Article Information

Authors: Angelina Kozary, Stephanie Dimovski
Service: Restructuring & Insolvency

High Court Decisions of Bryant v Badenoch Integrated Logging Pty Ltd and Metal Manufactures Pty Limited v Morton

The first High Court decisions in 2023; *Metal Manufactures Pty Limited v Morton Metal Manufactures Pty Limited v Morton* [2023] HCA 1 ('Metal Manufactures') and *Bryant v Badenoch Integrated Logging Pty Ltd* [2023] HCA 2 ('Bryant') have provided the final word on preference claims, establishing once and for all that:

1. set-off under s 553C of the *Corporations Act 2001* (Cth) ('**the Act**') does **not** apply to unfair transactions; and

2. the peak indebtedness rule does not apply.

***Metal Manufactures* and Statutory Set-Off**

Background and Summary

3. Metal Manufactures Pty Limited received payments of $190,000 during the relation back period from MJ Woodman Electrical Contractors Pty Limited. Before going into liquidation MJ Woodman purchased and obtained additional goods from Metal Manufactures in the amount of $194,727.23.

4. The liquidator of MJ Woodman claimed that the payment of $190,000 was an unfair preference under s 588FA of the Act and was to be recovered. Metal Manufactures claimed the benefit of a set-off in the amount of the subsequent debt of $194,727.23 was available.

5. The Full Federal Court, had determined that statutory set-off, under s 553C(1) of the Act, was not available as a defence to a claim for the recovery of an unfair preference, under s 588FA of the Act. Metal Manufactures sought and was granted leave to appeal to the High Court.

6. In a joint judgment Chief Justice Kiefel and Justices Gordon, Edelman and Steward dismissed the appeal and affirmed the decision of the Full Federal Court. Justice Gageler agreed with the conclusion of the plurality of the court, however his Honour dealt with the issue of mutuality differently.

Statutory Set-Off and Mutuality

7. Set-off, under s 553C of the Act functions as a form of statutorily imposed accounting applied in the determination of proofs of debt. The main object of the section is to prevent injustice and to do substantial justice where "a debt is really due from the bankrupt to the debtor to his estate".[1] The provision is to be given "the widest possible scope"[2], as long as it is recognised that the width and justice is confined within the limits of genuine mutuality as a matter of substance.[3]

8. The joint judgment of the High Court notes two key features of the set-off provision:

8.1 s 553C has a temporal element[4]; and

(a) For the purposes of assessing mutuality, the rights of the parties are to be taken and ascertained as at the time of the winding up[5]; however, the important factor is whether there is "an obligation or liability *prior to liquidation* which might mature into a debt owing."[6]

(b) Therefore, any acquisition of new claims on behalf of a company by a liquidator **cannot** vary the parties'

prior rights.[7]

8.2 There are three main aspects to a 'mutual dealing', as summarised in *Gye v McIntyre* (1991) 171 CLR 609.

> *"The first is that the credits, the debts, or the claims arising from other dealings be between the same persons.*
>
> *The second is that the benefit or burden of them lie in the same interests. In determining whether credits, debts or claims arising from other dealings are between the same persons and in the same interests, it is the equitable or beneficial interests of the parties which must be considered: see, e.g., Hiley.*
>
> *The third requirement of mutuality is that the credits, debts, or claims arising from other dealings must be commensurable for the purposes of set-off under the section. That means that they must ultimately sound in money."*[8]

9. In this matter, however, there was nothing to set of as between Metal Manufactures and MJ Woodman immediately before the commencement of the winding up –MJ Woodman owed money to Metal Manufactures, but Metal Manufactures owed nothing to MJ Woodman.[9]

10. The right to sue sprang into existence as a specific statutory right held by the liquidator for the purposes of recovering preference payments.

11. It follows that there is no relevant mutual dealing which is eligible to be set-off against the pre-existing amount owed to the Appellant.[10]

12. Importantly, section 553C does not address dealings which straddle the period before and after the commencement of the winding up.

13. The Court also notes that the presence of s 588FI within the statutory scheme of liquidation supports the outcome.[11]

14. The Court states at [58] that:

> *Permitting a preferred creditor to set off its liability under s 588FF(1)(a) with the liability owed to it by the company would undermine a purpose of the recovery of unfair preferences, revealed by this section, which is to restore to the pool of distributable assets those payments made under voidable transactions.*
>
> *A set-off, in contrast, would leave that pool diminished, for the reasons already expressed. Such an outcome can hardly have been intended.*

Bryant **and the Peak Indebtedness Rule**

Background and Summary

15. Gunns Limited (in Liq) (Receivers and Managers Appointed) ('**Gunns**') was a timber felling business, and following large losses and mounting debts, Gunns was placed in voluntary administration in September 2012 and liquidation in March 2013.

