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THE AVOIDANCE PROVISIONS OF THE BANKRUPTCY ACT 1995 AND THEIR APPLICATION TO COMPANIES

Taking the lead from the United Kingdom's Insolvency Act 1986, the Bankruptcy Act 1995 introduced into our bankruptcy laws novel concepts of transactions at an undervalue and extortionate credit transactions. At the same time, it revamped the law with regard to the giving of preferences. These new features are also made applicable to companies in winding up and judicial management. The following paper analyses the new provisions and the likely problems faced in their application. Particular attention is directed at the special difficulties which arise in their application to companies.

I. INTRODUCTION

AS is well-known, the law of bankruptcy recently underwent far-reaching reforms culminating in the enactment of the Bankruptcy Act 1995 (hereinafter referred to as 'BA95'). It is a laudable piece of legislation which succeeds commendably in modernising, rationalising and streamlining the key features of the bankruptcy regime previously contained in the somewhat antiquated provisions of the repealed Bankruptcy Act.[1]

However, the purpose of this article is not to deal generally with the merits of the new legislation which, in any event, would certainly become evident to all in due course, but to discuss certain important provisions in BA95 which are made to apply in both an individual's bankruptcy and in the winding up or judicial management of companies. These are the provisions dealing with the avoidance of certain transactions antecedent to bankruptcy or, as the case may be, judicial management or winding up (hereinafter referred to as the 'avoidance provisions').[2] They are entirely new provisions modelled substantially on similar provisions in the UK Insolvency Act 1986 (hereinafter referred to as 'IA86') and, as may be expected, they will probably have a very significant impact on both bankruptcy and corporate insolvency law. Three categories of transactions are liable to be challenged: transactions at an undervalue, unfair preferences and extortionate credit transactions. Unfair preferences are similar in concept to fraudulent preferences under the old law,[3] but the wording of the new

1 Cap 20, 1985 Rev Ed.
2 Ss 97-103 BA95.
3 See s 55 of the Bankruptcy Act, *supra*, note 1.

provision bears little resemblance to its predecessor. The other two categories of transactions are being branded as objectionable transactions for the first time under our bankruptcy and insolvency laws.[4]

An interesting, or rather, questionable feature of the new regime is the legislative technique by which the avoidance provisions are made to apply to companies. They are, for the lack of a better word, 'imported' rather bluntly into the judicial management and winding up regimes by sections 227T(1) and 329(1) of the Companies Act ('CA') respectively. Of course, such a parasitical process is not new, having been in place under the previous law,[5] but it is disappointing that it has survived the advent of the BA95. Surely it would have been neater, simpler and less problematic if similarly-worded provisions applicable only to companies had been separately enacted in the companies legislation[6] and sections 227T(1) and 329(1) CA were given their long-overdue repeal. There is every reason why the bankruptcy and corporate insolvency regimes should be kept distinct, no matter how alike the underlying principles may be. No conceivable advantage arises from retaining such a curious and anomalous association between the two regimes when their spheres of application are so obviously mutually exclusive.

[4] There is some similarity between transactions at an undervalue and s 52 of the Bankruptcy Act, *supra*, note 1. Under that section, a 'settlement of property' which was not made in consideration of marriage or in favour of a purchaser or encumbrancer in good faith and for valuable consideration was rendered absolutely void if it had taken place within two years of bankruptcy, and void if it had taken place within ten years of bankruptcy unless it is shown that the settlor was solvent at the time of the settlement. As will be seen, the scope of the new concept of transactions at an undervalue is wider in certain respects, the most important of which are that it applies to all transactions and not only 'settlements of property' and that it not only catches transactions for no value, but also transactions at a significant undervalue or in consideration of marriage. Another section which bears some similarities to the concept of a transaction at an undervalue is s 331 of the Companies Act (Cap 50, 1994 Rev Ed) (hereinafter referred to as 'CA'). The concept of a transaction at an undervalue is also wider than s 331 CA in most respects, the notable exception being that, unlike the former, s 331 CA does not require that the company must be insolvent at the time of the acquisition or disposal. Nevertheless, it may be that s 331 CA will be rendered practically obsolete with the introduction of the concept of a transaction at an undervalue. In any event, it is a rarely-invoked provision and, as far as the writer has been able to uncover, there has only been one reported decision on the corresponding Australian provision: *Re Norrich Pharmaceutical Co Pty Ltd* [1969] 1 NSWLR 125. See discussion on this question, *infra*, at notes 264-268 and the accompanying main text.

