The Effects of a Successful Action by a Liquidator to Avoid a Pre-Liquidation Transaction

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During the course of administering a liquidation, a liquidator of a company may seek to avoid certain transactions made by the company prior to the commencement of its liquidation. Prime among these transactions are preferences granted to creditors. The ultimate aim of avoiding transactions is to recover property or money disposed of pre-liquidation to enable the liquidator to distribute a larger dividend to the creditors of the company. Section 588FE of the Corporations Law,[1] which is part of an avoidance regime contained in Division 2 of Part 5.7B, provides that specific pre-liquidation transactions are voidable.[2]

A liquidator is empowered to apply to the courts under s 588FF to seek orders in relation to transactions which a liquidator believes should be avoided,[3] so that unsecured creditors are not prejudiced by a company disposing of its assets shortly before the winding up, which would have the effect of favouring certain creditors or other persons.[4] Before making any orders in relation to the transaction im-

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1 All references to sections in this article are to the Corporations Law, unless otherwise indicated.

2 These are unfair preferences (s 588FA), uncommercial transactions (s 588FB), unfair loans (s 588FD) and fraudulent transactions (s 588FE(5)). For a discussion of these see A Keay, *Insolvency: Personal and Corporate Law and Practice* (2nd ed, Longman Professional, 1994) pp 307-327; J O'Donovan, 'Voidable Dispositions and Undue Preferences: The Transition to the New Regime' (1994) 12 *Company & Securities Law Journal* 7; Z Singer, 'Invalidation of Antecedent Transactions Under the Corporate Law Reform Act 1992' (1994) 2 *Insolvency Law Journal* 36; A Keay, 'The Avoidance of Pre-Liquidation Transactions' (1994) 2 *Current Commercial Law* 98; A Keay, 'The Avoidance of Antecedent Transactions in Corporate Liquidations: The Australian Regime' (1995) 4 *International Insolvency Review* 139.

3 For a discussion of the orders which can be made by courts see A Keay, 'Court Orders Made in Relation to Voidable Pre-Liquidation Transactions' (1995) 8 *Corporate & Business Law Journal* 181.

4 Explanatory Memorandum to the Corporate Law Reform Bill 1992 at para 1035.

pugned by the liquidator, the Court must be satisfied that it is voidable pursuant to s 588FE.

This article examines the effects resulting from a court being satisfied that the transaction which is the subject of a liquidator's application under s 588FF is voidable. Initially, the article considers what it means for a transaction to be characterised as 'voidable' and the general effects of voidability. The article goes on to discuss the specific effects on parties who may be directly or indirectly involved in, or affected by, the voidable transaction.

The General Effects of a Transaction Being Characterised as 'Voidable'

Previous Avoidance Provisions

Despite the fact that sections 588FE and 588FF only came into existence after the enactment of the *Corporate Law Reform Act* 1992 (Cth) ('the Act'), the concept of a pre-liquidation transaction being voidable is not new. This is notwithstanding the fact that prior to the enactment of the Act, provisions providing for avoidance of pre-liquidation transactions stated that such transactions were *void* (as against the liquidator).[5] Ever since the *Statute of Elizabeth* in 1570,[6] provisions avoiding transactions which were entered into prior to bankruptcy or liquidation, and which could be impugned by a trustee or liquidator, employed the expression 'void' when referring to the effect of such a transaction.[7] Yet, clearly the word 'void' in these contexts has always been understood by the courts to mean 'voidable.'[8] Transactions have never been regarded as absolutely void.[9] While the cause of action to avoid a transaction fell to a liquidator at the date of winding up,[10] the

5 See s 122 of the *Bankruptcy Act* 1966 (Cth) which applied to liquidations through the operation of s 565 of the Corporations Law and its precursors.

6 13 Eliz c 5.

7 Australian examples can be found in s 95 of the *Bankruptcy Act* 1924 (Cth) and s 122 of the *Bankruptcy Act* 1966 (Cth).

8 *In re Brall* [1893] 2 QB 381 at 384; *In re Hart* [1912] 3 KB 6 at 9 and 12; *Re An Application by Tucker and Reid Murray Developments (Qld) Pty Ltd* [1969] Qd R 193 at 208; *NA Kratzmann Pty Ltd v Tucker (No 1)* (1966) 123 CLR 257 at 277.

9 *Stevenson v Newnham* (1853) 13 CB 285 at 302; 138 ER 1208 at 1215.

10 *Re Lebrain* (1975) 24 FLR 407 at 410; *Spedley Securities Ltd v Western United Ltd* (1992) 7 ACSR 721 at 722.

transaction was not affected in any way until the liquidator took action to avoid it.[11]

Historically, this has meant that on the application of a liquidator, a court could declare a transaction void and direct the transfer of property or the payment of money to the liquidator. If this occurred, the avoidance of the transaction annihilated, as against the liquidator, the title of anyone receiving property pursuant to the transaction, with the result that the liquidator could assert his or her original title (on behalf of the company) and deny the transferee any estate in that property.[12]

The liquidator was, if a court made a declaration of avoidance in relation to a payment made in favour of the defendant, in the position of an unsecured creditor vis-à-vis the defendant to the avoidance proceedings. Consequently, if the defendant became bankrupt or went into liquidation before paying what was owed, the liquidator was only entitled to prove as an unsecured creditor in the defendant's estate.[13]

Until a liquidator decided to avoid a transaction, it was valid.[14] In *Stevenson v Newnham*,[15] Parke B compared the effect of avoidance to rescission of a transaction on the ground of fraud: the property vested until avoided.[16] In *NA Kratzmann Pty Ltd v Tucker (No 1)*,[17] Kitto J was of the view that the avoidance provisions in the bankruptcy and companies legislation assumed that the transaction was validly made and that except for the payment of the debts and the costs of winding

11 This is to be contrasted with the situation applying under s 468, which provides that dispositions entered into after the commencement of winding up are void. Pursuant to that section, 'void', according to Priestley JA (with whom Clark JA agreed) in the Court of Appeal of the Supreme Court of NSW in *National Acceptance Corp Pty Ltd v Benson* (1988) 12 NSWLR 213 at 220 and 229, means void for all purposes related to or incidental to the administration of the winding up, and the disposition rendered void is void at the time when it took place. Kirby P took a wider view and saw 'void' here as meaning no legal effect for any purpose as against the world, as if the transaction never occurred (at 214).

12 *NA Kratzmann Pty Ltd v Tucker (No 2)* (1966) 123 CLR 295 at 298.

13 Id at 299. Also see *Starkey v DFC of T* (1993) 11 ACLC 558 at 565-566.

14 J O'Donovan, 'Procedural Aspects of Recovering Voidable Preferences' (1993) 1 *Insolvency Law Journal* 65 at 84. It was clearly stated in *Bank of New Zealand v Essington Developments Pty Ltd* (1991) 5 ACSR 86 at 89 that the avoidance provisions were only triggered by the appointment of a liquidator, because they provided that transactions were 'void as against the liquidator'.

15 (1853) 13 CB 285; 138 ER 1208.

16 Id at 302; 1215.

17 (1966) 123 CLR 257.

up or bankruptcy, the transaction would continue to be valid as between the parties to it.[18]

Asserting that the transaction was void *ab initio* would result in the disturbing of titles and cause commercial uncertainty.[19] Consequently, the courts and the legislation limited the effect of avoidance to immediate parties and their privies.[20] If X Ltd, prior to its liquidation, delivered goods to Y in payment of a debt and the transfer was capable of being classified as a preference on X's liquidation, the liquidator of X would be unable to demand the return of the goods if, before any election was made by the liquidator to avoid, Y sold them to Z who was a bona fide purchaser for value without notice.[21] The liquidator would only be entitled to the proceeds of the sale of the goods.

For a transaction to be affected in any way, a liquidator was obliged to take action by way of some positive act or election to avoid the transaction.[22] This usually involved an application to the courts for a declaration that the transaction was void. If no such action was initiated, nothing changed in relation to the apparent validity of the transaction. As McPherson JA has said, 'a corollary of holding that the transaction is void only against the liquidator ... is that it subsists for all other purposes.'[23] It is notable that the transaction was only void as against the liquidator and not as against the company. Except in limited cases this was not a crucial distinction.

18 Id at 291-292.

19 *Re Holden* (1887) 20 QBD 43 at 46; *In re Brall* [1893] 2 QB 381 at 384; *In re Hart* [1912] 3 KB 6 at 10-11; *NA Kratzmann Pty Ltd v Tucker (No 1)* (1965-66) 123 CLR 257 at 292; B McPherson, 'Avoiding Transactions in Insolvency', in *Corporate Insolvency Law* (Bond University, 1995) p 190. This is illustrated in *Re Hart* [1912] 3 KB 6 where Cozens-Hardy MR, with whom Buckley and Kennedy LJJ agreed, held that a trustee in bankruptcy was unable to recover shares which had been transferred to a bona fide purchaser for value without notice (at 10-11).

