VOIDABLE PREFERENCES

QUESTIONS AND ANSWERS

Question - Rory Derham (National Australia Bank, Melbourne):

John, on the *KDS* case, one point that always puzzled me about that, the High Court there said that the bank did not receive a preference because it had a lien on the cheque. Now what would have happened of course in practice was that the bank would have sent the cheque into the clearing system, payment then would have been received, the lien that the bank has on the cheque is a possessory lien, and it could have been said that the bank in fact lost its lien by sending it into the clearing system. I suppose the contrary argument may have been that the clearing system in fact is just the agent of the bank and therefore you delivered possession to your own agent and you retain possession yourself. But the High Court did not go into it and it always seemed to me unsatisfactory in that case that the High Court had a chance to consider the nature of the clearing system and did not go into it at all - a lot of people are puzzled as to the nature of how a clearing system works. And there seems to me to be a bit of a lost opportunity on that.

Response - John Karkar QC:

Yes, I do agree with you! It is a very short judgment! But as an officer of the National Australian Bank you shouldn't complain.

Question - Rowan Russell (Mallesons Stephen Jaques, Melbourne):

For the purposes of voidable preferences, who is a creditor? Does it or can it include a person who is a vendor under a pre-existing contract of sale and as an extension from that can it include someone who has the right to put a property or other asset to an insolvent party?

Response - John Karkar QC:

Erica will answer this question.

Response - Erica Simes (Chairperson):

Rowan, in answer to your question, it would seem a vendor would be a creditor, but it is not clear whether the holder of the property would be.

Question - Greg Harris (Freehill Hollingdale & Page, Melbourne):

John, if you are required to enunciate a statement as to what the test would be for having the effect of giving a preference, what would you enunciate?

Response - John Karkar QC:

Well, I would adopt what Chief Justice Barwick said in *Queensland Bacon and Rees* that the mere fact that the payment is in discharge of an existing or past indebtedness is not enough to require in all circumstances that the effect of the payment vis-a-vis other creditors is to give a preference. The claims should not be assessed in complete isolation. What you have got to do is to see whether, as part of the whole transaction, the effect of it is to prefer one creditor over others.

Question - Greg Harris (Freehill Hollingdale & Page, Melbourne):

My question is directed at the test or the doctrine that has developed in the United States and seems to be accepted in Canada where the judiciary there have drawn a distinction between preferring creditors as such and looking at the transaction to see whether there has been an overall diminution in the value of the assets of the insolvent. So that if the transaction is structured in such a way so as to discharge the debt but not reduce the assets of the insolvent then it does not constitute a preference.

Response - John Karkar QC:

Well in practical terms that seems to be the effect of the decisions in this country, particularly in respect of running accounts and overdraft accounts. The test has not been put in this way in the cases here but the practical result of the decisions here I think would be the same.

Comment - Greg Harris (Freehill Hollingdale & Page, Melbourne):

It seems that certain academics who have written in the area have adopted the view that if a creditor is preferred per se, that constitutes having the effect of giving a preference. So in your running account example if the overall indebtedness of the bank is reduced then to the extent that it has been reduced that amount constitutes a preference.

Question - Erica Simes (Chairperson):

Well I have got a question for you John if there are none forthcoming from the auditorium. You mentioned that a roll-over of bills would probably not be a preference even if it occurred in a six month period prior to insolvency if it was part of a larger transaction. I was wondering where you have got a debtor who is steadily becoming less and less solvent, and instead of just having a roll-over of bills, you are also finding that extra bills are being issued to take care of the discounted amount whether we are not entering a stage where the roll-over of bills might be set aside?

Response - John Karkar QC:

Yes. If all that is occurring is this - and I take an example - you have a facility for a period of two years and the facility has been utilised by the roll-over of bills every three months and these bills have been rolled over every three months in the ordinary course, I would doubt whether the court would hold on the present state of the authorities that that amounts to a preference. Although there is a powerful argument on the other side. I know that Peter Fox, I think, takes a different view. But where the position is the way you have postulated it, I would think the balance would tilt in favour of holding that there was a preference.

Comment - Peter Fox (Mallesons Stephen Jaques, Melbourne):

I thoroughly agree with your analysis - I have no disagreement with it whatsoever. The roll-over of bills in the ordinary course would not seem to prefer a creditor. The circumstance where I have some difficulty is where the roll-over occurs after clear notice of insolvency and in that case I have some concern as to whether or not you meet the defences. I suppose the answer to that is if you are not preferred you don't have to meet the defences.

Response - John Karkar QC:

You have got to show the preference first before you get your protection, but I would agree with you that once there is evidence of insolvency, the balance would tilt in favour of holding that there was a preference.

Question - Gary Best (Mallesons Stephen Jaques, Sydney):

I would just like to invite your comment on what the larger transaction means. I can sympathise with the view that transactions between a bank and its customer on a running account is part of a transaction and a bill facility in the circumstances you have described is a transaction. But how far can that concept be pushed, for example, where there is an outstanding obligation between creditor and debtor of one particular nature and by agreement that indebtedness or obligation is extinguished and replaced within the relevant period by an obligation which is completely different in its legal nature? How likely is it that the court will take a commercial view and say that together is one transaction as opposed to two separate transactions?

Response - John Karkar QC:

It is very difficult to lay down a general principle in respect of large transactions. Each of them will have to be viewed separately to see whether it is a transaction in the ordinary course of business or a transaction out of the ordinary course of business. Where, for example, a bank lends to a customer a very large sum of money, hundreds of millions of dollars, that is not repayable until say two years from now, circumstances occur in the meantime and payment is made prematurely. The question there becomes difficult as to whether that payment is in the ordinary course of business, because it was made before maturity.

My own view is that if the facts simply are those that I have stated, and there was some notoriety given to the transaction, the transaction would still be in the ordinary course of business because it is part and parcel of the common flow of ordinary business. It is probably not in the ordinary course of business in the circumstances that you have just mentioned, because if you have a situation of at least suspected insolvency or suspected financial difficulties and you have a discharge of a liability and the creation of a new liability of a different kind. It may well be said that that was not in the ordinary course of business. But I really cannot lay down a general principle about this. All I wanted to say earlier was that the mere fact that a transaction is large and that it receives public notoriety should not encourage liquidators to assume that those facts alone would make it out of the ordinary course of business. And regrettably, in my experience, at least in three cases, different liquidators have taken that view.

Question - Gary Best (Mallesons Stephen Jaques, Sydney):

I was really not wanting to get into the defensive, I was really just inviting comments on the earlier point in time of preference. Is that a preferential situation? Does a creditor in that situation enjoy an advantage, priority or benefit preference, which of course precedes that question.

Response - John Karkar QC:

Sorry, I misunderstood your question. I would think so, yes. I would think that if what you are doing is bringing one transaction to an end and entering into a new one it cannot be said that that was part and parcel of the one large transaction - entire transaction - and I think it would fall foul of the rule.