THE BALLAD OF THE RUNNING ACCOUNT—VOIDABLE PREFERENCES IN THE ORDINARY COURSE OF BUSINESS

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When the Commonwealth Government introduced new bankruptcy legislation in 1966 it wisely left largely unaltered the provision relating to voidable preferences.[1] There has been in the last five years a spate of litigation arising from the operation of the trustees' powers under this section.[2] It is suggested that when these particular decisions are assessed, the objective test,[3] embodied in our provisions, is seen to be quite satisfactory. In any event in this particular article I am not concerned with a comparison of the objective test, as illustrated by the Australian provision (a similar approach being adopted in the U.S.A.[4]) with the subjective test which was required under the English and Canadian legislation.[5]

Whichever approach is adopted it is clear that the particular provision as interpreted must remain flexible. The complexities of modern commercial life do not really form a sound foundation for some of the principles of 19th century and earlier bankruptcy law.[6] Much of our Bankruptcy Act is still based on these early principles.[7] It will be clear that the preference section of the Bankruptcy Act is phrased in a way which permits of a more neutral and more realistic interpretation in the light of commercial developments.[8]

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[1] Formerly s.95 of the Bankruptcy Act 1924-1964 (Cth) now s.122 of the Bankruptcy Act 1966 (Cth). See *Report of the Clyne Committee* paras 174-176.

[2] These cases are discussed in detail in this article. The major cases which went to the High Court of Australia are: *Sandell v. Porter* (1966) 115 C.L.R. 666; *Queensland Bacon Pty Ltd v. Rees* (1966) 115 C.L.R. 260; *Rees v. Bank fo N.S.W.* (1964) 111 C.L.R. 210; *Taylor v. White* (1964) 110 C.L.R. 129; *Rae v. Samuel Taylor Pty Ltd* (1963) 110 C.L.R. 517.

Other recent cases of note are: *North West Construction Co. Pty Ltd v. Marian* [1965] W.A.R. 205. *Re Beatty & anor; Ex parte Melsom* (1963) 20 A.B.C. 97.

[3] *I.e.* a test looking at the result of the payment etc., rather than the intention of the debtor. Compare s.44 of the English Act of 1914 and see Deane, Bohringer and Fernon *McDonald Henry and Meek's Australian Bankruptcy Law and Practice* (4th ed. 1968) 298-300.

[4] Bankruptcy Act U.S. (Chandler Act of 1938); see Hanna, 'Preferences' (1948) 15 *University of Chicago Law Review* 112.

[5] Bankruptcy Act 1952 (Canada), s.64; Bankruptcy Act 1914 (Eng.), s.44.

[6] The doctrine of relation back, for example, was introduced in the 16th century. See 13 Eliz. c.7(1571) and the *Case of the Bankrupts* (1592) 2 Co. Rep. 25; see generally Levinthal, 'The Early History of English Bankruptcy' (1919) 67 *University of Pennsylvania Law Review* 1.

[7] This is quite clear by comparing many of the current Australian provisions with the English Act of 1883 and to a very much less extent The English Act of 1869 as well as the earlier acts dealing with fraudulent dispositions and preferences *supra* n. 6.

[8] The provisions of s.122 are incorporated by virtue of s.293 into the companies legislation of the various states and territories. Indeed many of the cases discussed herein arose under that provision or one of its forerunners.

It is not my intention to deal analytically with all aspects of the definition of a preference. My aim is rather to ascertain to what extent payments made, in what are loosely referred to as 'running accounts', constitute preferences which are prima facie void as against the trustee in bankruptcy, and to what extent the defences which are specifically provided for in other sub-sections of s.122 are available to creditors who receive such payments. It will be apparent that the approach which has been adopted recently by the High Court, and by other courts is one which is aimed at ensuring a smooth, or as smooth as possible, continuation of commercial relations between various parties during the threat of or immediately before bankruptcy.[9] It may also become clear that this approach does not depart from the one which requires that all creditors be treated equally in the event of a man becoming bankrupt.[10]

A preference is prima facie a transfer, conveyance, or other dealing with property, a payment of money or the incurring of a debt or obligation by a person (the debtor), either within a period of six months prior to the presentation of a petition leading to the debtor's bankruptcy or between the date of the presentation of such petition and the sequestration order, provided that the particular transfer etc., is made when the debtor is insolvent, and provided further that the transfer etc., gives the creditor who receives same or who is to benefit from same a priority, advantage or preference over other creditors of the particular debtor. Assuming that a preference has been substantiated, the particular creditor may escape the avoiding powers of the trustee if he can show that he was a person who dealt with the debtor in good faith in the ordinary course of business and gave valuable consideration in respect of that dealing.[11]

[9] Or in many of the cases the winding up of the company.

[10] 'But if after the debtor becomes a bankrupt, he may prefer one . . . and defeat and defraud many other poor men of their due debts it would be unequal and unconscionable and a great defect in the law.' *Case of the Bankrupts* (1592) 2 Co. Rep. 25. This was the prime motivation for the introduction of the doctrine of relation back; see Levinthal *op. cit.*

[11] The relevant provisions of s.122 are:

'(1) A conveyance or transfer of property, a charge on property, a payment made or an obligation incurred by a person who is unable to pay his debts as they become due from his own money (in this section referred to as "the debtor"), in favour of a creditor, having the effect of giving that creditor a preference, priority or advantage over other creditors, being a conveyance, transfer, charge, payment or obligation executed,

made or incurred—

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

(b) after the presentation of a petition on which the debtor becomes a bankrupt and before the debtor becomes a bankrupt,

is void as against the trustee in the bankruptcy.

(2) Nothing in this section affects—

(a) the rights of a purchaser, payee or encumbrancer in good faith and for valuable consideration and in the ordinary course of business; or

(b) the rights of a person making title in good faith and for valuable consideration through or under a creditor of the bankrupt.

(3) The burden of proving the matters referred to in the last preceding sub-section lies upon the person claiming to have the benefit of that sub-section

(4) For the purposes of this section—

(c) a creditor shall be deemed not to be a purchaser, payee or encumbrancer

Where a relationship exists between a debtor and a creditor which requires not merely a series of instantaneously completed transactions, (for example where A buys goods from B, pays for them in cash, then some weeks later buys some more goods from B, pays for them in cash and so on) but a series of transactions on a relationship which is not brought to an end by any specific purchase or any specific payment, the question of whether the debtor would be regarded as preferring the creditor if payments are made when insolvency is imminent, represents a very difficult issue for the courts. Such relationships exist between suppliers of goods which are not paid for in cash but in respect of which extended credit facilities are provided,[12] or between a banker and his client where an overdraft arrangement has been made and substantial drawings are made in respect of the overdraft and at the same time payments are continually made in reduction of the overdraft,[13] or relationships where moneys are paid on account without differentiating between past or future services.[14] Where such relationships exist, not only is it a difficult issue to determine whether a preference is constituted by any payment made by the debtor in compliance with obligations which are incurred under the specific relationship, but an even more difficult question may arise in determining whether the particular creditor can safely invoke the defence available to him under section 122 sub-section 2. It is intended in this article to highlight some of these difficulties by discussing recent cases referred to earlier and to attempt some answers to difficult problems which have been raised.