20 See *Stevenson v Newnham* (1853) CB 286 at 302; 138 ER 1208 at 1215; McPherson, ibid.

21 See *Marks v Feldman* (1870) LR 5 QB 275 at 280 and 282; *Re Waters* (1887) 5 NZLR 431 at 433.

22 *Marks v Feldman* (1870) LR 5 QB 275 at 281; *Re Waters* (1887) 5 NZLR 431 at 433; *Sanguinetti v Stuckey's Banking Company* [1895] 1 Ch 176 at 180-181; *Wreckair Pty Ltd v Emerson* (1991) 5 ACSR 576 at 584-585; *Hamilton v Commonwealth Bank of Australia* (1992) 9 ACSR 90 at 124 and 125; *Starkey v DFC of T* (1993) 11 ACLC 558 at 565; McPherson, note 19 above, at p 189.

23 McPherson, note 19 above, at p 10. Also see *Sanguinetti v Stuckey's Banking Co* [1895] 1 Ch 176; *Re Farnham* [1895] 2 Ch 799.

If a transaction was void against a liquidator then, it would follow that the liquidator was unable to rely on it as against other persons.[24] It would be illogical for the liquidator to say on the one hand that the transaction was void against him or her and then on the other hand seek to rely on the transaction as against other persons. If the transaction was void, it was void for all purposes as far as the liquidator was concerned.

The Present Regime

The effect on a transaction under the present regime is, save for some important distinctions, the same as when transactions were said to be void as against the liquidator.

The distinctions are as follows: first, if a transaction is voidable pursuant to s 588FE and no defence is available to the defendant, the transaction will not necessarily be avoided. In the same circumstances under earlier avoidance provisions, the transaction would have been avoided. The present regime provides greater flexibility[25] because pursuant to s 588FF, a court, when confronted with a voidable transaction, has a wide discretion as to the orders it can make.[26] An order of avoidance is only one of a number of orders which could be made.[27] Saying a transaction is 'voidable' is to say no more than that the transaction is one covered by s 588FE and a court order can be made in relation to it. Such transactions may be classified as 'reviewable':[28] they are able to be reviewed by a court which may deem them to be voidable.

All of this means that it is not strictly correct to say that s 588FE deals with the *avoidance* of transactions. If a transaction is voidable (or reviewable) it does not mean that there will be an avoidance of the transaction. It is a matter of discretion then, whether the end result is the technical avoidance of a transaction under either regime.

24 *Sanguinetti v Stuckey's Banking Co* [1895] 1 Ch 176 at 181; *Re Farnham* [1895] 2 Ch 799 at 808; *NA Kratzmann Pty Ltd v Tucker (No 2)* (1968) 123 CLR 295 at 299-300, 302.

25 See Explanatory Memorandum to the Corporate Law Reform Bill 1992, at para 1056.

26 Keay, note 3 above.

27 Ibid.

28 This is the term employed by Keith Bennetts in 'Voidable Transactions: Consequences of Removing Avoidance Powers from the Liquidator and Vesting Them in the Court' (1994) 2 *Insolvency Law Journal* 136 at 138.

A second distinction is that previously, a transaction successfully attacked by a liquidator was void against the liquidator. Now, if a court decides in effect to order avoidance of the impugned transaction, the transaction is void against the company.

Thirdly, and related to the previous point, is the fact that previously if a transaction was void, any recovered property was property available to the liquidator for the purposes of the liquidation.[29] In contrast, if orders are made by a court now, the defendant to a liquidator's action will be directed to pay money or transfer property to the company and not to the liquidator.[30]

If a court finds a transaction to be voidable, it may order that property be delivered or money paid to the company. This might suggest that such property or money could be categorised as assets of the company. Yet, in *Re MC Bacon Ltd*,[31] Millett J held in relation to the equivalent provisions in the English legislation that a claim to set aside a preference is not a claim to get in an asset of the company.[32] This is despite the fact that under s 241 of the *Insolvency Act* 1986 (UK) the UK courts, like the Australian courts, have a discretion to require any property transferred as part of a voidable transaction to be vested in the company.[33] Millett J followed the decision in *Re Yagerphone Ltd*[34] and held that the assets which are received by the liquidator are impressed with a trust in favour of the general body of creditors.[35]

The Effect on Parties Involved Directly or Indirectly with the Voidable Transaction

We turn now to consider the effect of a liquidator successfully claiming that a pre-liquidation transaction is voidable on those parties who are related to the transaction. Naturally, the primary group includes those who were parties to the transaction. The formal parties

29 *Minerals & Chemical Traders Pty Ltd v T Tymczyszyn Pty Ltd (in liq)* (1995) 15 ACSR 398 at 416. The assets recovered are for the benefit of the creditors: *An Application by Tucker and Reid Murray Developments (Qld) Pty Ltd* [1969] Qd R 193 at 203.

30 For example, see s 588FF(1)(a) which states that the Court may make an order 'directing a person to pay *to the company* an amount ...' (emphasis added).

31 [1991] Ch 127.

32 Id at 137.

33 Section 241(1)(a).

34 [1935] Ch 392 at 396.

35 *Re MC Bacon Ltd* [1991] Ch 127 at 137.

will be the company on the one hand and some other party (often a creditor or an associate of the company) on the other. However, companies cannot operate without the intervention of natural persons who must arrange any transaction into which the company enters. Do persons who act on behalf of the company suffer some effect, personally, if the transaction is deemed to be voidable?

Besides the formal parties to a transaction and those who arrange it, there are often people who derive some benefit from the transaction or who purchase property the subject of the transaction from the original transferee. Also, very often a secured creditor has held a floating charge over the assets of the company which has gone into liquidation at the time when the voidable transaction was entered into. Are such creditors entitled to claim priority in relation to any recoveries made by the liquidator pursuant to an order under s 588FF?

The Company's Agents

A company must act through the agency of human persons. Generally, it will act through its chief executive officer or other executive directors. If a company enters into a voidable transaction, are such officers affected?

One of the earliest cases which examined the issue was *Re Washington Diamond Mining Company*.[36] In that case a director of a company was owed director's fees. The director held partly paid shares in the company. The director gave to the company a cheque to pay for the balance owing on his shares and at the same time he received from the company a cheque for his unpaid fees.[37] This latter cheque was signed by the director and another director. Within three months the company entered liquidation. The liquidator claimed that the cheque paid to the director was a preference. The English Court of Appeal found that the company was, at the time of the payment to the director, clearly insolvent.[38]

At first instance, Vaughan Williams J dismissed the liquidator's application, holding that no preference had been established. On appeal to the Court of Appeal this decision was reversed unanimously.

36 [1893] 3 Ch 95.

37 It appears that the action was initiated by the director because he would not, on a winding up, be able to set off his claim to fees against what he owed on his shares: id at 111.

38 Id at 109.

It is noteworthy that Kay LJ stated in his judgment in the Court of Appeal that all the directors who concurred in the making of the payment were guilty of a misfeasance and should be required jointly and severally to repay the amount in question.[39]

This aspect of the decision was referred to later by McLelland CJ in *Re Yorke (Stationers) Pty Ltd (in liq)*,[40] where his Honour was dealing with a case in which a company, which had only two shareholders who were also directors of the company, was in serious financial difficulty. One problem was that the company had fallen into arrears in relation to the payment of the rent for the premises which it leased. The landlord had secured a default judgment. The directors decided to carry on the same business conducted by the company, but in partnership and in other premises. The company ceased to carry on business and there was a stock-take. The directors met and passed a resolution accepting an offer from themselves, in their individual capacities, to purchase the assets of the company. The directors offered, by way of purchase price, £2155 which was to be satisfied by the payment of all trade creditors with the exception of any alleged liability for any premium due under the lease of the premises occupied by the company.

The landlord of the company's premises presented a petition for the winding up of the company because of non-payment of his judgment debt. An order for winding up was granted and the liquidator who was appointed applied for an order that the directors pay the sum of £2155 on the basis that they were guilty of a misfeasance in having the company sell its assets. This conduct was alleged by the liquidator to be a preference. McLelland CJ concurred with the liquidator's assessment.[41] His Honour, relying upon *Re Washington Diamond Mining Co*,[42] was of the view that directors who deliberately give voidable preferences are guilty of misfeasance.[43]

In later cases such actions have in general been attacked on the basis that they constitute a breach of directors' duties;[44] that is, in taking

39 Id at 115.

40 [1965] NSWR 446.

