fixed in relation to the actual costs of the services rendered with respect to the goods handled by the Board. On this basis, flat rate levies on producers, or levies based on considerations too remote from the cost of the services actually rendered with respect to each producer's goods, would not be described as ' payments for services rendered '. *Parton's* case for example could be distinguished from *Harper's* case on this ground since the levy in *Parton's* case was calculated, not only on the actual cost of servicing each distributor's milk, but also on the cost of promotion and advertising of milk for the purposes of the milk industry generally.

J. L. MERITY

## QUEENSLAND BACON PTY LIMITED v. REES[1]

*Bankruptcy—Avoidance of preferences—Protected transactions—Creditor ' had reason to suspect that debtor was unable to pay his debts as they became due '—Amount of preferential payment—Payments off running account—Bankruptcy Act* 1924-1960, *section* 95.

The ups and downs of the economic cycles cannot be mirrored by corresponding variations in the fundamental laws which lie at the base of modern commerce. This is true of the bankruptcy law. However, the decision of the High Court of Australia in *Queensland Bacon Pty Limited v. Rees* as to the operation of section 95 of the *Bankruptcy Act* 1924-1960 (Cth)[2] on the question of the avoidance of preferences, shows that the law is not entirely powerless to shift its ground in the face of economic upheaval. To some minds it might appear that the judicial interpretation of the majority (Barwick C.J. and Kitto J.; Menzies J. dissenting) provided a type of ' credit squeeze ' let-out from the full rigours of the bankruptcy provisions concerning this question.

*The Situation that Gives Rise to Reason to Suspect Insolvency*

The issues arose from the dealings in 1960 between an insolvent company and four of its trade creditors over a period of little under four months prior to the date of the presentation of the winding up petition. Each of the four trading relations involved running accounts and credit arrangements. In each of the financial dealings during the period of the four months prior to the petition, there had occurred the dishonouring of a cheque. Each of the payments which the liquidators sought to have set aside had been made after a cheque to the creditor concerned had previously been dishonoured. The dishonouring of the cheques gave rise to the chief problem in the case—whether, in the

[1] (1966) 40 A.L.J.R. 13. High Court of Australia; Barwick C.J., Kitto and Menzies JJ.

[2] The substantive provisions to be discussed have not been altered in the new bankruptcy legislation and they are contained in section 122 of the *Bankruptcy Act* 1966 (Cth).

circumstances, the creditors had 'reason to suspect that the debtor was unable to pay his debts as they became due' within the meaning of section 95 (4.). The determination of the correct construction of section 95 (4.) was crucial to the creditors who wished to use section 95 (2.) taken in conjunction with section 95 (4.) to show the inapplicability of section 95 (1.). But, as it was pointed out in *S. Richards & Co. Limited v. Lloyd*,[3] section 95 (4.) is in terms a prohibition that prevents a finding in a creditor's favour if its conditions are not satisfied. This prohibition is addressed to the court. In *Queensland Bacon Pty Limited v. Rees* the High Court was unable to agree as to the meaning of the situation that would give rise to this prohibition.

Barwick C.J. dealt with the legal aspect of the problem in his separate remarks on the Queensland Bacon payments. He noted two senses of the phrase 'to suspect a man's solvency':[4] in one sense to doubt whether he is solvent or insolvent; in another sense to suspect that he is in fact insolvent. He then declared that it is of the second suspicion that section 95 (4.) speaks. He continues:

> The whole structure of s. 95 is built round the fact of actual insolvency. It is only a payment made by an insolvent debtor which comes within the section, and it is the circumstances of such a payment which must give rise to the inference of knowledge of insolvency or of suspicion of it.[5]

In the proceedings before the Queensland Supreme Court, the judge at first instance, Gibbs J., had found that the company in liquidation had not in fact become insolvent until 1 November, 1960. In the cases of Burns Philp payments, the Egg Marketing Board payments and the Foley Bros payments any dishonour of cheques or arrangements between creditors and the insolvent company, which were relied on by the liquidator in his attempts to have the payments declared void, had occurred after 1 November, 1960. On the other hand, in the case of the Queensland Bacon payments, a cheque dated 10 October had been dishonoured on presentation and the payee was requested to present again in one week. Subsequently the cheque was re-presented and was paid on 22 October. The arrangements for the challenged payments had been made in the light of these events. Gibbs J. had considered that the pre-1 November dishonour had given the creditor the requisite 'reason to suspect'. Barwick C.J. did not agree with his Honour's conclusion and seized

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[3] (1933) 49 C.L.R. 49.