PREFERENCES AND RUNNING ACCOUNTS

The exact nature of a preference has never been clearly stated by the courts. There are a number of clear cut examples where the courts have encountered little difficulty in deciding whether a particular payment or a particular dealing is a preference or not. It is not intended here to relate a series of examples pointing out what are and what are not preferences.[15] The major issues which I shall be concerned with in this article, and in particular the question of preferences and running accounts, were fully discussed in the recent decision of the High Court of Australia in *Queensland Bacon Pty Ltd v. Rees*.[16] The case involved the application by the liqui-

in good faith if the conveyance, transfer, charge, payment or obligation made or incurred under such circumstances as to lead to the inference that the creditor knew, or had reason to suspect—

(i) that the debtor was unable to pay his debts as they became due from his own money; and

(ii) that the effect of the conveyance, transfer, charge, payment or obligation would be to give him a preference, priority or advantage over other creditors.

[12] *E.g. Queensland Bacon Pty Ltd v. Rees* (1966) 115 C.L.R. 266.

[13] *E.g. Rees v. Bank of N.S.W.* (1964) 111 C.L.R. 210.

[14] *E.g. North West Construction Co. Pty Ltd v. Marian* [1965] W.A.R. 205.

[15] See McDonald Henry and Meek *op. cit.* 300-3.

[16] (1966) 115 C.L.R. 266. All four creditors were appellants to the High Court. It will be convenient throughout this article to refer to the case as the *Queensland Bacon* case.

dator of the Queensland company Hennesseys Selfservice Stores Pty Ltd, (referred to hereafter as 'Hennessey's) to set aside alleged preferences made to a number of companies, namely Queensland Bacon Pty Ltd, (hereafter referred to as 'Queensland Bacon'), the Egg Marketing Board, (hereafter referred to as 'The Board'), Burns Philp & Co. Ltd, (hereinafter referred to as 'Burns Philp') and Foley Brothers Pty Ltd, (hereinafter referred to as 'Foleys'). The particular provision of the Companies Act 1931–1960 (Qld) incorporated the preference section of the Bankruptcy Act (Cth)—namely section 95 of the act of 1924-1960. To all intents and purposes the relevant section is reproduced in section 122 of the 1966 act.

Queensland Bacon and the other wholesale grocery suppliers had dealt for some time with Hennesseys. Hennesseys operated a chain of self service grocery stores in and around Brisbane. It enjoyed a rapid expansion in the early part of 1960. This exuberant expansion of its business required a substantial amount of capital on the part of Hennesseys as well as substantial quantities of trading stock. The wholesale suppliers arranged extensive credit terms for Hennesseys who in addition obtained generous bank overdraft arrangements from its bankers the Bank of New South Wales. The credit squeeze of late 1960 resulted in the bank calling in a substantial portion of this overdraft. The calling in gave rise to the litigation in *Rees v. Bank of N.S.W.*[17] Substantial reliance had been placed on this overdraft by Hennesseys, and as a result of the insistence by the bank of a reduction in the amount of overdraft outstanding, coupled with the difficult trading conditions that it was encountering, it was required to fall back upon the credit extended to it by the various wholesalers referred to above.

The overall decline in consumer spending which was directly attributable to the credit squeeze began to have a very definite effect on the trading performance of Hennesseys. Although a petition to wind the company up was not presented until February 1961 the Court[18] held that the company was in fact insolvent on 1 November 1960. It will become clear from the facts that the company had in fact experienced very severe financial embarrassment and difficulties prior to that date. Liquidation of the company was ordered on 16 March 1961 and one Rees was appointed liquidator.

From June 1960 until the petition was presented, Hennesseys had drawn a number of cheques in favour of the four wholesalers involved in the case. Many of these cheques were dishonoured on initial presentation; a variety of advices was given by Hennesseys' bank when these cheques were not met.[19] It was almost without exception that cheques which were required to be represented were honoured on the second presentation. Alternatively cheques were replaced when alternative financial arrangements were made. It was a question of fact that until the 19th of November 1960 no cheque which had been dishonoured remained unpaid. The actual date of

[17] See *Rees v. Bank of N.S.W.* (1964) 111 C.L.R. 210 (discussed *infra*).
[18] Queensland Supreme Court (Gibbs J.).
[19] *E.g.* 'present again; arrangements incomplete': see Barwick C.J. (1966) 115 C.L.R. 266, 279.

insolvency was however found to be 1 November 1960 and this particular issue was not disputed by the parties. The court was asked to determine whether or not payments made after 1 November 1960 to the various creditors were preferences, and if so whether or not the particular creditors were able to substantiate that they were acting in good faith for valuable consideration and in the ordinary course of business and thus retain the benefit of the preference.[20]

On both issues, namely, whether preferences occurred and whether the creditors were able to retain the benefit of them the court was divided—the Chief Justice Sir Garfield Barwick and Kitto J. found in favour of the creditors and Mr Justice Menzies in favour of the liquidator. It is appropriate to deal with the two issues in the order which the court dealt with them and to look generally at the particular issues in the light of other cases of a similar nature.

In this case there was no traditional relationship of debtor and creditor where the supplier of goods received payment for these goods on delivery or shortly thereafter. 'Each of the four appellants . . . had been trading with the company for some time . . . on the footing that goods of the kind dealt in by both the company and the creditor would be supplied by the creditor on agreed terms of credit upon the order of the company. . . . The course of business between the company and each creditor was such that the company could reasonably expect that so long as it paid the creditor's accounts according to the current credit arrangement between them, the creditor would continue to supply . . . goods. . . . On the other hand, that course of business was such that the company could expect a rejection of its further order for goods to be supplied on credit if it failed so to pay the creditor's account.[21] The various debits and credits were entered into a single account in the books of the company in respect of each creditor. It was essential to the case argued by the creditors that none of them should be shown, in respect of the various payments, to have acted on the basis that failure to pay meant insolvency. 'These creditors thought that the company was experiencing a temporary [credit] difficulty. . . . [They] believed that the stocks on hand were sound . . . and that they would be realised at such a rate as would make the company's embarrassment by a temporary lack of liquidity short lived.'[22]

All members of the High Court in this instance referred freely to the statement of the High Court in *Richardson v. Commercial Banking Company of Sydney Ltd*,[23] (hereinafter referred to as *Richardson's* case).

> A running account of any debtor who has reached insolvency must present difficulties under s.95. A debtor who pays something off his grocer's account in order to induce the shopkeeper to give him further supplies of groceries can hardly he held, as it seems to us, to give the grocer a preference, if that was the clear basis of the payment. If the grocer credited the money as a payment

[20] By virtue of s.122 (2).
[21] (1966) 115 C.L.R. 266, 281 *per* Barwick C.J.
[22] *Ibid.* [23] (1952) 85 C.L.R. 110, 133.

> for the future deliveries instead of the past deliveries of groceries he would in the end be in exactly the same position and yet he could not be attacked as having received a preference. But without stating any principle with an application beyond the facts of this case, it is enough to decide that the payments into the office account possessed in point of 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.