41 Id at 451.

42 See note 79 below.

43 Earlier, the High Court, in *Couve v J Pierre Couve Ltd (in liq)* (1933) 49 CLR 486 at 496, had accepted that the giving of a preference by a company at the instigation of the directors could constitute a misfeasance.

44 For example, *Nicholson v Permakraft (NZ) Ltd* [1985] 1 NSWR 249; 3 ACLC 453; *Grove v Flavel* (1986) 43 SASR 410; 11 ACLR 161; *Kinsela v Russell Kinsela Pty Ltd*

the action which they have taken directors are held to be in breach of their duty to the company to take into account the interests of the company's creditors. Actions have been limited, in the main, to where assets of a company are disposed of in circumstances where the company is insolvent,[45] near insolvent[46] or even where the company is solvent but there is a real risk of insolvency because the company is in financial difficulty.[47] Thus far, the exact limits of when a director will be held liable for breach of his or her duties, because creditors are prejudiced by his or her actions, have not been determined.[48]

McLelland CJ in *Re Yorke Stationers Pty Ltd (in liq)* did not indicate any limits as to when a director would be held liable for the giving of preferences. It would seem rather harsh to hold directors liable for all preferences. They may repay creditors haphazardly, unaware either that their company is insolvent or that the repayment constitutes a preference. Yet, in other cases, directors may deliberately grant preferences when they know that their company is insolvent. One such case was *West Mercia Safetywear Ltd (in liq) v Dodd.*[49] Dodd was a director of two companies, A and B, where A was a wholly owned subsidiary of B. Company B had an overdraft which was guaranteed personally by Dodd. A owed B some £30,000. Both A and B were in dire financial straits. Dodd transferred £4000 from A to B's overdraft account before both companies went into liquidation.

The liquidator of A sued Dodd for £4000, alleging that he was guilty of misfeasance and breach of duty in that he gave a preference to B. In the Court of Appeal, Dillon LJ, with whom Croom-Johnson LJ and Caulfield J concurred, accepted the decision in *Re Washington Diamond Mining Company*[50] and held Dodd liable. Importantly, Dillon LJ made it clear that the reason Dodd was liable was that he knew that A was insolvent and he was taking the action for his own pur-

(in liq) [1986] 1 NZLR 722; (1985) 10 ACLR 395. See R Fisher, 'Preferences and Other Antecedent Transactions: Do Directors Owe a Duty to Creditors?' (1995) 8 *Corporate & Business Law Journal* 203.

45 *Kinsela* [1986] 1 NZLR 722.

46 *Nicholson v Permakraft* [1985] 1 NSWR 249.

47 *Grove v Flavel* (1986) 43 SASR 410.

48 In the US, directors owe a duty to the entire corporate enterprise, including creditors, when the corporation is operating in the 'vicinity' of insolvency: *Credit Lyonnais Bank Nederland NV v Pathe Communications Corp* cited by M Roberts, 'The Conundrum of Directors' Duties in Nearly Insolvent Corporations' (1993) 23 *Memphis State University Law Review* 273 at 287.

49 [1988] BCLC 250.

50 [1893] 3 Ch 95.

poses,[51] that is, boosting B's assets (at the expense of A) so that he would be less likely to be liable under the guarantee.

The Australian High Court in *Couve v J Pierre Couve Ltd (in liq)*[52] had earlier held that a director was liable for misfeasance because he sought to benefit from the giving of a preference after he was aware that a petition had been presented for the winding up of his company. This appears to be a reasonable position where directors intend to benefit themselves. However, it is submitted that the decisions in *Couve v J Pierre Couve Ltd (in liq)* and *West Mercia Safetywear* should also apply where directors' conduct is designed to benefit associates.

There is a potential difficulty for liquidators in taking action in that they would have the onus of proving both intention and knowledge of the insolvency of the company on the part of directors. In some situations, the difficulty would be in obtaining sufficient evidence of intention. However, the difficulty may be alleviated somewhat if the courts were willing to infer from sufficiently strong evidence that directors knew of the insolvency of the company and were intending to benefit themselves or associates. Directors would then have the onus of proving such an inference to be wrong, and this might have the effect of making them more circumspect in paying individual creditors where the company is in a financial malaise.

While cases have focused on the granting of preferences, it appears that the reasoning in these cases can be applied to other voidable transactions. In fact, where a transaction which can be classified as an uncommercial transaction under s 588FB was entered into, the liquidator would probably find it easier to establish that the director was intending to provide an improper benefit. For instance, if directors A and B entered into an agreement on behalf of their company, X Pty Ltd, whereby X sold property valued at $100,000 to Y and Z, the children of A and B, for $50,000, the transaction is likely to be classified as an uncommercial transaction and the sale of the property at a marked undervalue might cause a court to infer that the directors were intending to benefit Y and Z. The burden should be on A and B to prove that the transaction was not colourable.

Liquidators would only seek to sue those persons who acted as the company's agents in the entering into of a voidable transaction for misfeasance if they (the liquidators) could not recover successfully any money or property disposed of pursuant to the transaction. A prime

51 *West Mercia Safetywear* [1988] BCLC 250 at 253.

52 (1933) 49 CLR 486 at 496.

instance is where the person who benefited from the voidable transaction is impecunious. In the above example, a liquidator would take action against the recipients of the benefit, Y and Z, unless for some reason—such as the fact that Y and Z could rely on the defence in s 588FG[53]—the liquidator would not recover from Y and Z, in which case he or she would look to A and B.

In practice, it is unlikely that directors will be deterred by the prospect that they can be held liable for misfeasance when they orchestrate voidable transactions. They may well reason that if they succeed 'all well and good' and if they fail, nothing has been lost save the cost of court proceedings. Directors who are guilty of misfeasance may be subject to a civil penalty order for a breach of their duties under s 232 or, if they can be proved to have knowingly, intentionally or recklessly breached the section and acted dishonestly, intending to gain an advantage (for themselves or others) or intending to defraud someone, they may be guilty of a criminal offence.[54] However, this will rarely act as a deterrent because either directors will not know of the sanction, or if they do know of it, they may well decide to take a risk. Furthermore, the Australian Securities Commission may refrain from prosecuting errant officers on the basis that they have more weighty matters to proceed with, and a limited budget. In such a case a liquidator would be permitted to launch a prosecution under s 534 but such action will be rare—the liquidator will require the approval of creditors as the costs of prosecution will be payable from the assets of the company, and the creditors are unlikely to be interested in endangering their potential dividends with an action which will bear little, if any, fruit. Of course, if the company has insufficient assets to fund a prosecution the liquidator will have to ask the creditors to indemnify him or her in any prosecution, and it is unlikely that creditors would be keen to do so.[55]

53 In the scenario presented, this defence is very unlikely as X and Y would probably not be able to say that they acted in good faith, gave valuable consideration and had no reasonable grounds to suspect the insolvency of X Pty Ltd. See Andrew Keay, 'Defending a Liquidators's Avoidance Action Commenced Under Part 5.7B of the Corporations Law' (1995) 5 *Australian Journal of Corporate Law* 17.

54 Section 1317FA(1).

55 One of the few cases where they may do so is where they believe the officer(s) has acted most improperly and they are very bitter about the insolvency of the company. Another situation where support may be forthcoming is where there are public-spirited creditors who earnestly believe that for the sake of the community the officer(s) should be prosecuted.

If a prosecution was initiated and the officer(s) found guilty, the defendant(s) could be ordered to pay compensation to the company.[56] This would benefit the creditors, who would share in such compensation, but the creditors might be unwilling to accept the risk of the director(s) being found not guilty and/or no order of compensation being made.

The Australian Securities Commission may be more ready to launch a civil penalty action under s 1317EB(1)(a). If not, the Commission could delegate its power to make such an application to the liquidator.[57] The attraction of applying for a civil penalty order is that the burden of proof is lighter: the applicant is only required to prove the case on the balance of probabilities as opposed to the criminal burden of proving the case beyond reasonable doubt. Furthermore, on an application for a civil penalty order, a court is permitted to order that the defendant pay the company compensation.[58] In fact, if the Commission initiated an application for a civil penalty order, the liquidator could intervene in the proceedings on behalf of the company and may be heard on the question of whether the court should order the officer(s) to pay compensation to the company.[59]

Another element would have to be considered before proceedings were initiated against miscreant directors. It is questionable whether the unsecured creditors would benefit from any compensation ordered to be paid if a secured creditor held a charge over company assets. Any compensation order is likely to be made in favour of the company and it has been held[60] that in such circumstances the compensation to be paid will be considered as a contribution to the assets of the company. Consequently, if a creditor held a charge over company assets then that creditor may have first claim to the compensation.