16. Badenoch Integrated Logging Pty Ltd ('**Badenoch'**) provided logging and transport services to Gunns. Over the period from 30 March 2012 to 24 September 2012, Badenoch received $3,360,876.16 from Gunns in 11 payments. It was determined that these payments were made whilst Gunns was insolvent.

17. The liquidators of Gunns claimed that the payments totalling $3,360,876.16 constituted an unfair preference under s 588FA of the Act and was to be recovered. Badenoch, however, maintained that it had a running account with Gunns.

18. The case was on appeal from the Full Federal Court, which held that the 'peak indebtedness rule' is not available to a liquidator in establishing an unfair preference under s 588FA(1) of the Act. Badenoch sought and was granted leave to appeal this decision to the High Court.

19. The appeal raised three main questions about the operation of s 588FA(3) of the Act[12]:

19.1 Whether the "peak indebtedness rule" is part of or is excluded by s 588FA(3);

19.2 What is the proper approach to determining whether a "transaction is, for commercial purposes, an integral part of a continuing business relationship" as referred to in s 588FA(3)(a); and

19.3 Were certain payments in this case from debtor (Gunns) to the creditor (Badenoch), for commercial purposes, an integral part of a "continuing business relationship" between them within the meaning of s 588FA(3).

20. Justice Jagot, with the agreement of the bench, dismissed the appeal and upheld the judgment of the lower court.

s 588FA(3) and the Peak Indebtedness Rule

21. Section 588FA(3) of the Act is a statutory embodiment of the "running account principle" which has long been a part of insolvency law in Australia.

22. The effect of s 588FA(3) is that if a transaction is, for commercial purposes, an integral part of a continuing business relationship (e.g., a running account) between a company as debtor and a creditor, then all transactions forming part of that relationship are to be treated as if they together constituted one, single transaction in determining if the transaction is an unfair preference given by the company to the creditor, voidable on application by a liquidator.[13]

23. Overall, her Honour summarised her conclusions as follows:

23.1 Pt 5.7B of the Corporations Act does not incorporate the "peak indebtedness rule"[14];

(a) The first transaction that forms part of the continuing business relationship is *either* the first transaction after the beginning of the prescribed period or after the date of insolvency, **or** the first transaction after the beginning of the continuing business relationship – whichever is the later.

23.2 The proper approach is one of characterisation of the facts, involving an objective ascertainment of the business character of the relevant transaction; and

(a) It is necessary to consider the whole of the evidence of the "actual business" relationship between the parties.

23.3 In relation to the Full Federal Court's judgment of the status of payments from Gunns to Badenoch, the Full Federal Court:

(a) Did not err in concluding that certain payments were transactions forming an integral part of the continuing business relationship between Gunns and Badenoch

(b) Did not err in concluding that other (later) payments were not transactions forming part of the continuing business relationship between Gunns and Badenoch

(c) Did not err in concluding that the continuing business relationship did not cease until 10 July 2012; and

(d) Did not err in applying s 588FA(1) to the deemed single transaction created by s 588FA(3)(c) and as required by s 588FA(3)(d), finding that there could be no unfair preference given by Gunns to Badenoch.

[1] *Gye v McIntyre* (1991) 171 CLR 609, 618-19 ('***Gye***').

[2] *Day & Dent Constructions Pty Ltd (in liq) v North Australian Properties Pty Ltd (prov liquidator apptd)* (1982) 150 CLR 85, 108 (***Day & Dent***).

[3] *Day & Dent*, 95; *Gye*, 619.

[4] *Metal Manufactures* [18] per Kiefel, Gordon, Edelman and Steward JJ.

[5] *Hiley v Peoples Prudential Assurance Co Ltd* (1938) 60 CLR 468 at 480 per Latham CJ, 495-496, 499 per Dixon J.

[6] *Metal Manufactures* [18] per Kiefel, Gordon, Edelman and Steward JJ; *Day & Dent Constructions Pty Ltd v North Australian Properties Pty Ltd* (1982) 150 CLR 85 at 91 per Gibbs CJ, 109 per Mason J.

[7] *Metal Manufactures* [18] per Kiefel, Gordon, Edelman and Steward JJ.

[8] *Gye*, 623 per Mason CJ, Brennan, Deane, Dawson, Toohey, Gaudron and McHugh JJ.

[9] *Metal Manufactures* [46] per Kiefel, Gordon, Edelman and Steward JJ.

[10] *Metal Manufactures* [47] per Kiefel, Gordon, Edelman and Steward JJ.

[11] *Metal Manufactures* [58] per Kiefel, Gordon, Edelman and Steward JJ.

[12] *Bryant* [9]-[11] per Jagot J.

[13] *Bryant* [7] per Jagot J.

[14] *Bryant* [13] per Jagot J.