Where a running account can be shown to exist, the relationship of debtor and creditor is never really ended so long as the account is left standing. '[I]t seems to me that it is one thing to pay a sum of money in the liquidation of an indebtedness, so as to end the relationship of debtor and creditor, and that it may be quite another to make a payment on account of a running indebtedness, the payment not in any wise intended or understood to end the relationship of the debtor and creditor, but rather to ensure its continuance.'[24]

The important criteria which Sir Garfield Barwick said were to be relied upon to support the assumption that the payments in this case were made on a running account (with no fixed plan that payment would in turn ensure future supplies) was that the 'payment is made [on] a mutual assumption by the parties that there will be a continuance of the relationship of buyer and seller with reluctant continuance of the relation of debtor and creditor in the running account'.[25] This assumption would enable the court, the liquidator or trustee, or any interested person to be certain that it would not be possible 'to pause at any payment in the account and treat it as having produced an immediate effect to be considered independently of what followed'.[26]

Barwick C.J. (and Kitto J, although he was inclined to avoid the issue of whether any preference could be said to have been created and to limit his discussion to the defences available to the creditors) interpreted the evidence broadly to conclude that no preferences in fact occurred. Menzies J. on the other hand after exposing the various accounts of the four suppliers to close examination concluded that preferences were quite clearly revealed. Relying to a large extent on the same 'definition' of running account as enunciated in *Richardson's* case (Barwick C.J. also relied on it) Menzies J. stressed that what the court in *Richardson's* case had in mind in talking of running accounts were cases 'where the payments made would not exceed the value of the groceries to be supplied'.[27] He found on examination of the various accounts that it was intended on each occasion when the company was to pay its creditors that the latter's position *vis-à-vis* the company as a creditor would be improved. However on close examination of the figures that his Honour relied on, this is hardly substantiated.

[24] (1966) 115 C.L.R. 266, 283. [25] *Ibid.* 286.
[26] *Ibid.* (Barwick C.J. referring to *Richardson's* case).
[27] *Ibid.* 317.

In the case of Queensland Bacon, the figures do not substantiate such a conclusion at all. The debit balance was reduced in November, but reached a new peak in February. Menzies J. suggests that this was indication enough that Queensland Bacon was aware to some extent of the insolvency or difficulties of Hennesseys. It seems a little unlikely however that in such circumstances Queensland Bacon would have permitted Hennesseys to have become more deeply in debt by virtue of inadequate payments to cover increased supply in December and January.[28]

The Burns Philp account also revealed no consistency to support the contention that the amount owing was reduced each month[29] and the account of Foleys, also showed little if any conclusive support for His Honour's reasoning.[30]

Menzies J. was quite plausibly arguing that if it could be shown that the amount outstanding on the account was at each payment being gradually reduced, then there would be some proof in favour of the notion that the particular creditor had been preferred.[31]

Hennessey's insolvency was also the background for *Rees v. Bank of N.S.W.*[32] The Bank of N.S.W., as has been noted above, were the bankers for Hennesseys. By March of 1960 the account of Hennesseys with the bank was overdrawn to the extent of £17,230. A limit of £20,000 was placed on the overdraft. This was exceeded throughout the following period but the bank was relatively unconcerned prior to the end of September 1960 because the company was negotiating for the sale of all its shares. Shortly after these negotiations were brought to an unsatisfactory conclusion, the bank informed Hennesseys that the overdraft would have to be reduced by a total of £3,000 a month. However, for the next 1½ months the overdraft was increased substantially, so that further request was made by the bank to reduce the overdraft by £7,000 a month. Between 1 December 1960 and 8 February 1961, the overdraft was in fact reduced by a total of £20,292. The company was, as we have seen, wound up pursuant to a petition presented on 10 February 1961.

The Bank of N.S.W. argued that no preferences were created by the substantial reduction of the overdraft, and relied heavily on the High Court's decision in *Richardson's* case.

In *Richardson's* case the relationship which existed between the bankrupt Price and the bank, The Commercial Banking Co. of Sydney, was however more complex than the relationship between Hennesseys and The Bank of N.S.W. Moneys were outstanding on both his Office Account and his Trust Account and there were a number of occasions when moneys were transferred from the Office Account to the Trust Account in order to ensure that Price was not in breach of the Trust Fund rules applying to solicitors. On each occasion where money was transferred to the Trust

[28] *Ibid.* 319. [29] *Ibid.* 316. [30] *Ibid.* 320.

[31] His Honour stated that the whole amount of the payment would have been set aside (*ibid.* 317) but the correct position would be, it is suggested, for the amount to be limited to the amount by which the debit balance was reduced (*ibid.* 282).

[32] (1964) 111 C.L.R. 210. Referred to as *Rees'* case.

Account the trustee in bankruptcy argued that a preference was being given to the bank.[33] The High Court was unanimous in refusing to grant the trustee's application. 'In considering whether the real effect of a payment was to work a preference, its actual business character must be seen, and when it forms part of an internal transaction which . . . will leave the creditor without any preference . . . the payment cannot be isolated and construed as a preference.'[34] Price was very favourably treated by the bank manager, and this enabled him to put off the evil day when his financial misbehaviour was finally uncovered. In fact on his arrest for fraud his overdraft (on his office account) was greater than at the beginning of the relevant period.

Dealing specifically with *Richardson's* case, Barwick C.J. found that there was no similarity between that decision and the facts before him in *Rees* case. Each deposit received on behalf of Hennesseys was used by the bank partly in ensuring that cheques drawn by Hennesseys were honoured (the sole use to which the deposits made to the trust account in *Richardson's* case were put), and also in reducing the company's overdraft commitment with the bank. Individual payments could be examined to ascertain individual preferences, but it was, Barwick C.J. found, 'sufficient in the circumstances of the case to take the overall effect of the deposits with the withdrawings in the period'.[35] The ultimate effect of Hennesseys' deposits was indeed the basis upon which the liquidator brought his claim against the bank.

The High Court was unanimous[36] in finding that the bank had received preferences in the relevant period. The evidence clearly pointed to the conclusion that the company was insolvent on 1 December 1960 (although as we have seen in our discussion of the *Queensland Bacon* case the date agreed upon there was a month earlier) and that the effect of the arrangement to reduce the overdraft mant that the bank was improving its position on each occasion, and was thus in receipt of a preference.

It is clear that this particular factual situation illustrates more reliably the argument that Menzies J. was making on the question of preferences in the *Queensland Bacon* case. In *Rees'* case the substance of the transaction was the overdraft with the bank—an improvement in the bank's position as a creditor of Hennesseys. On the evidence referred to in the decision this important element was missing in the *Queensland Bacon* case.

One further clear example of a solution where preferences occurred as between a banker and a customer where overdraft accommodation existed, was in the Western Australian case of *Re Beatty*,[37] which is discussed in some detail later.[38]

Apart from the situation involving banker and customer the running

[33] The Office Account being the personal account; the Trust Account comprising sums held by Price in a fidiciary capacity.
[34] (1952) 85 C.L.R. 129.
[35] (1964) 111 C.L.R. 220.
[36] Barwick C. J., Kitto and Taylor JJ.
[37] *Re Beatty and anor; Ex parte Melsom* (1963) 20 A.B.C. 97.
[38] *Infra* p. 194.

account may create certain difficulties in relation to what are commonly referred to as 'budget accounts'. Severe stamp duties have always been a major factor in influencing retailers of consumer goods to seek ways and means of avoiding hire purchase and similar transactions. One method which has been successfully adopted is the credit account or the budget account.[39] These are generally not subject to stamp duty so long as the particular goods being purchased are never in fact paid for at the instant of delivery.[40] The important thing is that the customer continues to make regular weekly or monthly payments to his account, the credits being offset by the value of goods which have been in fact purchased by the customer.