In sum, few actions have been initiated against company officers for misfeasance where they have orchestrated the giving of a benefit to themselves or others, pursuant to a voidable transaction. There is no indication at the moment that under the present avoidance regime we will see a dramatic change in the situation.

56 Section 1317HB(1).

57 Section 1317EB(1)(b).

58 Section 1317HA(1).

59 Section 1317HA(3).

60 *Couve v J Pierre Couve Ltd (in liq)* (1933) 49 CLR 486.

Unsuccessful Defendants

This part of the article considers the effect on those persons who unsuccessfully defended actions commenced by liquidators. Specifically, the effect on a defendant in this type of situation will depend on the kind of order made by the court under s 588FF.[61]

Most frequently, those who are defendants to a liquidator's action are the recipients of unfair preferences. If the preference is voidable, normally the defendant will be ordered to pay to the company an amount equal to the money received under the transaction.[62] In such a situation, having complied with the order, the defendant may prove in the winding up as if the transaction had not been entered into.[63] Importantly, the creditor is not penalised for having accepted the preference. In fact, s 588FI(2) states plainly that a court must not, in making a s 588FF order, prejudice a right or interest of creditors. Hence, even if a court is of the opinion that a creditor has acted most improperly in obtaining a preference, the court is not entitled to allow that opinion to be reflected in an order preventing the creditor from recovering the debt, or part thereof, in the winding up. This state of affairs mirrors the law as it applies in bankruptcy,[64] and how it applied prior to the enactment of the Act in 1993.[65]

A defendant in a liquidator's action must appreciate that if unsuccessful and ordered to pay to the company an amount equal to what was received under the voidable transaction, he or she will, ordinarily, be required to pay the liquidator's costs and interest on the amount ordered to be paid.

Can a preferred creditor claim a set-off?

It was established in relation to previous avoidance provisions that a preferred creditor was not entitled to set off the liability to repay an unfair preference against the company's liability for the original debt.[66] The specific reason for this is the subject of disagreement.

61 Keay, note 3 above.

62 See s 588FF(1)(a).

63 Section 588FI(3). The provision was included on the recommendation of the Australian Law Reform Commission, *Report No 45: General Insolvency Inquiry* (1988, known as 'the Harmer Report') at para 657.

64 Section 122(5) of the *Bankruptcy Act* 1966 (Cth).

65 H Ford and R Austin, *Ford's Principles of Corporations Law* (6th ed, Butterworths, 1992) p 839.

66 *Lister v Hooson* [1908] 1 KB 174 at 176-177; *Re Clements* (1931) 7 ABC 255 at 268; *Re Smith* (1933) 6 ABC 49 at 57; *Re Buchanan Enterprises Pty Ltd and the Companies Act* (1982) 7 ACLR 407 at 409.

Bennetts is of the view[67] that the reason is that there is an absence of mutual dealings existing between the company in liquidation and the creditor.[68] As Bennetts says, '[t]he amount payable in these circumstances is not an amount due to the company, but to the liquidator pursuant to recovery powers with the result that liabilities are not "mutual".'[69]

In contrast, Professor O'Donovan argues that the creditor is prevented from invoking set-off not because of an absence of mutuality but on policy grounds.[70]

With respect, it is submitted that both of the reasons proffered are valid. In *Re Armour*,[71] Clyne J, after stating that there could be no set-off because no mutuality existed between creditor and debtor, approved of the words of Clauson J in *In Re a Debtor* to the effect that set-off should not be allowed on the basis of policy.[72] In *In Re a Debtor*, Astbury J indicated that he would not allow set-off because of an absence of mutuality.[73]

If the only reason for not permitting the creditor to employ set-off was a lack of mutuality a creditor could now, arguably, seek to rely on set-off. Under s 588FF, orders are made in favour of the company and not, as under previous provisions, in favour of the liquidator. The creditor could say that if a s 588FF order was made there was, in fact, mutuality. This would, as both O'Donovan[74] and Bennetts[75] recognise, be absurd. Clauson J in *In Re a Debtor* articulated the nature of the absurdity well when he said:

> If a creditor of a company receives payment of the sum due to him in such circumstances that the payment amounts to a fraudulent preference, the position is that he has no right to receive his debt in full, but has a right only to be paid a dividend on his debt pari passu with the other

67 K Bennetts, 'Voidable Transactions: Consequences of Removing Avoidance Powers From the Liquidator and Vesting Them in the Court' (1994) 2 *Insolvency Law Journal* 136.

68 Id at 137.

69 Ibid. In support, Bennetts refers to *Re Armour* (1956) 18 ABC 69 at 75-76; and *Lister v Hooson* [1908] 1 KB 174 at 176-177.

70 J O'Donovan, 'Undue Preferences: Some Innocents 'Scape Not The Thunderbolt' (1992) 22 *UWALR* 322 at 326. In support, O'Donovan refers to *In Re a Debtor* [1927] 1 Ch 410 at 419-420.

71 (1956) 18 ABC 69.

72 Id at 76 citing comments of Clauson J's decision: [1927] 1 Ch 410 at 420.

73 [1927] 1 Ch 410 at 419.

74 O'Donovan, note 70 above, at 326.

75 Bennetts, note 67 above, at 139.

> creditors: the decision of the Court in a winding up subsequently supervening, that the payment to him was a fraudulent preference, must necessarily amount to a decision that he had a right to receive his debt in full, but a right only, in the circumstances, to claim pari passu with the other creditors.
>
> It would be an absurdity if the appellant were entitled to set off, against the claim of the liquidator for the money which he wrongly received in full, a claim to be paid under his judgment an equivalent amount as a debt. The most that the appellant can be entitled to is to rank pari passu with the other creditors.[76]

What if the property sought to be recovered has increased in value?

If the defendant received property pursuant to a voidable transaction the court may order that the property be transferred to the company.[77] The defendant may be annoyed because since receiving the property he or she has improved it, by building a house on land transferred under the voidable transaction, for example The defendant might argue that to permit the liquidator to have the property in its improved state would unjustly enrich the estate of the company (and, hence, the creditors) at the expense of the defendant. In the United States, a good faith transferee of property conveyed pursuant to a voidable transaction from whom a trustee in bankruptcy can recover, has a lien[78] on the property for any improvement effected. This causes one to ask why a transferee not taking in good faith is not entitled to the same benefit. If he or she is so entitled then only fair compensation would be received for what has been done or paid out.[79] It is not as if the transferee is receiving a windfall gain.

Historically, the defendant would have had to rely on asking the court to invoke the rule in *Ex parte James*,[80] which makes it incumbent on officers such as trustees in bankruptcy and liquidators to refrain from doing anything which could be deemed to be unconscionable if done by an ordinary person. Whether or not the rule will be invoked in any given case is always a matter of some uncertainty. However, it is likely that now the defendant would not have to rely upon the rule. The

76 *In Re a Debtor* [1927] 1 Ch 410 at 419-420.

77 See s 588FF(1)(b).

78 See s 550(d)(1) of the *Bankruptcy Reform Act* 1978 (US).

79 There is American authority under previous legislation (*Bankruptcy Act* 1898) suggesting that those who benefited under a voidable transaction and who improved property which they were required to return were entitled to reimbursement: *Ladd v Perry* 28 F 2d 975 (1928).

80 (1874) 9 Ch App 609.

defendant could suggest to the court that if it is determined to make an order under s 588FF, it should take into account the increase in the value of the property. In fact, the recipient of an unfair preference may be able to argue on the basis of s 588FI(2) that the court is obliged to do so because in making an order it must not prejudice a right of the creditor.

The court could order, pursuant to s 588FF(1)(c), that the defendant pay to the company an amount which represents the benefits which the defendant received because of the transaction; ie the value of the property at the date of the voidable transaction.[81] It is unlikely that a court would order both the return of the property and the payment by the liquidator to the defendant of an amount to cover the increase in value of the property between the date of the original transfer and the date of re-transfer. Such an order would impose an obligation on the liquidator to find funds to pay the defendant. In any event, it appears that the court does not have the power to make such an order under s 588FF.[82]

If a court was inclined to make an order under s 588FF(1)(c) in the terms suggested above, a liquidator might object with some justification that the defendant has had the use of the property ever since reception while the company has been deprived of the property and, accordingly, that the defendant should be required to pay for that use. If such a submission was to find favour with a court, the court should, in calculating the amount to be paid to the liquidator, factor in an amount for use of the property. Given the wording of s 588FF(1)(c), this does not appear to be a problem. The paragraph states that the court may order the defendant to pay a sum which represents some or

81 Prior to the enactment of the *Bankruptcy Reform Act* 1978 (US), the federal Bankruptcy Commission proposed that property should be valued at the date of judgment: House of Representatives Report No 595, 95th Congress, 1st Session 376 (1977); Senate Report No 989, 95th Congress, 2nd Session 90 (1978) and referred to by V Countryman, 'The Trustee's Recovery in Preference Actions' (1986) 3 *Bankruptcy Developments Journal* 449 at 461. However, the proposal was not adopted in the 1978 statute. The proposal does not account for improvement in the property from the time it is received by the defendant until the date of judgment. In Australia that could be many years. For example, if the defendant received the property under a fraudulent transaction (s 588FE(5)) he or she may receive it up to 10 years before the relation-back day and it may be some years after this date that a liquidator secures a judgment. In the American case of *In Re Southeast Community Media Inc* 27 Bankr 834 at 844 (1983) the court gave the trustee the value of the property at the time of transfer.