[4] Kitto J. adopted a view of the phrase 'to suspect a man's solvency' very similar to that of the Chief Justice. He considered that a suspicion that something exists is more than a mere idle wondering, it is rather a positive feeling of actual apprehension or mistrust. Moreover, his Honour thought that a reason to suspect that a fact exists is more than a reason to consider the possibility of its existence. At page 25, Kitto J. sets out a test to assist in applying the notion of 'reason to suspect' in section 95 (4.):

> [S]omething which in all the circumstances would create in the mind of a reasonable person in the position of the payee an actual apprehension or fear that the situation of the payer is in actual fact that which the subsection describes . . . .

[5] (1966) 40 A.L.J.R. 13, 20.

upon the facts of the Queensland Bacon payments and related them to his argument that section 95 is built around actual insolvency:

> Again, the further inference must be that the creditor knew or had reason to suspect that the payment amounted to a preference. The preference that is here spoken of is the preferences to which s. 95 (1.) refers: namely, a preference given by a debtor who is in fact insolvent when the preference is given. His Honour refused to find that the company was in fact insolvent on 15th October. It seems to me, therefore, impossible to say that the creditor had reason to suspect a state of affairs actually to exist which, according to that finding, did not exist.[6]

The Chief Justice concluded that he was unable to draw the inference that the creditor ' had reason to suspect ' within the meaning of section 95 (4.). This is not to say his Honour placed his sole emphasis on his ' actual insolvency ' construction of section 95. His Honour was clearly influenced by the actual dealings between parties. He was at pains to point out that large stocks on hand and creditor optimism about a company's future well-being, two factors that all of the creditors in the cases in issue relied on to show they had no reason to suspect their debtor's solvency, would not afford protection if a serious lack of liquidity had been demonstrated. However, his Honour was able to find for the creditors on the facts before him:

> But their optimism, backed up as it was in this case, by their action in continuing to give credit to the company cannot, in my opinion, be ignored when deciding whether the recipient of a preferential payment ought to have known or suspected the insolvency of his debtor.[7]

On the question of the accumulation of stock his Honour considered that the rate of realization would be an important factor, in fact, a vital factor in deciding whether or not insolvency had arrived. Nevertheless his Honour confessed:

> I find great difficulty in refusing to accept the business man's contemporaneous view as to what was a proper estimate of that rate and I am not prepared to hold that a reasonable and responsible business man ought [on the payment in question] to have suspected that his debtor was in fact insolvent.[8]

Kitto J. also noted that a reasonable person in the place of one of the creditors could reject the idea of insolvency and regard the dishonour of most of the cheques as being due to some temporary difficulty. His Honour after examining the Burns Philp payments made reference to the credit-squeeze situation existing at the time:

> To a reasonable business man the facts I have mentioned might have been expected to suggest, not an inability to pay debts as they became due, but an understandable disinclination . . . to sell stocks

[6] *Ibid.* 20.
[7] *Ibid.* 24.
[8] *Ibid.* 24.

> improvidently or to forego the attractions of expansion of business for the sake of overcoming what might well be a temporary shortage of cash brought about by a general restriction of bank credit in the community, a consequential unexpected drop in the retail sales, and by reason of these events the disappointment of expectations that had led to heavy purchases of stock.[9]

Kitto J. then pointed up the distinction between an inability to pay debts and a willingness to allow a cheque to be dishonoured which could be paid only by a drastic disrupture of present business arrangements. His Honour observed that many business men, who could rearrange their affairs so that a cheque be honoured on presentation, might prefer to risk possible damage to their credit rather than disrupt their business arrangements to preserve a clean credit record. His Honour did not avert to the possibility of the debtor not drawing a cheque in the first place to achieve this result. One would have thought that the courts would not look kindly on the device of drawing a cheque, knowing that it will first be dishonoured, although subsequently met, to keep creditors at bay or to provide a type of assurance that in time their claims will be satisfied.