What is the position of a retailer who receives payments in respect of goods being purchased in this manner? Can it be said at any point of time where one of the customers is insolvent that the retailer is receiving a preference? It would appear that the position of the retailer in this example is very similar if not identical to the situation which confronted the wholesalers in the *Queensland Bacon* case. This would be so even though no purchases were being made at specific points of time when the account of the particular customer was in debit. The question of knowledge would again be one purely determined on the facts, and it would be more difficult, it is submitted, for retailers in a situation such as this, to ever be fully aware that a particular debtor is insolvent or that they are receiving preferences.[41] Retailers operating these budget accounts must encounter many instances where cheques are not met on first presentation, and it would hardly be a justification on the part of the retailer to assume that a particular debtor is bankrupt. A more valid assumption would be that the particular debtor may have failed to make suitable arrangements with his bank.

Running accounts may make it a different question to determine whether or not a preference has been given where payment is made periodically in respect of services rendered and to be rendered. In *N.W. Construction Co. Pty Ltd v. Marian*[42] the defendant was at all relevant times solicitor for the plaintiff company. His fees for specific work were paid by the company following the presentation of a petition to wind it up in September 1964. Previously in May 1964 two payments of £50 each were paid by the company to Marian. It was held that these were not paid in respect of any particular work done but on a general account for legal work done or to be done by the defendant on behalf of the plaintiff company. Neville J. dismissed a claim that there were preferences caught by the equivalent of section 122. Referring to *Richardson's* case and in particular to the des-

[39] See Corr and Begg, 'Legal Aspects of Credit Plans' (1964) 38 *Law Institute Journal* 366, 379.

[40] *Ibid.*

[41] This of course is relevant more particularly to the defence which is available to the retailer rather than to the issue of 'preference'. More pertinent is the question of whether the debtor would continue to be supplied with goods if no payments were made.

[42] [1965] W.A.R. 205 see also *King v. Hutton* [1900] 2 Q.B. 500 (running account with a stockbroker).

cription of running accounts set out above his Honour stated[42a] 'at that time [when the £100 was paid] although the defendant had done legal work for the company, no bill of costs had been rendered, so it is least doubtful whether at that time the defendant was in fact a creditor of the company. But in any event the moneys were paid not in respect of any specific work already done but on a general account for legal work done or to be done . . .'. This case is even stronger than the example given by their Honours in *Richardson's* case. (The grocer's account), as in that example there would have been debts due and payable by the customer to the grocer at the time the payment was made, whereas no moneys were presently due and payable by the company to the defendant in May 1964.

WHEN IS A DEBTOR INSOLVENT?

The obligation on the part of a trustee to show a preference has been created involves, *inter alia*, the proving of the debtor's insolvency at the time the preference was given. In addition to this particular onus which is placed on the trustee, it is also a question of importance for a creditor who wishes to avoid the setting aside of a particular preference. The creditor must show that he acted in good faith, and he is deemed not to have acted in good faith if he knew or had reason to suspect that the debtor was insolvent.[43]

Insolvency here is said to exist where the debtor is unable to pay his debts as they become due from his own money.[44] The particular meaning of this term has recently been discussed by the High Court.[45] However the discussion of this question dates back to 1907 when in the case of the *Bank of Australasia v. Hall*,[46] Isaacs J. stated:

> This does not mean that he is always bound to keep by him in cash a sum sufficient to meet all his outstanding indebtedness however distant the date date of payment may be. If at the time he makes the assignment, the debtor's position is such that he has property either in the form of assets in possession or of debts, which if realised would produce sufficient money to pay all his indebtedness, and if that property is in such a position as to title and otherwise that it could be realized in time to meet the indebtedness as the claims mature, with money thus belonging to the debtor, he cannot be said to be unable to pay his debts as they become due from his own moneys. In other words, if the debtor can, by sale, or mortgage of property which he owns at the time of the assignment, change the form of the property into cash wholly or partly but sufficient for the purpose of paying his debts as they become due, that requirement of the section is satisfied.

In addition to judging whether the particular debtor has sufficient cash on hand or whether his assets may be turned into cash, one must 'look at all the surrounding circumstances of the case, the nature of his trade or

[42a] [1965] W.A.R. 209. [43] S.122 (4) (c). [44] S.122 (1).
[45] *Sandell v. Porter* (1966) 115 C.L.R. 666.
[46] (1907) 4 C.L.R. 1514, 1543.

business, the manner or method, or payment of debts in that trade or business, the time when the proceeds of such trade or business will be forthcoming, the manner or method of obtaining credit, and the nature of the assets, and perhaps several other matters'.[47] It is not a question of gauging what resources may be immediately available to the particular debtor. The final question of whether the debtor is insolvent will be clear 'from a consideration of the debtor's financial position in its entirety and generally speaking ought not to be drawn simply from evidence of a temporary lack of liquidity. It is the debtor's inability, utilizing such cash resources as he has or can command through the use of his assets, to meet his debts as they fall due, which indicates insolvency'.[48]

Expert evidence may be called to assist the court in ascertaining whether or not a man is insolvent, but it is basically a question for the court, the expert's evidence being merely a guide as to the speed and efficiency of the particular assets of the debtor being able to yield cash, and the actual yield that may take place on a speedy sale.[49] For example, it may be more difficult for a debtor to obtain the full market price for a particular asset on a quick sale than if he were to bide his time, within reasonable limits, and sell in the open market for the best price possible.

There is some dispute as to whether the words 'from his own money' should be construed as including money available to the debtor by borrowing.[50] It is suggested that the better view is that this issue now can be resolved by looking at the extent to which the debtor may be able to realize his assets either by sale, by mortgage, or pledge within a relatively short period of time.[51]

TO SET ASIDE, OR NOT TO SET ASIDE?

Assuming that a preference has in fact been substantiated, the onus then turns to the creditor, to whom the preference has been made, to show (1) he is a purchaser, payee or encumbrancer acting in good faith (2) that he has advanced valuable consideration[52] and (3) that the transaction was in the ordinary course of business.

The defence is also available to a person who takes title in good faith and for valuable consideration through or under a creditor, but we are not here concerned with this defence.

The three elements in this defence have again been the subject of discussion in the courts, but it is not our intention to deal with the question of valuable consideration. It has not presented any special problems requiring its meaning to be 'modified' in dealing with preferences. On the

[47] *Re E. C. Smith, Ex parte Official Receiver* (1929), A.B.C. 186, 188.

[48] *Sandell v. Porter* (1966) 115 C.L.R. 666, 670.

[49] *Sandell v. Porter* (1966) 115 C.L.R. 666.

[50] *Re Armour; Ex parte Official Receiver v. Commonwealth Trading Bank of Australia* (1963) 18 A.B.C. 69.

[51] *Sandell v. Porter* (1966) 115 C.L.R. 666, 670-1.

[52] See s.120 (1) and discussion of the term valuable consideration in Deane, Bohringer and Fernon *McDonald Henry and Meek; Australian Bankruptcy Law and Practice* (4th ed. 1968).

other hand the concepts of (a) good faith and (b) in the ordinary course of business have raised some problems deserving special consideration.

