock as undisclosed principal. The answer to that question would also have borne on the question what rights and obligations survived the settlement agreement. We would therefore not permit the applicants to advance this argument for the first time on appeal.

Ground 5 — Good faith defence

136 Finally, the applicants contend that, if the payment had constituted a preference, the judge was in error in upholding the 'good faith' defence under s 588FG(2). In particular, it was submitted that the judge misapplied the requirement in s 588FG(2)(b)(ii) that a reasonable person in Mad Brothers' circumstances would have had no grounds for suspecting that Eliana was insolvent at the time of the payment. The judge had found that a reasonable person 'could conclude that Mr Sowiha was deciding not to pay, rather than that he could not pay', and 'could conclude that Eliana had access to fairly significant funds, and that persons … providing these funds were satisfied as to Eliana's … ability to repay'.[95]

137 The applicants submitted that, when the correct test was applied, the circumstances known to Mad Brothers were grounds for a reasonable person to suspect Eliana's insolvency. Eliana's debts to Mad Brothers were well overdue when the statutory demand was served, Mad Brothers had been chasing payment for some time despite Eliana having made offers to pay by instalments and promises to pay, the statutory demand expired without payment, and, when Mad Brothers pursued winding up proceedings, it learnt of the WorkCover application and the fact that it

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95 Reasons [123].

was supported by several other creditors.

138 The respondent submitted that Eliana produced extensive evidence in the winding up proceeding to demonstrate that Eliana was solvent and explaining how it had come not to act to set aside the statutory demand. The financial controller of Mad Brothers and one if its directors had formed the view that Eliana was solvent, based on their knowledge of matters including Eliana's success in having caveats removed from several properties, documents relating to forthcoming finance and the material filed in the winding up proceeding. The judge had made an affirmative finding that a reasonable person could conclude that Eliana was solvent, which went beyond what the section requires.

Applicable principles

139 As the judge observed,[96] s 588FG(2) was recently considered by the Court of Appeal of Western Australia in *White v ACN 153 152 731 Pty Ltd (in liq)*.[97] More recently still, the statements in *White* were approved by the Queensland Court of Appeal in *Queensland Quarry Group Pty Ltd (in liq) v Cosgrove*.[98]

140 In *Cosgrove*, Morrison JA (with whom Philippides JA and Flanagan J agreed) stated:

> To succeed on the defence the onus is on the creditor … to prove both elements of subsections (b)(i) and (ii). The two subsections impose different tests. Section 588FG(2)(b)(i) imposes a hybrid test, which necessitates consideration of whether the particular creditor had grounds for suspecting insolvency. That is a subjective test, but the requirement that the grounds be 'reasonable grounds' means that the question whether the grounds are reasonable is determined objectively.
>
> By contrast, s 588FG(2)(b)(ii) imposes an objective test, to be determined by reference to the knowledge and experience of an average person in the circumstances of the particular creditor.

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96 Reasons [94].

97 (2018) 53 WAR 234, 238 [116], 259–60 [120]–[122], 261 [126] (Murphy and Mitchell JJA and Allanson AJA) ('*White*').

98 [2019] QCA 220 [13] (Morrison JA, Philippides JA and Flanagan J agreeing at [84] and [85]) ('*Cosgrove*').

The difference in the tests was succinctly expressed in *White v ACN 153 152 731 Pty Ltd (in liq)*:

> Accordingly, the question raised by the first limb is whether the facts and matters actually appreciated by 'the person', ie, the particular creditor, were sufficient to induce a suspicion as to insolvency in the mind of a reasonable person. The question raised by the second limb is whether the facts and matters which would have been appreciated by a hypothetical person with the knowledge and experience of the average business person in the creditor's circumstances, were sufficient to induce a suspicion as to insolvency in such a hypothetical person. In each case, the negative must be proved by the creditor.