In his dissent, Menzies J. adopts a wider interpretation for the operation of section 95 (4.) He states:

> The section does not require that the reason to suspect insolvency should be something arising after actual insolvency; it is sufficient if, when the payments in question are made subsequent to insolvency, the creditor had reasons for suspicion.[10]

Applying his view of the law to the facts, Menzies J. considered that the dishonouring of the cheque in October constituted ' reason to suspect ' and accordingly all the impeached payments made to Queensland Bacon should be set aside as voidable preferences. Menzies J. did not deal at length with the actual circumstances of the dealings but more or less made an absolute inference on the basis of the dishonour of the cheques.

The fact that the three judges found the resolution of the problem of the operation of section 95 (4.) so complex is not difficult to understand. Plainly the words of the subsection equally admit of the very wide interpretation of Menzies J. and the fairly narrow interpretation of Barwick C.J. How is the issue to be resolved ? This takes the discussion into the fairly arid realm of the canons of interpretation.

The collocation of knowing and suspecting in the subsection leads one at first glance to think that the wide interpretation of Menzies J. is the proper one. But this is too hasty an approach and fails to give proper weight to the distinction of suspecting an actuality and suspecting a possibility referred to in the judgments of Barwick C.J. and Kitto J.

On the other hand, even admitting the value of this distinction does not answer the observation of Menzies J. that acts done prior to actual

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[9] *Ibid.* 28.
[10] *Ibid.* 31.

insolvency can constitute reasons to suspect even actual insolvency if nothing occurs to dispel the suspicion. Menzies J. gave the illustration of a debtor informing his creditor of the likelihood of insolvency. That this could constitute a reason to suspect actual insolvency would be true. But, with respect, it is suggested that where the statement of the law of Menzies J. is incomplete and that why his decision in regard to the Queensland Bacon payments was wrong is that there will always need to be some additional factor occurring after the actual insolvency, be it ever so slight, that in conjunction with the reason to suspect possible insolvency prior to the actual insolvency constitutes a reason to suspect actual insolvency when both come to the attention of the creditor. The important thing is that they are taken in conjunction. On this view it is not enough to attack a transaction after 1 November by showing a suspicion based on a pre-1 November dishonour that insolvency was possible, in the sense of possibly coming, and the absence of any evidence to destroy such a suspicion. Menzies J. considered that it was sufficient to have evidence of the knowledge of dishonour prior to 1 November and no further information to suggest that the position was different after 1 November.

In the event it would be quite wrong to characterize the *Queensland Bacon Pty Limited v. Rees* decision as a ' credit squeeze ' let-out. Rather the majority seem to have arrived at both the correct and satisfactory interpretation of section 95 (4.).

*The Extent of the Preference in Cases of Running Account*

A further matter was considered by the Court. This concerned the question of the fact of, and the extent of, a preference where there is a ' running account ' which continues operative after the creditor's receipt of the payments which are challenged. How is the court to determine the extent of a preference when there is implicit in the dealings of debtor and creditor that they intend to continue their business dealings with the resultant continuance of the relation of debtor and creditor ? Is the court to determine this payment by payment so that if there is a preference element in a payment the whole payment is void, or is it to look to the state of the ' running account ' at the date of the first impugned payment and at the date of the liquidation ? Barwick C.J. and Menzies J. were unable to agree as to the correct interpretation of the bankruptcy law on this question and Kitto J. expressed no opinion.

The problem had been discussed by the High Court in *Richardson v. Commercial Banking Co. of Sydney Limited.*[11] There the Court noted that two things needed to be kept in mind: the ' effect ' of giving the preference as set out in the provision itself:

> The second thing is that the effect is a consequence of the payment and that where the payment forms an integral, and inseparable, part of the entire transaction its effect as a preference involves a consideration of the whole transaction.[12]

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[11] (1952) 85 C.L.R. 110.

[12] *Ibid.* 129.