(a) *Good Faith*

This expression normally connotes propriety or honesty.[53] However in relation to the meaning of this expression in section 122 an artificial meaning has been superimposed. In this regard the meaning of this expression should be differentiated from the same expression used in other sections of the Bankruptcy Act.[54] Section 122 (4) (c) provides that the creditor 'shall be deemed not to be a purchaser payee or encumbrancer in good faith if the conveyance, transfer, charge, payment or obligation was executed, made or incurred under such circumstances as to lead to the inference that the creditor knew, or had reason to suspect—

(i) That the debtor was unable to pay his debts as they became due from his own money; *and*

(ii) That the effect of the conveyance, transfer, charge, payment or obligation would be to give him a preference, priority or advantage over other creditors' (emphasis added).

There are many cases falling on either side of the dividing line which separates a creditor acting in good faith and one not acting in good faith. We will not discuss all of the possible ramifications of this particular expression. Recent cases referred to earlier have dealt more specifically with the meaning of this particular expression in situations involving running accounts. The two cases surrounding the collapse of the Hennesseys group of chain stores serve a very useful background to our discussion of this issue of good faith.

In *Rees'* case, as noted above, the bank's request that Hennesseys reduce the amount of its overdraft came after a period of financial strain. The bank was in an excellent position, if not the best position, save perhaps the directors of Hennesseys, to review the company's financial straits. A wholesaler or a supplier of a company in straits such as Hennesseys would not be able to assess the implications of this financial crisis as well as its bankers.

When the negotiations for the sale of shares in Hennesseys broke down, the bank became adamant in its demands for a reduction of the rather substantial overdraft. Verbal negotiations were held between the governing director of Hennesseys and the bank, and he promised that the overdraft would gradually be reduced. This promise was not performed. Indeed the amount owing by Hennesseys was substantially increased over the next few weeks. In addition to this the bank was forced during the period (November 1960) to dishonour some 13 cheques drawn by Hennesseys. The total amount of these dishonoured cheques was approximately £41,000. Whilst all but two of these cheques were substantially represented and paid, the pattern continued, and in December 42 cheques and drafts for a

[53] See *Re Tetley; Ex parte Jeffrey v. T.* (1896) 66 L.J.Q.B. 111.
[54] See *e.g.* ss123, 124.

total of £78,000 were dishonoured, and in January 61 cheques (£72,000) were dishonoured and this was followed in February with a further 65 cheques representing £60,000 being dishonoured.

The bank had also called for the presentation to it of the company's balance sheet and profit and loss statement, in September but they were not presented until mid December. When produced they showed a slight profit in respect of the previous financial period, but this was later shown to be a grave exaggeration. The company in fact suffered a trading loss of some £200,000 for the period ending 13 February 1961. The major assets of the company were its stock, and its goodwill, but the unsecured debts of the company totalled slightly more than a generous valuation of particular assets.

Throughout the period December–February the company consulted the bank in relation to the possibility of the bank having to dishonour various cheques, with a view to preventing this—yet a substantial number were still dishonoured. All these factors added to a conclusion. which cannot easily be denied, that the bank was fully aware of the company's financial embarrassment, and the court held that this amounted to a knowledge of the company's insolvency.

Taylor J. who delivered the major judgment on this point relied on these factors to sustain his conclusion that the bank could not be regarded as a creditor acting in good faith.

The High Court in the *Queensland Bacon* case was asked by the liquidator to reach a similar conclusion with respect to the position of the various creditors. The major contention was that the particular creditors had evidence of the alleged insolvency of Hennesseys when the various cheques presented after 1 November 1960 continued to be dishonoured by the bank. His Honour Gibbs J. at first instance found that the continued dishonouring of cheques represented facts which would have made the particular creditor's aware of Hennesseys' insolvency.[55] The examples Gibbs J. relied on to substantiate his conclusions[56] were consistently interpreted by the majority in a different light. The fact that cheques for even relatively small amounts were being dishonoured pointed to a state of affairs which could not be easily explained by insolvency.

Both Barwick C.J. and Kitto J. felt that whilst these examples pointed to financial embarrassment being experienced by the company, they did no more than arouse such an inference. At that particular time a credit squeeze was being applied and this was affecting not only the particular debtor in this case but many hundreds of businessmen in similar and different situations. Barwick C.J. noted:

> The general restriction of credit then present must have affected a great number of quite solvent people who would find themselves temporarily short of cash and under a necessity to make arrangements to cover the 'short fall'

[55] See (1966) 115 C.L.R. 266, 286-7.
[56] *E.g. Queensland Bacon* case (1966) 115 C.L.R. 266, 289-290.

in their overdraft accommodation. The appellant [Queensland Bacon] had every reason in my opinion, to think, in the circumstances, that the debtor whom he understood to have a large, valuable, saleable and well managed stock would be in a position speedily to make arrangements to remedy what appeared to be the appellant to his temporary lack of liquidity. I would not wish to minimise the significance of the issue of a cheque by a trader which is dishonoured by his banker . . . That the dishonour calls for inquiry and probably some action is undoubted and, in some circumstances, it may provide ground for suspicion of insolvency. But, here in the circumstances I have outlined, although it indicated a lack of liquidity, it did not, in my respectful opinion, indicate insolvency.[57]

This notion of a temporary lack of liquidity was also emphasized by Kitto J. He submitted that there was no reason to suspect the difficulties were due to anything but overstocking by the company for the Christmas trade.

If the situation had dragged on for a substantial time, and a payment had then been offered to the appellant [Queensland Bacon], the proper inference might have been that the appellant had reason to suspect both that the company could not pay its debts as they became due and that the payment would prefer the appellant over other creditors.[58]

A particular example relating to Burns Philp, an alarming sequence of events relating to dishonouring of cheques, was interpreted in a similar fashion by Barwick C.J. In this instance a cheque for some £3,082 was dishonoured twice within ten days before finally being paid three weeks later. Evidence was submitted and accepted of the difficult liquidity situation at the time. This was well known by the creditor, who was also aware that the company was expanding its business and was further aware that despite some difficulty on the part of other creditors in being paid, the company was in fact meeting its obligations. In the light of this knowledge his Honour considered the approach that would be adopted by a reasonable businessman in such a case:

It must be remembered that trading of the kind with which these applications is concerned is, as of present times, predominantly carried on by means of extensive credit and that overdraft accommodation supplements that credit to furnish the circulating capital. Consequently, liquidity can be lost overnight upon reduction of overdraft limits. Whether this spells insolvency must be determined, it seems to me, by the speed with which assets of a readily realizable kind can be turned into cash. That time will be relative at least to the nature and extent of the indebtedness. . . . After much consideration I have come to the conclusion that with the knowledge and belief of the extent of the stock in trade and with no circumstance to suggest it was in any significant degree 'dead' stock, the reasonable businessman ought not to suspect actual insolvency, though the circumstances demonstrated a serious and perhaps a dangerous lack of liquidity.[59]

Finally Barwick C.J. resolved that on the evidence of businessmen, it was clear that as each creditor knew the facts, the time interval to be

[57] *Ibid.* 293. [58] *Ibid.* 306. [59] *Ibid.* 296-7.

allowed for the realization of the stock was believed, and reasonably upon their information, believed to be brief.