82 See Keay, note 3 above, for a discussion of the orders which can be made pursuant to s 588FF.

all of the benefits received by the defendant as a result of the voidable transaction.

The real problem facing the court is that of valuation. The valuation of assets is not guided by scientific precision; it involves the making of a judgment as to what buyers will pay for an asset at a given time.[83]

Valuation is particularly difficult where no market value has been established for the relevant assets. Even where a market value has been established, factors which may affect the value of an asset can vary substantially and influence the sum which can be obtained for an asset.

A court might have to determine the value of property both at the date of the voidable transaction and at the date of judgment, as well as deciding what value to place on the defendant's use of the property in the period between these two dates. Such tasks are onerous, but to ensure fairness and to do justice between the parties, according to the intention of the legislature in enacting s 588FF,[84] it appears that a court may have no choice.

What if the property sought to be recovered has decreased in value?

This will be a frequent occurrence where goods are concerned because they will be 'second-hand'[85] at the time of judgment. The liquidator would prefer an order under s 588FF(1)(c) rather than under s 588FF(1)(b) because the latter only enables the court to order the re-transfer of the property—the former would allow an order whereby the defendant is required to pay a sum which represents the benefits he or she received.

If the liquidator was to obtain an order which provided for the return of property which has decreased in value, naturally the unsecured creditors would be worse off. Yet the defendant, if he or she received the property as a preference, would be able to prove in the winding up once the property was re-transferred to the liquidator and would be able to prove for the full value of the debt owed. This seems a little unfair.

Yet, it has been argued by Professor O'Donovan in relation avoidance provisions which applied in the past that the value of the property

83 R Goode, *Principles of Corporate Insolvency Law* (Sweet & Maxwell, 1990) p 27.

84 See note 4 above, at para 1056.

85 Goods are not the only assets which may be devalued. Professor O'Donovan, note 70 above, at 331 gives the example of shares which are transferred to the defendant and then plummet in value before the liquidator's action for recovery.

should be determined at the time when the transaction is declared void, even if the liquidator thereby receives a lesser benefit.[86] If this approach is not adopted, O'Donovan argues, the court would be conferring a windfall on the company at the expense of the defendant and imposing a form of retribution and not compensation.[87] O'Donovan has submitted that because a transaction was valid until avoided, the value of the property at the time the transaction was declared void was the pertinent value.[88] In effect, the same argument could be employed under the present regime because until a court is satisfied that a transaction is voidable and makes a consequential order pursuant to s 588FF, the transaction is valid.

If however the property has a reduced value because of some action or inaction of the defendant, perhaps it would be appropriate for a court to make two orders: one under s 588FF(1)(b) for the return of the property and a second under s 588FF(1)(c) for a sum which represents the benefit received by the defendant (ie the loss in value). It may be said that there is no benefit to the defendant in a technical sense. If that view can be sustained, then the approach advocated by Professor O'Donovan might be invoked. He submitted in relation to past provisions that the court could order the return of the property and an order for damages because of conversion.[89] It is contended that this remains a possibility under the present regime but is dependent on the action or inaction of the defendant being classified as conversion.

If the liquidator bears the brunt of a reduction in value because the property is 'second-hand' or for reasons other than the action or inaction of the defendant, it seems only equitable for the liquidator to enjoy the benefit of an accretion in the value of the property, where such accretion is not due to the endeavours of the defendant. The liquidator bears the risks of fluctuations in value since the company would, but for the voidable transaction, have borne such risks.

Can the costs of realisation be claimed?

One last issue remains to be considered. If the defendant sells the property which he or she received pursuant to the voidable transaction, and the liquidator is not entitled to recover the property from the new owner but is entitled to the proceeds of the sale in the hands

86 Id at 330.
87 Id at 331.
88 Id at 330.
89 Id at 333.

of the defendant, has the defendant a case for asking the court to take into account the costs expended in effecting the sale? The defendant would seek to argue that the liquidator would have been obliged to sell the property (and incur costs) in any event in order to permit him or her to distribute the estate to creditors.

It has already been submitted that it would seem unfair to allow the company's estate to be unjustly enriched through an avoidance action. The defendant in the scenario just outlined would argue that if his or her costs are not deducted from the proceeds of sale the company would be enriched unjustly to the defendant's detriment.[90]

The costs of realisation might be regarded as analogous to the defendant's expense in improving the property, and unless the defendant's actions in incurring expenses were unnecessary or the expenses paid were well in excess of the norm, it seems reasonable that the costs be deducted from the sum which should be paid to the liquidator. Certainly, the court could accommodate this in an order under s 588FF(1)(c). Each case would have to be considered on its merits and this is something which s 588FF was obviously designed to allow.

Subsequent Transferees

What is the position of those persons (subsequent transferees) who take property from the defendant, the original transferee, under the voidable transaction? It is likely that a liquidator would not be concerned about taking any action against such persons unless one of the following occurs: the original transferee is insolvent (or close to insolvency); the liquidator wants to recover the actual property transferred by the company and conveyed to the subsequent transferee; or the original transferee gave the money or transferred property to the subsequent transferee by way of gift or for less than something close to market value.

A liquidator might join a subsequent transferee as a defendant in an action brought pursuant to s 588FE, as the court may be empowered pursuant to s 588FF to order such a person to transfer the property to the company.[91] This will depend upon whether the court interprets 'a person' in s 588FF as inclusive of subsequent transferees. For instance, s 588FF(1)(b) states that a court may make 'an order directing

90 An American court in *Cedar-Comp Materials Co v Bumb* 344 F 2d 256 at 259 (1965) accepted the fact that the amount to be paid by the defendant should be reduced by the sum expended to realise the property.

91 Section 588FF(1)(b).

a person to transfer to the company property that the company has transferred under the transaction [voidable]'. It is submitted that it is open to the courts to take the view that they have the power to make orders in relation to subsequent transferees; however, it would have been far better if the legislature had adopted the same wording used in the English *Insolvency Act* 1986 which states that an order might affect the property of, or impose obligations on, 'any person.'[92]

To err on the side of safety a liquidator would be well-advised to rely not only on s 588FF, but on other additional grounds. The liquidator may be able to argue that the subsequent transferee holds the property or money as a contructive trustee for the company. This could be argued if the transferee received property of the company where it was obtained originally as a result of a director's breach of fiduciary duties and the transferee was aware of this.[93] As discussed earlier, directors are in breach of their duties if they orchestrate the giving of benefits to others or to themselves under voidable transactions and if the subsequent transferee was aware of the action of the director, he or she would be regarded as a constructive trustee.

In the past, the courts have tended to restrict the effect of avoidance to immediate parties and their associates.[94] Subsequent transferees have not been affected where they take the property in good faith, for value and without notice. In *Marks v Feldman*[95] goods were assigned by a debtor to one of his creditors shortly before the debtor's bankruptcy. The assignment was effected pursuant to a bill of sale which was attacked by the bankrupt's trustee as a fraudulent preference. It was found that the bill constituted a preference. The real question was whether the assignment was valid because the creditor had sold the goods before the onset of bankruptcy. The Court said that that question was irrelevant in relation to the question of whether a preference had been given, although it did mean that the trustee could

92 See s 241(2).

93 See *Barnes v Addy* (1874) 9 Ch App 244 at 251. The transferee's knowledge does not necessarily need to be actual—it can be constructive: *Belmont Finance Corp v Williams Furniture Ltd (No 2)* [1980] 1 All ER 393. Generally, see O'Donovan, 'Procedural Aspects of Recovering Voidable Preferences' (1993) 1 *Insolvency Law Journal* 65 at 81-82; S Fryer-Smith, 'Voidable Transactions in Corporate Insolvency: The Constructive Trust Alternative' (1996) 4 *Insolvency Law Journal* 34.