Ultimately what is required to be shown to establish the defence under s 588FG(2) is that there were 'no reasonable grounds for suspecting' insolvency. That means that the creditor has to establish a negative, recognised by authority as a substantial task, namely that the matters appreciated by that creditor were insufficient to induce a suspicion of insolvency.[99]

141 In relation to the objective aspect of the test, the Court in *White* referred to the decision of the New South Wales Court of Appeal in *Cussen v Federal Commissioner of Taxation*[100] and concluded in respect of s 588FG(2)(b)(ii):

> The following propositions may be drawn from that case:
>
> 1. The words 'in the person's circumstances' refer to the actual circumstances as they exist at the time they entered into the relevant transaction, and denote external, objective factors or circumstances rather than factors personal to the person concerned, such as their particular perspicacity, financial acumen and the like.
>
> 2. The reference to whether a 'reasonable person' in the person's circumstances 'would have had' reasonable grounds for suspecting that the company was insolvent is a reference to the 'reasonable person's' assessment of the information in fact in the possession of the creditor.
>
> 3. In this context, the information in the possession of the creditor includes the fact (if it be the fact) of the absence of enquiries, but not information which a 'reasonable person' would theoretically have obtained had enquiries been made and responded to.
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> 4. The test is an objective test, and the standard of measurement is that of a hypothetical person who is assumed to have the knowledge and experience of the 'average business person'. It does not require an examination of whether the particular creditor, with their skills,

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99 Ibid [11]–[14] (citations omitted).

100 (2004) 57 ATR 499; [2004] NSWCA 383.

> training and experience, acting reasonably, would have had reasonable grounds for suspecting insolvency.
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> We would respectfully accept, and adopt, those propositions as to the proper construction of s 588FG(2)(b)(ii). In relation to proposition 1, we would add that the objective circumstances may include the nature and practices of the industry in which the relevant transactions occurred, insofar as they are established as objective matters of fact, but not merely the particular creditor's subjective views as to the operation of the industry and its practices.[101]

142 The Court in *White* also adopted the following passage from the judgment of Kitto J in *Queensland Bacon Pty Ltd v Rees*[102] as to the meaning of 'suspecting' in this context:

> A suspicion that something exists is more than a mere idle wondering whether it exists or not; it is a positive feeling of actual apprehension or mistrust, amounting to a 'slight opinion, but without sufficient evidence' …[103]

Error of law argument

143 In our view, the judge's references to what a reasonable person 'could' conclude as to solvency must be read in context. The judge concluded, after reviewing the evidence:

> I consider that the appellant has established that the facts and matters which were actually appreciated by Mr Maddalon and Ms Haddrell [on behalf of Mad Brothers] were insufficient to induce a suspicion as to insolvency in the mind of a reasonable person. A reasonable person could conclude that Mr Sowiha was deciding not to pay, rather than that he could not pay. A reasonable person could conclude that Eliana had access to fairly significant funds, and that persons or entities providing those funds were satisfied as to Eliana's (or its director's or related entity's) ability to repay those loans. A reasonable person would tend to believe the contents of documents which have been filed in this court. A reasonable person inexperienced in questions of solvency and insolvency would rely on legal advice from their advisors as to the adequacy of material filed by the other party.
>
> Were there any other facts or matters which a hypothetical, reasonable business person in Mad Brothers' position would have appreciated that Mad Brothers did not?
>
> Eliana and the associate justice refer to the WorkCover winding-up application, which was also on foot against Eliana as a matter which should

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101 *White* (2018) 53 WAR 234, 260 [123]–[124] (citations omitted).

102 (1966) 115 CLR 266.

103 Ibid 303.

> have induced suspicion. While the fact of this other proceeding was not subjectively appreciated by Mad Brothers (or by its individual representatives), it is a matter which a hypothetical, reasonable person would have appreciated.
>
> … In my view, the fact of the WorkCover winding-up application, when considered together with its dismissal some two months prior to Mad Brothers receiving payment, is not a matter sufficient to induce a suspicion as to insolvency in a reasonable person.
>
> I conclude that Mad Brothers has established that *the facts and matters which subsisted* at the time it received payment from Eliana *fell short of being capable of establishing a positive apprehension of actual insolvency in the mind of a reasonable person*. The associate justice should therefore have found that Mad Brothers made out a defence under s 588FG(2). By operation of that section, the Court could not make any order materially prejudicing Mad Brothers' rights or interests.[104]

144 It may be noted that the references upon which the applicants fasten were made in the context of applying s 588FG(2)(b)(i), the 'subjective' or 'hybrid' limb of the inquiry. The applicants do not challenge the judge's conclusion in relation to that limb, but contend, in effect, that the alleged errors infect the analysis under the second, 'objective', limb.