> That businessmen do not infer insolvency or find ground to suspect its existence does not of course mean that the court cannot find that the circumstances were such that the creditors had reason to know or to suspect that insolvency. 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.[60]

It was clear to Barwick C.J., (and *sic* Kitto J.) and it was suggested that such a conclusion is quite proper on the facts—that reasonable businessmen could have appreciated that the company was no more than in temporary financial difficulty.

Failure to act in this rather flexible way may result, it is suggested, in a complete breakdown of commercial relationships as they exist today.

What the creditor wishing to escape the setting aside of the preference has to prove, is that he neither knew nor suspected the insolvency of the debtor.[61] Knowledge is more difficult to infer than suspicion, and Kitto J. suggested that suspicion was more than a mere idle wondering whether a particular set of facts existed or not.

> It is a possible feeling of actual apprehension or mistrust, amounting to 'a slight opinion but without sufficient evidence,' as Chambers Dictionary expresses it . . . . The notion . . . in sub-s. (4) is, I think, of something which in all the circumstances would create in the mind of a reasonable person in the position of the payee an actual apprehension of fear that the situation of the payer is in actual fact that which the sub-section describes—a mistrust of the payer's ability to pay his debts as they become due.[62]

Menzies J. took a more literal approach to the whole issue. Examining the Burns Philp example discussed above, he concluded that where a cheque had been dishonoured twice and then finally met on third presentation, the view expressed by Gibbs J. 'that a retailer of goods whose circumstances are such that he is reduced to the desperate expedient of giving his wholesale supplier a bad cheque ought thereafter, until his solvency is established, at least be suspected of inability to pay his debts'[63] was correct. His Honour found it difficult if not impossible to suppose that upon a creditor finding that a cheque was dishonoured, he could do otherwise than automatically suspect that the reason for dishonour was simply a question of a lack of funds.[61]

[60] *Ibid.* 300.

[61] The question of onus is a difficult one. The Act throws the initial burden on the creditor (s.122). However Barwick C.J. took the view that the creditor had to negative the existence of any circumstances from which an inference could be drawn regarding the creditor's knowledge or suspicion of insolvency. As long as on balance the defence is established that is enough *ibid.* 287; see also *S. Richards & Co. Ltd v. Lloyd* (1933) 49 C.L.R. 49, 60).

[62] *Queensland Bacon* case (1966) 115 C.L.R. 266, 303.

[63] *Ibid.* 315.

[64] *Ibid.*

> What debtor, able to pay, would, except in error give his creditor a cheque that would be dishonoured? I cannot suppose that it would occur to a creditor that a debtor being able to pay his debt, had deliberately passed a cheque that would be dishonoured simply as a means of obtaining further credit.[65]

In the *Queensland Bacon* case there was a series of dishonoured cheques prior to the actual date on which the company was found to be insolvent. But this would on the reasoning of Menzies J. have implied that on each occasion that a cheque was dishonoured the particular creditor would have immediately reached the conclusion that the debtor was insolvent.

> It seems to me that what a person does before insolvency may afford reasons to suspect insolvency and that the suspicion may continue to exist when, after insolvency, payments are made which are impeached in the insolvency. . . . The section does not require that the reason to suspect insolvency should be something arising after actual insolvency . . .[66].

Barwick C.J., however, suggested that the creditor's knowledge or suspicion must arise at the time that the debtor is insolvent, not before insolvency.[67] In any event, it is suggested that supporters of Mr Justice Menzies' view have one important obstacle to overcome. Why would creditors who had reason to suspect that the particular debtor was insolvent continue to have supplied this debtor with goods where it was clear that all payments made after the suspicion had arisen might well have been set aside by the liquidator? The commercial community could not act or operate in a situation where each dishonoured cheque might well bring an end to the relationship between debtor and creditor because of the imputed suspicion. It is suggested that these conclusions are not easily tenable in a commercial community where the flexibility of conduct referred to by Barwick C.J. and Kitto J. is the expected practice.

If the view that Menzies J. takes is not to be supported, what would the liquidator or a trustee have to show in circumstances such as these to sustain a conclusion that there was suspicion of insolvency? One is a little perplexed, even assuming that commercial people do not in fact suspect insolvency when cheques are dishonoured, that creditors in a given situation would allow a consistent flow of cheques to be dishonoured without doing something positive to bring about an end to this unsatisfactory state of affairs. It is clear that the rather difficult times brought about by the credit squeeze made this particular case a special one on its facts. But where is the line to be drawn? I would agree that the failure of one cheque to be met (or even two cheques—it is a matter of degree) may not be sufficient to warrant a creditor doing anything more than perhaps querying his debtor and demanding tighter control over him; but where the event follows the same pattern over a period of months as occurred in the *Queensland*

[65] *Ibid.* [66] *Ibid.* 318.
[67] *Ibid.* 292. ('It is only a payment made by an insolvent debtor which comes within the section.')

Bacon case then suspicion would in most normal circumstances certainly be warranted. In cases of a similar nature the better approach is to decide the issue, if possible, on whether the payments were preferences. In Queensland Bacon that is a decision I find more attractive than the conclusion that the creditors were acting in good faith.

A further illustration of the difficulty that always faces the court in assessing good faith or otherwise in situations such as those pertaining in *Queensland Bacon* and *Rees'* case is the case of *Re Beatty*.[68] The case involved certain overdraft arrangements being entered into between the debtors and the relevant branch of the Bank of N.S.W. On two occasions where the debtors allowed their overdraft account to become excessively in debt, arrangements were made for funds received by the debtors in the running of their business to be deposited with the bank, thus creating a situation whereby the bank was preferred over other creditors. Mr Justice Hale held that these deposits were preferences in the relevant circumstances. However he upheld the claim by the bank that it was a payee in good faith. It was sufficient for the bank to establish, either that the circumstances under which the payment was made were not such as to lead to an inference that it knew or had reason to suspect that the debtors were then unable to pay their debts as they became due, or that the circumstances were not such as to lead to an inference that it knew or had reason to suspect that the effect of the payment would be to give it a preference.[69] An overdraft accommodation may only be arranged for a short period of time, although many overdrafts represent a permanent arrangement.[70] In any event, it is clear that the particular payments in this case were made at a time when the credit squeeze was still being felt and there is no doubt that limitations upon the length of borrowing were quite in order, and probably were imposed as a general principle of banking business at the time.

Suspicion or knowledge was clearly evident in the circumstances arising in the case of *Taylor v. White*[71] (referred to as *Taylor's* case). Mr E. J. Taylor and his wife were the sole shareholders of E. J. Taylor & Son Pty Ltd, Mrs Taylor's mother, Mrs Quinn, had agreed to lend to the company the sum of £4,000 on 8 per cent interest. Re-payment was to be made within six months of demand being made of the company in writing. Mrs Quinn was an invalid, and at the time of the loan her affairs were very much under the control of her daughter. No long after the loan was made, Mrs Taylor ascertained that Mrs Quinn's account, from which sums were paid to take care of her during her period of incapacity, was in need of replenishment. A written demand was therefore made by Mrs Taylor on

[68] (1963) 20 A.B.C. 97. [69] *Ibid.* 100.

[70] The 'permanency' is usually only evidenced by a gentleman's agreement. In most cases banks have complete control as to when they will call in their overdraft—normally only exceptional circumstances such as the 'credit squeeze' of 1960 or particular knowledge of a debtor's dangerous position will lead to such a result.