94 See *Stevenson v Newnham* (1853) 13 CB 285 at 302; 138 ER 1208 at 1215; McPherson, note 19 above, at p 190.

95 (1870) LR 5 QB 275.

not recover the goods; the trustee was only entitled to the proceeds of the sale in the hands of the creditor.[96]

Re Waters; Ex parte Hodgens,[97] where there was a preference granted in the form of an assignment of shares, was a similar case. The assignee sold the shares before the trustee in bankruptcy avoided the preference and, consequently, the trustee was only able to recover the proceeds of the sale of the shares and not the shares in specie.

It is likely that the courts will continue with the same approach because the powers to make the orders in s 588FF(1) have been given by the legislature to ensure that justice is done between all parties,[98] and to allow a liquidator to recover from a transferee who had no notice of the impugned transaction would be unfair and, moreover, could precipitate commercial uncertainty.

In the United States, a person who takes a transfer from the defendant where the transfer is for value, in good faith and without knowledge of the voidability of the transaction has a complete defence to the claim of a trustee in bankruptcy.[99] Likewise, in England, orders made in relation to transactions at an undervalue or transactions which are preferences are not to prejudice any interest in property acquired in good faith, for value, and without notice of the circumstances surrounding the transaction attacked by the liquidator.[100] It is submitted that a similar approach should be adopted by Australian courts.

'Good faith' is likely to be construed in a manner similar to its construction under insolvency legislation.[101] Essentially, it requires that there is no intention on the part of the person who is required to act in good faith to circumvent the purposes of the laws of insolvency.[102] More specifically, this means that the relevant person must not intend to benefit at the expense of the creditors of the insolvent or collude with the insolvent in order to prejudice creditors.[103]

96 Id at 281.

97 (1887) 5 NZLR 431.

98 Note 4 above, at para 1056.

99 Section 550(b)(1) of the *Bankruptcy Reform Act* 1978 (US). Section 550(b)(2) provides that all subsequent transferees have a defence if they take in good faith.

100 *Insolvency Act* 1986, s 241(2).

101 For example, s 588FG of the Corporations Law and s 122 of the *Bankruptcy Act* 1966 (Cth).

102 *Re Macadam* (1913) 13 SR (NSW) 206.

103 *Shears v Goddard* [1986] 1 QB 406 at 411; *Re Donovan* (1910) 10 SR (NSW) 532 at 533.

It is probable that 'value' will be interpreted in the same way as 'valuable consideration' in s 120 of the *Bankruptcy Act* 1966 (Cth);[104] that is, the consideration given for the transfer of the property is real and of substantial value and not merely nominal or trivial.[105]

As far as the requirement of taking the transfer without notice is concerned, the courts are likely to say that the person must take the transfer without notice of the actual voidable transaction. This begs the question whether a liquidator needs to prove that the transferee had actual notice or whether constructive notice would suffice.

In the United States, the courts have only permitted recovery where the transferee had actual notice.[106] Unless courts in Australia adopt the same view, there is a danger that certainty will be disturbed because a transferee could never be sure that the transferor would not go into liquidation, and if that happened the transfer could be set aside. Moreover, an acceptance of constructive notice could give the liquidator an unfair and unwarranted advantage. It must not be forgotten that ordinarily the liquidator will be able to recover the proceeds of the sale of the property from the original transferee who received the property under the voidable transaction.

It is submitted that while the liquidator should be required to demonstrate that the transferee had actual notice of the voidable transaction, a liquidator must be entitled to ask a court to infer actual knowledge on the part of the transferee from the circumstances.[107] Unless this occurs, a liquidator's task is very onerous. It is always very difficult to impugn a statement of subjective knowledge and it would be in the interests of a person 'to play down' his or her awareness.

Holders of Floating Charges

If a court determines that a pre-liquidation transaction is voidable under s 588FE, orders will be made under s 588FF in favour of the company.[108] Under previous avoidance provisions the orders (such as

104 It is submitted that 'value' in s 588FG will be construed in a similar fashion.

105 *Barton v Official Receiver* (1986) 161 CLR 75; *Shirlaw v Malouf* (1989) 15 ACLR 641; *Official Trustee v Martin* (1990) 24 FCR 504; *Official Trustee v Mitchell* (1992) 110 ALR 484; *World Expo Park Pty Ltd v EFG Australia Ltd* (1995) 129 ALR 685.

106 *Smith v Mixon* 788 F 2d 229 at 230-31 (1986).

107 As in the case where a person's good faith is being considered in bankruptcy law in relation to the acceptance of a preference: see *Bankruptcy Act* 1966 (Cth) s 122(4)(c).

108 The US equivalent of s 588FF, s 550 of the *Bankruptcy Reform Act* 1978, provides that any recovery is preserved for the benefit of the estate.

a declaration of avoidance) were made in favour of the liquidator.[109] For instance, when a court found a payment to be a preference, the court usually would first declare such a payment void as against the liquidator and secondly order that the defendant/creditor pay to the liquidator an amount equal to the preference payment.[110]

It has been held in relation to past avoidance provisions where transactions were said to be void against the liquidator that the amount recovered was for the benefit of the unsecured creditors.[111] In fact, some cases have stated that the liquidator held it in trust for the unsecured creditors of the company.[112] Although McPherson JA (with whom Pincus JA agreed) in the Queensland Court of Appeal case of *Starkey v Deputy Commissioner of Taxation*[113] did not agree that the payments recovered as preferences were held in trust for the unsecured creditors,[114] his Honour said that payments recovered as preferences did not become part of the property of the company in liquidation.[115] His Honour was of the opinion that the amount recovered formed part of the general assets under the control of the liquidator that are, inter alia, available for paying the claims of unsecured creditors.[116] The result was that a secured creditor who had a floating

109 See *Re Chisum Services Pty Ltd* (1982) 1 ACLC 292; *Re Feldmanis Finance Pty Ltd (in liq)* (1983) 1 ACLC 823; *The Commissioners of the State Bank of Victoria v Judson* (1985) 3 ACLC 576; *Taylor v ANZ Banking Group Ltd* (1985) 6 ACLC 808; *Shirlaw v Malouf* (1989) 15 ACLR 641; *Spedley Securities Ltd (in liq) v Sparad (No 100) Ltd* (1993) 12 ACSR 32; *Starkey v Sogelease Australia Ltd* (unreported, Supreme Court of Queensland, 5 May 1994, White J); *Hall v Press Plumbing* (unreported, Federal Court, 20 September 1994, Lindgren J).

110 See *Taylor v ANZ Banking Group Ltd* (1988) 6 ACLC 808 at 827; *Spedley Securities Ltd (in liq) v Sparad (No 100) Ltd* (1993) 12 ACSR 32 at 46; *Hall v Press Plumbing* (unreported, Federal Court, 20 September 1994, Lindgren J) at 38.

111 *Ex parte Cooper; In re Zucco* (1875) 10 Ch App 510 at 511 and 512; *Wilmott v London Celluloid Company* (1886) 34 Ch D 147 at 150; *Sanguinetti v Stuckey's Banking Company* [1894] 1 Ch 176 at 180; *Re Yagerphone Ltd* [1935] 1 Ch 392 at 396; *Re Quality Camera Co Pty Ltd* (1965) 83 WN (pt 1) (NSW) 226 at 229; *NA Kratzmann Pty Ltd (in liq) v Tucker (No 2)* (1968) 123 CLR 295 at 300; *Campbell v Michael Mount PPB* (1995) 13 ACLC 50 at 509, and on appeal (1996) 14 ACLC 218.

112 *Re Yagerphone Ltd* [1935] 1 Ch 392 at 396; *Re Quality Camera Co Pty Ltd* (1965) 83 WN (pt 1) (NSW) 226 at 229.

113 (1993) 11 ACLC 558. Also, see *Re Quality Camera Co Pty Ltd* (1965) 83 WN (pt 1) (NSW) 226 at 229; *NA Kratzmann Pty Ltd (in liq) v Tucker (No 2)* (1968) 123 CLR 295 at 300; *Horn v York Paper Co Ltd* (1991) 5 ACSR 112; *Bibra Lake Holdings Pty Ltd v Firmadoor Australia Pty Ltd* (1992) 7 ACSR 380.

114 *Starkey v Deputy Commissioner of Taxation* (1993) 11 ACLC 558 at 567.

115 Ibid. Also see *Bibra Lake Holdings Pty Ltd (in liq) v Firmadoor Australia Pty Ltd* (1992) 7 ACSR 380 at 383 and 386.

116 *Starkey* (1993) 11 ACLC 558 at 567.

charge over the company's assets could not claim the amount recovered.[117]

Now that orders are made in favour of the company and not the liquidator, a secured creditor who held a floating charge over the undertaking of the company (this has been established to mean a charge over all present and future property of the company[118]) which has entered liquidation, may wish to argue that any recoveries are company property and, as a consequence, can be claimed by the secured creditor.[119] The fact that the charge has crystallised (this will ordinarily be at the commencement of liquidation, at the latest) before the recovery is made by the liquidator is of no concern for the secured creditor.