145 The last paragraph in the extract from the judge's reasons set out above encompasses a conclusion as to both limbs of the test, reached after setting out the legal principles in terms to which no objection is taken. In our view, it is clear that the judge's references to what a reasonable person 'could' have concluded as to certain factual matters were not applications of an incorrect test, but findings made along the way to applying the correct test, as reflected in the words we have emphasised above.

Evidence as to solvency

146 The applicants next submitted that, even if the judge applied the correct test, he reached the wrong decision on the facts of the case and that the suspicion of insolvency in the case was overwhelming. In that regard, it is convenient to start with a preliminary matter. The applicants take issue with the judge's finding that

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104 Reasons [123]–[127] (emphasis added) (citations omitted); see also [93].

the hypothetical reasonable person would only have known about the existence of the WorkCover application and not that there were a number of supporting creditors. The applicants point to the identification of supporting creditors on an order dated 29 June 2016 which was on the file in the WorkCover winding up proceeding. However, as the judge correctly observed, it is not appropriate to take account of information which a reasonable person might have obtained had inquiries been made; the test looks to how a reasonable person would have assessed the information in fact in the possession of Mad Brothers. There was no evidence that Mad Brothers knew of this order. In any event, the order referred also to the fact that terms of settlement were to be drawn up between WorkCover, Eliana and 'certain other of the appearing creditors appearing today'. Knowledge of the order therefore might well have operated to alleviate suspicion as to Eliana's insolvency.

147 It is necessary to describe at greater length the evidence as to the state of knowledge of Mad Brothers. As to its knowledge as at the time of the making of the payment, Mad Brothers relied primarily on the evidence of Ms Susan Haddrell, its financial controller, and Mr Anthony Maddalon, a director.

148 The evidence was that the amount claimed by Mad Brothers in its statutory demand dated 26 April 2016 consisted of monies said to be owing from invoices issued between 26 November 2015 and 24 February 2016, less a payment of $80,000 made on 10 March 2016, making a total claim of $236,952.31.

149 In January 2016, Mr Sowiha was disputing the rates charged by Mad Brothers. However, on 18 January 2016, he agreed to pay the amount claimed. From this time until around March 2016, Ms Haddrell contacted Eliana approximately weekly and received assurances that the disputed amount would be paid.

150 On 30 March 2016, Eliana offered to pay the full amount claimed by way of instalments. Mad Brothers accepted this offer, but on 8 April 2016 Eliana claimed that the true amount owing was $156,952.31, because $80,000 had already been paid. Mad Brothers contested this, pointing out that this payment had already been

accounted for, but received no reply. In the end, the statutory demand was made on 26 April 2016. Ms Haddrell and Mr Maddalon gave evidence that they took this course, rather than instigating proceedings to recover the claimed amount, on the advice of their solicitors that the issuing of a statutory demand would be a simpler procedure.

151 Ms Haddrell swore an affidavit in support of the application for winding up which was ultimately made on or about 8 June 2016. She exhibited to that affidavit an ASIC search which disclosed that an application had been made to wind Eliana up on 30 May 2016. The search did not reveal the identity of WorkCover as the party making the application. Ms Haddrell gave evidence that, although she saw the search, she had not understood this aspect of it. She stated that she had not known about WorkCover's application until after the liquidation had commenced.

152 After the winding up proceeding was commenced, Mad Brothers received on 6 July 2016 notice of an application commenced by Eliana in the Victorian Civil and Administrative Tribunal ('VCAT') in which Eliana claimed, in a single short paragraph, that the disputed work was priced at $55,000 to $65,000 but that Mad Brothers had overcharged it and that the works performed were worth only the $80,000 which Eliana had already paid.

153 The winding up proceeding was listed for hearing on 20 July 2016. Before that time, the solicitors for Mad Brothers lodged a notice of application for winding up orders. No creditor of Eliana applied to be substituted as a supporting creditor in the winding up proceeding.

154 Ms Haddrell and Mr Maddalon referred in their evidence to the affidavits relied upon by Eliana in the winding up proceeding. First, on 20 July 2016, Mr Sowiha deposed that either he or Eliana were the registered proprietors of over 17 different properties, and a company had lodged a caveat over the properties which had severely impacted on Eliana's financing arrangements and its capacity to pay the debt said to be due to Mad Brothers. Mr Sowiha said that Eliana had

commenced proceedings for removal of the caveat and that the matter was due to be heard on 27 July 2016.