[71] (1964) 110 C.L.R. 129. These proceedings were brought under the equivalent to s.293 of the Uniform Companies legislation—see *supra* n. 8.

behalf of her mother to the company for repayment of the loan. Within six months of the written demand being given the total loan was repaid. The 'replacements' took place in the following order; *viz.* £500 on 8 April, £500 each on 17 June, and on 20 June, and £2,500 on 30 July. Some three weeks after the last payment was made the company was placed into liquidation by its creditors. The liquidator sought declarations that the last three payments were preferences.

The judge at first instance found that all the payments concerned were preferences but excused Mrs Quinn, on the ground she had received payments in good faith, for valuable consideration, and in the ordinary course of business. The major portion of the judgments given by members of the High Court, when the matter was taken on appeal, was concerned with the issue of whether the payments were made in the ordinary course of business. All of the justices[72] except Kitto J., held that they did not take place in the ordinary course of business—they also doubted whether good faith could be shown. It was suggested by Kitto J. that Mrs Quinn was incapable, because of her physical and mental condition, of assessing the solvency or otherwise of the company. Furthermore, Mrs Taylor was unaware of the affairs of the company as the business and associated matters were left entirely in the hands of her husband, and thus could also be said to have been unaware that the company was insolvent. One finds this conclusion rather difficult to accept even though Mrs Taylor did not participate actively in the running of the company. We would agree with the comment made by Dixon C.J. that there is 'great difficulty in sustaining the finding that the payments were made in good faith. We are inclined to think that on the facts Mrs Taylor had reason to suspect that the company was unable to pay its debts as they became due',[73] and that the payments to Mrs Quinn took the form of preferences. Kitto J. relied strongly on the lack of knowledge on the part of Mrs Taylor on the running of the company.[74] Although the point is not an essential issue, it is suggested that the lack of an arms' length relationship between the relevant parties would make the argument that Mrs Taylor was unaware of the company's insolvency almost untenable.[75]

Many other instances may illustrate the absence of good faith.[76] We have limited our discussion more particularly to the problems peculiar to relationships between debtor and creditor whose dealings are illustrated by running accounts.

It is important to note that whilst we have limited our discussion of the notion of good faith to the criteria of knowledge or suspicion of the debtor's insolvency, that section 122 (4) (c) specifies that in addition to such knowledge the creditor in order to be regarded as acting without good faith must either know or have reason to suspect that the effect of the

[72] Dixon C.J., Kitto, Taylor, Menzies and Windeyer JJ.
[73] *Taylor's* case (1964) 110 C.L.R. 129, 135.
[74] *Ibid.* 139. [75] See also Menzies J. *ibid.* 161.
[76] See *e.g Rae v. Samuel Taylor Pty Ltd* (1963) 110 C.L.R. 517.

particular payment, transfer, conveyance, charge or obligation, which has been given to him by the debtor is to give him a preference priority or advantage over other creditors.[77]

(b) *In the Ordinary Course of Business*

This particular expression does not receive any specific definition in section 122 and the particular notion is one that occurs not only in that section but also in sections 123 and 124.

Apart from the special relationship which existed in *Taylor's* case, this aspect of the defence has not created any particular difficulty for the courts. There may be some concern expressed that no specific discussion was deemed necessary in relation to the specific facts that existed in the *Queensland Bacon* case. Would it be proper to say that the relationships between the creditors and Hennesseys were such as to infer that business was being conducted in the ordinary course, or would it be more accurate to describe the particular relationships as being governed by the rather special factual situation that existed at the time? Certainly one would express some surprise that a creditor would *expect* a number of cheques to be dishonoured in a very short period in the course of dealing with a particular customer. Before dealing with this particular problem let us first consider the meaning given to the term by the courts.

The majority in *Taylor's* case had little difficulty in striking down the payments made by Taylor and Co. Pty Ltd, to Mrs Quinn. All judges referred at some length to earlier statements in the court on the meaning of the particular expression. It is useful to review some of these tests here.

Gavan Duffy C.J. and Starke J. in *Robertson v. Grigg*[78] referred at length to early English decisions concerned with the meaning of the expression as used in dealing with fraudulent preferences.[79] In these cases payments were made on the eve of bankruptcy and these payments were contrasted with those that were made in the ordinary course of trade. The test as propounded by them in the light of this historical analysis, an analysis repeated at some length by Kitto J. in *Taylor's* case[80] was as follows:

> The test under section 95 [the predecessor and for present purposes equivalent to section 122 of the 1966 Act] of the ordinary course of business is not whether the act is actual or common in the business of the debtor or of the creditor but whether it is a fair transaction and what a man might do without having any bankruptcy in view.[81]

Peculiarities which may pertain to any particular relationship between debtor and creditor are disregarded. This was emphasized by Evatt J. in

[77] See Kitto J. in the *Queensland Bacon* case (1966) 115 C.L.R. 266, 393.
[78] (1932) 47 C.L.R. 257.
[79] *E.g. Alderson v. Temple* (1768) 4 Burr 235, 78 E.R. 165—see also *Robertson v. Grigg* (1932) 47 C.L.R. 257, 267 and the *Queensland Bacon* case (1966) 115 C.L.R. 266, 272.
[80] (1964) 1110 C.L.R. 129, 142.
[81] (1932) 47 C.L.R. 257, 267.

the same case,[82] and in the joint judgment of Rich, Dixon and McTiernan JJ. in *Burns v. McFarlane*:[83] 'it does not require an investigation of the course pursued in any particular trade or vocation, and it does not refer to what is normal or usual in the business of the debtor or the creditor'. Both Rich and Williams JJ. extended this emphasis in *Downs Distributing Co. Pty Ltd, v. Associated Blue Star Stores Pty Ltd.*[84] In particular Rich J. tied in the notion of good faith to his test. 'It is therefore not so much a question of fairness and absence of symptoms of bankruptcy as of the everyday usual or normal character of the transaction. The provision does not require that the transaction shall be in the course of any particular trade, vocation or business. It speaks of the course of business in general. But it does suppose that according to the ordinary and common flow of transaction in affairs of business there is a course, an ordinary course. It means that the transaction must fall into place, as part of the undistinguished common flow of business done, that it should form part of the ordinary course of business as carried on, calling for no remarks and rising out of no special or particular situation.'[85] In the same vein Williams J. in a more detailed discussion of the case before him noted that if a transaction in itself called for no special comment and was one 'into which it would be usual for a creditor and debtor to enter as a matter of business . . .',[86] then it would be be regarded as in the ordinary course of business.

Dixon C.J. in *Taylor's* case made his own individual contribution to the literature on this particular subject. Having accepted the facts before the court, he regarded the particular relationship between Taylor & Co. Pty Ltd, and Mrs Quinn as failing to qualify within the ambit governed by the time honoured phrase which he described as referring to '. . . transactions regularly taking place in a sustained course of activity or some usual process naturally passing without examination'.[87]

One can easily adopt the conclusions of the High Court in *Taylor's* case. The payment was hardly one that occurred within a business relationship at all—the particular infirmity of Mrs Quinn meant in effect that the company was at all times dealing with one of its own directors.[88]

This particular decision can be contrasted, on the facts, with the earlier cases. In *Robertson v. Grigg*[89] the transactions in question were roadmaking contracts and these provided good profits for the particular debtor. A loan was extended to the debtor, who to secure the loan, assigned moneys due under the terms of the contract, to the lender. This was a reasonable arrangement and one which did not call for any particular inference of suspicion of insolvency. It was not unusual for such an assignment to take

[82] (1932) 47 C.L.R. 257, 273.
[83] (1940) 64 C.L.R. 108, 125.
[84] (1948) 76 C.L.R. 463.
[85] *Ibid.* 477.
[86] *Ibid.* 480.
[87] (1964) 110 C.L.R. 129, 131.
[88] One could almost classify this as a case of lifting the corporate veil!
[89] (1932) 47 C.L.R. 257.

place. The particular debtor in this instance made a calculation of how much would be left for him after the assignment of the major portion of the moneys due under the contractual payments.