There is High Court authority to the effect that property acquired after the crystallisation of a floating charge can be claimed by the chargeholder.[120] The holder of a floating charge has an interest in the assets of the company before crystallisation,[121] so he or she would be concerned about any dispositions which are voidable transactions. It

117 If the liquidator recovered property in specie, it was included in the assets of the company, and if a secured creditor had a charge over the assets then he or she was entitled to the benefit of the recovery: *Bank of New Zealand v Essington Developments Pty Ltd* (1991) 5 ASCR 86 at 89-90. In the US, bankruptcy courts have held for a long time that recoveries are available for all creditors of the estate: N Sanborn, 'Avoidance Recoveries in Bankruptcy: For the Benefit of the Estate or the Secured Creditor?' (1990) 90 *Columbia Law Review* 1376 at 1386. This is due to the fact that s 550 of the *Bankruptcy Reform Act* 1978 states that any recoveries are preserved for the benefit of the estate.

118 *Re Panama, New Zealand and Australian Royal Mail Co* (1870) 5 Ch App 318; *Mineral and Chemical Traders Pty Ltd v T Tymczyszyn Pty Ltd* (1994) 15 ACSR 398.

119 See K Bennetts, 'Voidable Transactions: Consequences of Removing Avoidance Powers from the Liquidator and Vesting Them in the Court' (1994) 2 *Insolvency Law Journal* 136 at 139-140.

120 *Ferrier v Bottomer* (1971-72) 126 CLR 597. Also see *Robbie and Co Ltd v Whitney Warehouse Co Pty Ltd* [1963] 1 WLR 1324 at 1331 and 1337-1338; *Re Rex Developments Pty Ltd (in liq)* (1994) 13 ACSR 485 at 494; *Mineral and Chemical Traders Pty Ltd v T Tymczyszyn Pty Ltd* (1994) 15 ACSR 398 at 414. Professor Roy Goode explains that where there is a charge over future property an inchoate security interest is created and when the asset is acquired by the company the interest is deemed to have attached as at the date of the security agreement: 'Is the Law Too Favourable to Secured Creditors?' (1983-84) 8 *Canadian Business Law Journal* 53 at 61. If for any unlikely reason crystallisation had not occurred, the chargeholder would not be able to claim the recovery made by the liquidator: *Re Quality Camera Co Pty Ltd* (1965) 83 WN (pt 1) (NSW) 226.

121 *Evans v Rival Granite Quarries Ltd* [1910] 2 KB 979 at 999; *Hamilton v Hunter* (1984) 7 ACLR 295 at 305; *Re Margart Pty Ltd (in liq)* (1984) 2 ACLC 709 at 712; S Wheeler, 'Swelling the Assets for Distribution' [1993] *Journal of Business Law* 256 at 261-262.

would appear that a liquidator is unable to argue that the disposition was in the ordinary course of business and therefore the chargeholder cannot have any remedy,[122] because while the expression 'in the ordinary course of business' has been construed widely, the disposition (assuming that it is held to be a voidable transaction) would be prohibited by statute.[123]

It would seem that if the creditor's charge had crystallised before the time of the voidable transaction, the creditor would not be entitled to claim any recovery unless the transaction affected his or her title.[124]

Bennetts has stated[125] that a secured creditor could look to the English decision of *Re Produce Marketing Consortium Ltd (No 2)*[126] for some support. In that case, Knox J held that a chargeholder was entitled to any amounts paid by directors to the company pursuant to his orders made under s 214 of the *Insolvency Act* 1986 (UK). The reason for Bennetts' submission is that the wording of s 214(2) is similar to s 588FF, in that it states, inter alia, that a court may order a miscreant director to make a contribution to the company's assets and, therefore, arguably, it should produce the same result.[127]

Further support for a chargeholder may be found in the High Court's decision in *Couve v J Pierre Couve Ltd (in liq)*.[128] In that case a director of a company appealed against a decision that he was guilty of misfeasance on the basis that he paid out certain amounts from company funds to his own advantage. It was accepted by the Court that the payments which the director was ordered to pay would become part of the assets of the company (as recoveries would, apparently, under s 588FF) and, accordingly, it was acknowledged that the chargeholder

122 This would be based on the fact that most debenture deeds which provide for floating security permit the debtor company to dispose of assets in the ordinary course of business. For a discussion of what is 'the ordinary course of business' see *Reynolds Bros (Motors) Pty Ltd v Esanda Ltd* (1983) 1 ACLC 1333; *Fire Nymph Products Ltd v The Heating Centre Pty Ltd* (1992) 10 ACLC 629.

123 Wheeler, note 121 above, at 262.

124 See *Re Asiatic Electic Co Pty Ltd* (1970) 92 WN (NSW) 361; *Campbell v Michael Mount PPB* (1995) 13 ACLC 506. This is the position in the US (see Sanborn, note 117 above, at 1398)

125 Bennetts, note 119 above, at 121.

126 [1989] BCLC 520.

127 Bennetts, note 119 above, at 140. V Finch, in 'Directors' Duties: Insolvency and the Unsecured Creditor' in Alison Clarke (ed), *Current Issues in Insolvency Law* (Stevens, 1991) p 99, states that the approach of Knox J was consistent with the ruling in *Re Anglo-Austrian Printing and Publishing Union* [1985] 2 Ch 891 that damages received for misfeasance are available to a chargeholder.

128 (1933) 49 CLR 486.

was entitled to claim the money paid.[129] However, in *Re Asiatic Electric Co Pty Ltd (in liq)*,[130] a case involving a misfeasance action commenced by a liquidator against the directors of the company being wound up, Street J contrasted the claim with a claim to recover a preference on the basis that the latter was only available because of the liquidation, while the former could have been brought prior to any winding up.[131] While his Honour was of the view that a secured creditor was entitled to the amount recovered under the misfeasance action, he clearly felt that this would not be the case if the action had been for the recovery of a preference.[132]

This does not cast doubts on a chargeholder's argument based on *Re Produce Marketing Consortium Ltd (No 2)*, as an action is only available pursuant to s 214 of the *Insolvency Act* 1986 (UK) where a winding up has occurred, and, therefore, such an action is distinguishable from the misfeasance action considered in *Re Asiatic Electric Co Pty Ltd (in liq)*.

The response which a liquidator may give to an argument based upon *Re Marketing Consortium* is that it was held in *Re Yagerphone Ltd*[133] that property received pursuant to the court's order is impressed with a trust in favour of the unsecured creditors of the company as soon as it is recovered by the company.[134] The courts may find such an argument attractive, as the judgment in *Re Yagerphone Ltd* has been consistently approved of for many years,[135] and there has been judicial resistance to the notion that the recovery of assets revests property in the company for the benefit of chargeholders.[136] This resistance seems to be based on the fact that avoidance provisions are designed

129 Id at 496.

130 (1970) 92 WN (NSW) 361.

131 Id at 364.

132 Id at 363-364

133 [1935] 1 Ch 392 at 396.

134 This was suggested by Professor O'Donovan when arguing that the company should be the proper plaintiff in a preference action. See J O'Donovan, 'Procedural Aspects of Recovering Voidable Preferences' (1993) 1 *Insolvency Law Journal* 65 at 67. McPherson JA in *Starkey v Deputy Commissioner of Taxation* (1993) 11 ACLC 558 at 576 did not accept that a trust existed.

135 For example, see *Re Quality Camera Co Pty Ltd* (1965) 83 WN (pt 1) (NSW) 226; *NA Kratzmann Pty Ltd (in liq) v Tucker (No 2)* (1968) 123 CLR 295; *Re MC Bacon Ltd* [1991] Ch 127; *Bibra Lake Holdings Pty Ltd (in liq) v Firmadoor Australia Pty Ltd* (1992) 7 ACSR 380.

136 Bennetts, note 119 above, at 142.

to ensure that creditors are treated equally.[137] In the English decision of *Re MC Bacon Ltd*,[138] Millett J said that the court's powers to make orders in relation to cases where a preference has been found to have been given are not intended to enable a chargeholder to benefit from proceedings initiated by a liquidator.[139] His Lordship said that the principle in *Re Yagerphone Ltd* is still good law despite the changes brought about by the enactment of the *Insolvency Act* 1986 (UK).[140]

Certainly there appears to be no indication in either the Explanatory Memorandum to the Corporate Law Reform Bill 1992 (Cth) or the speeches in Parliament in relation to the Bill that the Government wished to see the extant law on this issue changed and secured creditors especially favoured; one would envisage that if a change was intended to the inveterate principle discussed above, the Government would have signalled it clearly. The silence of the Government may offer some support to liquidators who wish to fight off secured creditors by arguing that the principle in *Re Yagerphone Ltd* subsists.