155 In his second affidavit, sworn 17 August 2016, Mr Sowiha stated that the caveat had been ordered to be removed and that he had arranged for this to happen so that he could proceed to enter into the financial arrangements which had previously been hindered by the caveat. He stated that he had been informed by his financial consultants that settlement of the mortgages would take place within two to three weeks. Mr Sowiha exhibited documents showing that he had entered into mortgages in the total amount of more than $4.2 million.[105]

156 On 23 August 2016, Eliana filed a further affidavit of Mr Sowiha sworn on that date which was said to be made in support of proving the solvency of Eliana. In that affidavit, Mr Sowiha deposed to the circumstances which it was said had led to the inadvertent failure of Eliana to seek to have the statutory demand set aside. Mr Sowiha said that there was a genuine dispute as to the debt, based on the method by which Mad Brothers had calculated its invoiced charges. He asked that Eliana be permitted to pay the funds in dispute into court pending the outcome of the VCAT hearing.

157 Eliana also relied on an affidavit sworn by Mr Mokbell Gendy on 23 August 2016. Mr Gendy deposed to being the accountant for Eliana since 2000. He said that he had prepared its tax returns since about 2000. He said that Eliana had traded at a profit in each of the financial years ending 30 June 2013, 2014 and 2015. He said that its total assets comprised significant real estate in the amount of $37,224,000 and that its '[t]otal liabilities comprising amounts required to satisfy compromised litigation and alleged defective building disputes' were $236,952.31. It may be noted at this point that this indicates that the dispute with Mad Brothers was Eliana's only defective building dispute. Mr Gendy said nothing as to other disputes. However, in their affidavits, both Ms Haddrell and Mr Maddalon described Mr Gendy's

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105 This Court was not provided with those documents.

affidavit as having made this observation about 'business disputes'.[106]

158 Mr Gendy also deposed that Eliana had total borrowings representing a lending ratio of 45.98 per cent and net assets over liabilities, conservatively, of $20,108,360. He stated that a cash injection of more than $3 million was being organised and expected to be available by 30 August 2016. It was said that this 'will arrest outstanding amounts currently on [Eliana's] accounts'. By implication, therefore, Eliana required a substantial 'cash injection' to pay other creditors.[107] Mr Gendy went on to say that, in addition, 'continuing efforts are being made by [Eliana], and transactions underway, to procure further funds', exhibiting some mortgage documents.[108]

159 Mr Gendy exhibited copies of Eliana's tax returns and financial reports for each of the 2013, 2014 and 2015 financial years. Mr Gendy did not refer to the financial reports in his affidavit but they are described by Ms Haddrell and Mr Maddalon as having been exhibited to the affidavit. Each of the financial reports contained a declaration signed by Mr Sowiha to the effect that the financial statements fairly presented Eliana's financial position and that, in the directors' opinion, there were reasonable grounds to believe that Eliana would be able to pay its debts as and when they became due and payable.

160 Mr Gendy deposed that he considered Eliana to be 'stable and solvent'. He further stated that, having reviewed Eliana's overall financial position, he was 'confident' that it was solvent and able to satisfy its debts and responsibilities.

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106 They were not cross-examined about this inaccuracy, but this does not detract from its potential relevance to the objective test in s 588FG(2)(b)(ii).

107 Again, Ms Haddrell and Mr Maddalon did not refer to this statement and were not cross-examined about it.

108 We were not provided with those documents, but since Mr Sowiha's affidavit of the same date referred to no new transactions, it appears that they may have been those exhibited by Mr Sowiha in his affidavit sworn a week earlier. Ms Haddrell and Mr Maddalon also did not give evidence as to this statement.