In *Burns v. McFarlane*[90] the debtor borrowed money from McFarlane his landlord. The loan was secured by a bill of sale over the debtor's garage plant, part of which was under hire purchase. After the bill of sale was executed McFarlane drew a number of cheques and handed them to the debtor. Two of the cheques were in favour of certain creditors under the hire purchase agreements and three of them were in favour of the debtor. One of the cheques was handed back by the debtor to the landlord's clerk who gave him a receipt of rent in respect of a particular period. Some three months later a sequestration order was made against the debtor. The High Court held that the transaction was one which was entered into in good faith for valuable consideration and in the ordinary course of business. The particular purpose of the transaction was to place the finances of the debtor's business on a sound basis by turning portion of his assets into cash to allow him to carry on the business, to permit him to meet obligations due at the particular time, and also so that he could have some ready cash available to him.

In *Downs Distributing Co. Pty Ltd v. Associated Blue Star Store's Pty Ltd*[91] the High Court held that the expression did not encompass the settlement of a debt between traders involving a transaction under which there was to be redelivery of certain goods which had been sold, together with other goods, subject to an arrangement that the debtor was able to purchase those goods once again for cash.

The term in the ordinary course of business as used in section 122 and other sections of the Bankruptcy Act must be distinguished from the expression where used in other legislation or use to refer to other types of transaction[92] and we are limited to bankruptcy cases in ascertaining its meaning.

It is clear from these cases that the particular relationship between the debtor and the creditor must have been uninfluenced by the fear that insolvency might have intervened. It is also clear in reading the judgments of Barwick C.J. and Kitto J. in the *Queensland Bacon* case that both considered that the creditors dealing with Hennesseys would not have been contemplating insolvency on the part of Hennesseys. I have referred in some detail to expressions made by both their Honours pointing out that the lack of liquidity which was experienced by Hennesseys at the time was not unusual and that all creditors were aware of Hennesseys' trading operations and were convinced that sufficient stock was on hand to see Hennesseys through the particular difficult period.[93] In the circumstances it

[90] (1940) 64 C.L.R. 108.
[91] (1948) 76 C.L.R. 436.
[92] See *e.g. Re Bradford Roofing Industries Pty Ltd* (1966) 84 W.N. (N.S.W.) 276, 283-4.
[93] See *e.g.* n. 59 and 60 *supra*.

would not have been unusual, in their Honours' opinion for the creditors to have continued to deal with Hennesseys. Here there was evidence only of some 'temporary' difficulty experienced by that company in meeting its debts as they were falling due—a different matter from being *unable* to meet debts as they fell due.

It is quite clear that the line between that taken by the majority and that by Menzies J. (who I have noted earlier were not attuned to this particular problem) is a very fine one and there would be little difficulty in imagining a set of circumstances slightly different from those that pertained in the *Queensland Bacon* case which would support a conclusion that the conduct of the affairs of Hennesseys were not in the ordinary course of business.

The situation in *Rees'* case was slightly different. In that particular case the bank was quite aware of the particular difficulties that were facing its client company and it was not usual for the bank to demand a regular reduction of the overdraft which existed. The facts of that case are at first glance rather difficult to distinguish from those in *Re Beatty*. In the latter case the particular debtors had carried on all the banking business with the particular branch of the Bank of N.S.W. depositing any money that they received in the current account maintained with the particular bank. The overdraft accommodation was also administered through this current account and as Hale J. noted 'it was perfectly natural that they should pay [the moneys], as and when received, into that account; it would seem to me to be the obvious course to follow for people who wished both to pay off the bank overdraft and draw cheques on the balance for outstanding trade debts'.[94] On the other hand in *Rees* case Henneseys would have preferred the overdraft accommodation to be maintained at the level prior to the banks demand that it be reduced by £7,000 per month. If the bank had agreed to this particular course of action, then, as far as the company was concerned, there might have been some hope in avoiding liquidation. The bank was aware of the consistent failure of the company to meet its current obligations and was continually forced to dishonour cheques made out by the company to its creditors. In these circumstances the demand for the payment of the specific amounts each month was not in the ordinary course of business but was made in a situation where the bank was fully aware that the company was either insolvent or on the verge of insolvency and was seeking to recoup its position as quickly and as painlessly as possible.

Once more the particular facts in *Rees'* case may be altered slightly to reach a different result which is perfectly acceptable. The test of the ordinary course of business may well be coupled with the test of good faith—so long as the creditor in dealing with the debtor is unaware or uninfluenced by the possible insolvency of the debtor, the particular transaction can generally be regarded as being in the ordinary course of business.

[94] (1963) 20 A.B.C. 97, 102.

CONCLUSIONS

The decisions in the recent cases point out some of the very serious practical difficulties that face a court in assessing the rights of creditors to retain payments of a 'preferential character' in situations where a particular debtor has been extended substantial credit accommodation to allow him to deal with his creditors. It may be argued that the creditors who have not extended such credit terms will be unfairly prejudiced by a liberal interpretation of section 122 in dealing with payments made to creditors who have been generous in their arrangements.

The major aim of bankruptcy law is to ensure that all creditors, where a man becomes bankrupt, are dealt with equally and that none receives an undue or unfair advantage.[95] It is suggested that in none of the cases we have discussed have the learned judges departed from this particular principle. Relationships in a modern commercial community are conducted in such a way that bankruptcy must be the most unexpected event to interfere with debtor—creditor relationships. If it is assumed that creditors are constantly keeping one eye on the level of solvency of their particular debtor, then it is suggested that business would cease to function as it does today.[96] There is much evidence that extensive credit must continue to play an important role in the conduct of business in an expanding economy.

It is suggested that any interpretation of the particular cases discussed herein denying the existence of liberal credit policies would be unwarranted. There is perhaps need for elaboration of section 122 to deal specifically with the position of running accounts. It is suggested that when the particular section was drawn in 1924 the presence of such extensive credit operations was unusual and problems arising therefrom were not before the draftsman of that particular legislation. The present section of the Bankruptcy Act was drawn up by the committee headed by the late Sir Thomas Clyne and that committee did not have before it at that particular time the decisions in these recent cases that we have discussed. However until the legislature sees fit to introduce, if ever, amendments to the section, the decisions of the courts in these cases would appear to present a very useful and perhaps a fully accurate and satisfactory (if not complete) guide to trustees of bankrupts, liquidators of companies and others in similar position, as to the relevant criteria in evaluating the existence of a running account and in ascertaining whether or not particular creditors who may have received 'preferential treatment' in such circumstances may be said to have acted in good faith and in the ordinary course of business.

[95] See n. 6 *supra*.
[96] One need hardly document the tremendous amount of credit in circulation today.