The Court in *Richardson's* case gave the particular illustration of a grocer's account. The Court would not accept the notion that if a person paid something off a grocer's account in order to obtain further supplies, this gave the grover a preference. The Court noted that if the payment was credited for future deliveries the end result would be the same but the grocer could not be attacked as having received a preference. The following statement of general principle was then made in regard to the particular payments in question:

> [T]he payments . . . possessed in point of fact a business purpose common to both parties which so connected them with the subsequent debits to the account as to make it impossible to pause at any payment into the account and treat it as having produced an immediate effect to be considered independently of what followed and so to be adjudged a preference.[13]

Barwick C.J. commented on the guarded character of these remarks. He considered that they covered two situations: the situation where the payment is part of a larger single transaction and the 'running account' situation. His Honour considered that they did indicate that the mere fact a payment was made in respect of past indebtedness did not mean that the position of such a payment *vis-a-vis* other creditors was to be looked on without having regard to the overall situation.

A payment made on 'running account' may possess a number of distinct aspects. It could be any one of the following: a payment composed of two elements, one element intended to cover specific liabilities to be undertaken in the future, the other element intended to reduce existing indebtedness; a payment made to reduce existing indebtedness without any specific future obligation intended but made to ensure the continuance of credit on the 'running account'; or a payment which has the effect of reducing existing indebtedness but made without any clear idea as to the course of future dealings between the parties.

Barwick C.J. noted that the judgment at first instance had distinguished the cases before him from *Richardson's* case as each of the payments had been made in discharge of an existing indebtedness and not in pursuance of any firm arrangement to ensure further supplies. Barwick C.J. agreed that the dealings between the company and its suppliers bore no analogy to the overdraft situation in *Richardson's* case. He also agreed that if the payment had been made solely to discharge existing indebtedness the payments were void. But he was unable to agree with the implication in the judgment of the trial judge that there had to be an express purpose in the payments to ensure further supplies. He said:

> In my opinion, it is enough if, on the facts of any case, the court can feel confident that implicit in the circumstances in which the payment is made is a mutual assumption by the parties that there will be a continuance of the relationship of buyer and seller . . . .[14]

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[13] *Ibid.* 133.

[14] (1966) 40 A.L.J.R. 13, 17-18.

The Chief Justice has laid down the following approach to the problem. First look at the nature of the transaction in its entirety and then ask if a payment that had the effect of reducing existing indebtedness was made on the basis of the continuance of dealings between them. If it was, the payments made are to be avoided only to the extent of any actual net preference given:

> [T]he question of preference or no preference . . . was not to be determined payment by payment but . . . by the fate of the running account between the date of the first of the payments [challenged] and the date of the liquidation.[15]

Menzies J. reached a totally opposed result. His Honour dealt with the question in the context of the Burns Philp payments and after setting out the month-by-month position of the Burns Philp account and reciting passages from *Richardson's* case which in his Honour's view was a very special case in that the payments there in question were made by a debtor to a bank, in the case of an overdrawn account.

He continued:

> In the present case it seems to me that it was intended that, [upon each payment] . . . its [the appellant's] position would be improved, notwithstanding current supplies and that the object of the arrangement was to bring about a reduction of an existing liability. Every payment having that effect would improve the position of the creditor and it is sufficient that the payment actually made should give the creditor some advantage over other creditors. I consider that payments made in the carrying out of such an arrangement could constitute preferences, and his Honour's finding that they were is not one that should be disturbed.[16]

Since Kitto J. gave no opinion on this issue, *Queensland Bacon Pty Ltd v. Rees* has left the law undecided. It has had the effect of stating the opposing views that must one day be resolved. Each view has its merits. The view of the Chief Justice is attractive for the leniency of his approach and his concentration on what has actually occurred in the running account. The view of Menzies J. involves a tougher approach and an unwillingness to read into the Act notions that the Act does not spell out and the recognition of the protections afforded to honest creditors by the let-outs in section 95 (4.). Two things are reasonably certain: the problem will soon face the courts a second time; many must be wondering why the problem was not given a statutory solution when the new bankruptcy legislation was drafted.[17]

P. A. PATERSON.

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[15] *Ibid.* 20.

[16] *Ibid.* 31.

[17] The late Sir Thomas Clyne in an article in this Review entitled 'An Outline of Some Recommendations for the Amendment of the Bankruptcy Act' mentioned the problem of the running account in the context of section 95 (1.). It is unfortunate that the *Report of the Committee Appointed by the Attorney-General of the Commonwealth to Review the Bankruptcy Law of the Commonwealth* (1962) commented on by the judge in that article was unable to devise a suitable statutory provision to cover the running account situation. See (1964) 1 *Federal Law Review* 24, 39.