Application of the principles

161 The associate judge recorded the parties' submissions as to these matters but did not make specific findings. He concluded as follows:

> Here the plaintiff made offers to pay by instalments, a statutory demand was served, a wind-up application was served, and there was at least one other creditor who had applied to wind-up the company. Those are important matters which must be taken into account. When there is a wind-up application on foot and a party accepts payment of the debt, it takes the risk that this payment could be found to be a preference. Here, it is clearly a preference. A reasonable business person would have no basis to believe Eliana was solvent in the circumstances of this case. The defendant has not discharged the onus to prove that it has a good faith defence.[109]

162 The judge held that the associate judge had erred by failing to have proper regard to the information provided to Mad Brothers and other events which occurred after the winding up proceedings were commenced. Consideration of these matters, the judge held, showed that the associate judge ought to have found that the defence was established.

163 The judge considered that the associate judge had found that Mad Brothers must have known that the material filed in the winding up proceeding was not sufficient to prove solvency, and that the accounts were not up to date or audited.[110] The judge rejected those findings. He observed that proving insolvency and dispelling a suspicion of insolvency in a reasonable business person are two different things which ought not be conflated. The judge continued:

> While I accept that the provision of older, unaudited accounts may, in some cases, be insufficient to dispel a suspicion of insolvency, in the circumstances of this case, I consider it was a relevant countervailing factor to the indicators of insolvency which had preceded it. As counsel for Mad Brothers submitted, company accounts can take some time to prepare and it was not unusual for 2015–2016 financial year accounts to not be finalised by September 2016. The accounts were not audited, but I do not consider that a reasonable business person (as opposed to an insolvency practitioner, financial expert or the Court) would consider this was reason enough to

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109 Associate Judge's Reasons [87].

110 The relevant paragraph of the associate judge's reasons ([86]), while expressed in unqualified terms, appears in a section where the submissions of Eliana are set out. But at least implicitly, that part of the paragraph appears to have reflected findings of the associate judge.

> reject their contents. Further, this material was provided relatively contemporaneously with other material which indicated that Eliana had current access to not insignificant funds.[111]

164 The question that arises in applying the test in s 588FG(2)(b)(ii) is whether, at the time of the payment, a reasonable person in Mad Brothers' circumstances would have had no grounds for suspecting that Eliana was insolvent. As explained above,[112] this requires reference to the reasonable person's assessment of the information in fact in the possession of the creditor, including their knowledge as to the enquiries that had been made but not information that would have been produced upon further enquiry. The onus rests on Mad Brothers to establish the absence of reasonable grounds for suspicion.

165 It is true that a person reading the affidavits which were served on Mad Brothers in the winding up proceeding would have seen that Mr Gendy, Eliana's long term accountant, believed the company to be solvent. But this was based on accounts more than a year old. As to more recent events, in the same affidavit Mr Gendy stated that a 'cash injection' which was being organised and 'expected' to be available by 30 August 2016 would 'arrest outstanding amounts currently on [Eliana's] accounts'. This indicated that there were substantial amounts outstanding to Eliana's creditors. Moreover, Mr Gendy's description of the purpose of the cash injection made it clear that it was necessary to 'arrest' the position regarding creditors and that the cash injection was the intended means of doing so. To the knowledge of Mad Brothers, one other creditor had commenced a winding up proceeding. By the date of the disputed payment to Mad Brothers, more than two weeks had passed and, despite then being paid, Mad Brothers had no confirmation that the expected cash injection had materialised. In our opinion, it is hard to see how a reasonable person could not have harboured an apprehension or mistrust about Eliana's solvency in those circumstances.

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111 Reasons [122] (citations omitted).

112 See [140]-[141] above.

166 The other evidence further fuels suspicion as to Eliana's insolvency. Not only were there two winding-up applications against Eliana within a few months of each other but, in respect of the debt to Mad Brothers, Eliana undertook to pay, then contested, the debt before proposing to pay it by instalments — before revising its offer by wrongly discounting the amount by $80,000 — then finally determining on an alternative strategy of seeking to challenge the debt in VCAT by a one paragraph claim seeking a declaration that the works performed by Eliana were only 'worth' the $80,000 which had been paid.

167 In our view, it cannot be said that a reasonable person, knowing the history of the matter, the overall conduct of Eliana and the circumstances revealed in the affidavits filed in the winding up proceeding, would not have suspected that Eliana was insolvent. Thus, if a preference had been proved, the good faith defence under s 588FG(2) would not have been established and we would have upheld this ground.

Conclusion

168 Leave to appeal should be granted, but the appeal must be dismissed.

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