A liquidator may also point to what Millett J had to say in his judgment in *Re MC Bacon Ltd*[141] about sums recovered as a result of a preference action. His Lordship said that such sums enure for the benefit of the unsecured creditors and not for the benefit of the company or a holder of a floating charge.[142] Millett J determined this despite the fact that the *Insolvency Act* 1986 (UK) does not state that preferences are void as against the liquidator. The legislation states that any order made in relation to a preference claim is to restore the position to what it would have been had the preference not been given.[143] But for his Lordship's pronouncement, chargeholders may have sought to argue with some force that they were entitled to claim the benefits of any recoveries made by liquidators, on the basis that if the transactions had not been entered into they could have attained or

137 *Re An Application by JGA Tucker and Reid Murray Developments (Qld) Pty Ltd* [1969] Qd R 193 at 200 and 203. The requirement of equality was one of the reasons given by the US Court of Appeals for its decision in *In re First Capital Mortgage Loan Corp* 917 F 2d 424 at 428 (1989) that recovered property was the property of the bankrupt estate.

138 [1991] Ch 127.

139 Id at 137.

140 Ibid.

141 Ibid.

142 Ibid.

143 See s 239(3).

retained an interest over the property transferred.[144] A liquidator in Australia may seek to argue that any order made under s 588FF which directs a person to repay a preference to the company is effecting a restoration of the position which would have existed had the preference not been granted and, on the basis of *Re MC Bacon Ltd*, the liquidator was entitled to hold the funds for the general body of creditors.

Furthermore, in *Starkey v Deputy Commissioner of Taxation*,[145] McPherson JA said that if a secured creditor could not initiate for his or her own benefit poceedings for the avoidance of preferences, it follows logically that the secured creditor should not be able to claim the proceeds of such proceedings.[146] While his Honour was addressing the avoidance scheme in place before 1993, the central point made by his Honour may provide a further argument in favour of a liquidator. Also, the recent decision of the Full Court of the Supreme Court of South Australia in *Campbell v Michael Mount PPB*[147] suggests that the fact that courts will order payment of money recovered as preferences to the company does not mean that a secured creditor has a charge over that money. The case involved the issue of whether a secured creditor should be entitled to any recovery made by a liquidator under s 468 of the Corporations Law. However, in the course of delivering the leading judgment, Doyle CJ considered the position of secured creditors where liquidators recovered preferences. His Honour observed that while claims to recover preferences had to be initiated in the name of the liquidator, the appropriate order, if the liquidator succeeded, was, according to *Octavo Investments Pty Ltd v Knight*,[148] for payment to be made to the company.[149] Doyle CJ went on to say that this suggested that the fact that the money is to be paid to and received by the company is not sufficient to enable a charge to attach to the money. This was, according to his Honour, because the recovery of a preference payment is for the benefit of unsecured creditors.[150]

144 This was proposed by Finch, note 127 above, at p 98, before the decision in *Re MC Bacon Ltd.*

145 (1993) 11 ACLC 558.

146 Id at 566-567

147 (1996) 14 ACLC 218.

148 (1979) 144 CLR 360 at 372.

149 (1996) 14 ACLC 218 at 226.

150 Ibid.

To hold that chargeholders are entitled to recoveries would be antithetical to the whole ethos underlying the enactment of the avoidance provisions contained in the Division.[151] The Explanatory Memorandum to the Corporate Law Reform Bill 1992 clearly indicates that the provisions were designed to protect the unsecured creditors. The Memorandum states that:

> The purpose of the provisions in this proposed Division [Division 2 of Part 5.7B] is to ensure that *unsecured creditors* are not prejudiced by the disposition of assets or the incurring of liabilities by a company in a period shortly before the winding up which would have the effect of favouring certain creditors or other persons, and especially related entities ... The provisions also seek to avoid transactions where the body of *unsecured creditors* might be prejudiced by the company having given away assets or incurred liabilities without adequate consideration passing to the company.[152]

Holding that chargeholders are entitled to any recoveries could cause ailing companies to be dismembered more quickly, as creditors are likely to be even more aggressive in seeking payments, particularly where companies appear to be insolvent and likely to end up in liquidation.[153]

Furthermore, if chargeholders were favoured by orders under s 588FF, the frustration which unsecured creditors often feel with the distribution rules in liquidation[154] would be heightened, and this is likely to have the undesirable result of having the winding-up process regarded by creditors with disdain.

It has been argued by an American commentator that a secured creditor who held a floating charge should be entitled to claim the benefits flowing from an avoidance action, as this would be consistent with the benefits which the creditor would have received but for the entering into of the voidable transaction.[155] With respect, it appears that this argument overlooks the fact that bankruptcy or liquidation changes everything. While the company continues to exist, it is no

151 See J O'Donovan, 'Who Should Benefit From the Recovery of Void Dispositions Under Section 468 of the Corporations Law?' (1995) 12 *Company & Securities Law Journal* 460 at 461.

152 See note 4 above, at para 1035 (emphasis added).

153 A Keay, 'An Exposition and Assessment of Unfair Preferences' (1994) 19 *MULR* 545 at 570.

154 Generally, see R Goode, 'The Death of Insolvency Law' (1980) 1 *The Company Lawyer* 123.

155 N Sanborn, 'Avoidance Recoveries in Bankruptcy: For the Benefit of the Estate or the Secured Creditor?' (1990) 90 *Columbia Law Review* 1376 at 1399-1400.

longer directed by directors, and it is not run for the benefit of the shareholders. A liquidator acts on behalf of the company and he or she does so for the general body of creditors.[156] Liquidation produces a whole new set of relationships and duties. While a secured creditor may argue that the general creditors are sometimes unjustly enriched by receiving the benefits of a recovery, the rebuttal to that might be that those creditors were prejudiced before liquidation because they did not receive any benefit from the voidable transaction and, in any event, they have suffered losses as a result of the liquidation.

Obviously, the resolution of the issue awaits a judicial opinion in a case where an amount has been recovered pursuant to s 588FF.

Conclusion

So much of the focus in the area of the avoidance provisions is on the question of whether a transaction is or is not voidable. While this is undoubtedly a crucial issue, one must not forget that the issues surrounding the effects of a transaction being held to be voidable are of equal importance, certainly in practice.

If a court is satisfied that a transaction is voidable, the court may make orders in relation to the transaction. A court does not have to make an order which avoids the transaction; instead, under s 588FF, the court can make one or more of ten orders. The right to make one or more of a number of orders enables greater flexibility than was previously allowed.[157]

If a court determines that a transaction is voidable, many parties may be affected by subsequent orders. Those persons who entered into the impugned transaction on behalf of the company may, if they intended to benefit themselves or associates, or knew of the company's insolvency, be held liable for misfeasance.

Persons against whom the liquidator takes legal proceedings are, if unsuccessful in their defence, subject to a number of effects, depending on the nature of orders made by the court. One of the major issues is this: what if the defendant improved the property received pursuant to the voidable transaction, and he or she is required to

156 Of course the liquidator has certain responsibilities to ensure that the public interest is not compromised.

157 However, it has been submitted (Keay, note 3 above, at 200-201) that the legislature would have achieved a better result if it had included a general power which entitled the courts to construct their own orders, rather than having to remain within the parameters set by the orders enumerated in s 588FF(1).

transfer it to the liquidator? Perhaps the most appropriate order in such a case is an order that the defendant pay the liquidator the value of the property as at the date of the voidable transaction.[158] In dealing with this issue and all issues relating to the transfer of property under a voidable transaction, the court is required to seek to do justice and this will mean that rigid orders cannot be sought or made. Courts need to make decisions on a case-by-case basis.

Those persons who act in good faith and take property from the defendant are protected. It has been submitted that orders should only affect those who knew about the voidable transaction. If not, then not only will injustices occur but commercial uncertainty may eventuate.

Finally, it appears that secured creditors who held floating charges over the assets of companies in liquidation have, depending on the circumstances, an arguable case that they are entitled to claim the money which they are owed from any recoveries made by liquidators under s 588FF. It is submitted that to allow such claims would be unfortunate. There appears to be no discernible legislative intention to change the law as it has existed for some time; that is, that secured creditors have no claim to amounts received by liquidators as a result of avoiding pre-liquidation transactions. Also, the purpose behind the enactment of avoidance provisions is to ensure that unsecured creditors, and not secured creditors, are protected.

158 It is probable that the liquidator would claim and receive an order for interest on the value of the property.