[5] S 329(1) CA was held to be effective in importing s 53 of the Bankruptcy Act, *supra*, note 1, which dealt with fraudulent preferences: see, *eg*, *Lian Keow Sdn Bhd* v *Overseas Credit Finance* [1988] 2 MLJ 449; *Ho Mun-Tuke Don* v *Oslo Finans AS* [1990] 3 MLJ 84; *Re Kim San Engineers Pte Ltd* [1992] 2 SLR 749; *Lin Securities Pte* v *Royal Trust Bank (Asia) Ltd* [1995] 1 SLR 97.

[6] This is the position under the IA86. Ss 239, 340 and 343 IA86, on which the avoidance provisions of BA95 are modelled, apply only in bankruptcy while the similarly worded ss 238, 239 and 244 IA86 apply exclusively to the administration and winding up of companies.

Even if it were desirable, for some reason, that the avoidance provisions of BA95 should apply to companies, one would expect great care and meticulousness to have been taken in the drafting of the avoidance provisions in the BA95 and the 'piggy-back' provisions in the CA in order that the importation process would be as smooth as possible. It is thus with some dismay that one notes that, in this respect, the drafting of both sets of provisions is defective in many places and may in fact pose difficulties much more serious and fundamental than the previous provisions. The avoidance provisions of BA95 appear to be drafted solely with the bankruptcy regime in mind and the adjustment and alignment sought to be achieved by the amendments to sections 227T(1) and 329(1) CA and by the newly-enacted Companies (Application of Bankruptcy Act Provisions) Regulations 1995[7] (hereinafter referred to as the Regulations) are inadequate. The result is that the operation of the avoidance provisions in the context of insolvent companies is inept, clumsy and ridden with anomalies.

II. Section 98: Transactions at an Undervalue

Section 98 BA95[8] applies to transactions entered into, at the relevant time,[9] by the debtor with any person at an undervalue.[10] The Official Assignee may apply to the court for an order and the court shall make such order[11] as it thinks fit for restoring the position to what it would have been if the debtor had not entered into that transaction.[12] It is to be noted that there is no requirement that the party dealing with the debtor must have been acting in collusion with him to divert his property from his creditors; an entirely *bona fide* transaction may thus be liable to be set aside or otherwise impugned.

A transaction is entered into at an undervalue if it is a gift or entered into for no consideration or in consideration of marriage, or if the value of the consideration, in money or money's worth, provided by the other person is significantly less than the value of the consideration, in money or money's worth, provided by the debtor.[13]

7 S 293/1995. The Regulations came into operation at the same time as BA95 on 15th July 1995.

8 Modelled on s 339 IA86.

9 See the discussion of the concept of the relevant time, *infra*, at notes 117-143 and the accompanying main text.

10 S 98(1) BA95.

11 See the discussion of the scope of the court's powers in making such orders, *infra*, at notes 175-190 and the accompanying main text.

12 Ss 98(1) and 98(2) BA95.

13 S 98(3) BA95.

1. *'Transaction'*

The term 'transaction' is generously defined to include any gift, agreement or arrangement.[14] It further appears that the question of what constitutes a transaction is one of substance and not form. Of course, at the minimum, there must have been some disposal of assets or the undertaking of liability by the debtor which would deplete his estate of assets otherwise available for distribution to his creditors. Where there have been a series of transactions, it is likely, and indeed sensible, that the court will look to the substance of the transactions and, if appropriate, classify them as a single transaction for the purpose of section 98 BA95.[15]

It is sufficient that the transaction is entered into with 'any person'. In England, this expression has been held not to be subject to any implied restriction as to its extra-territorial effect and includes literally any person, wherever resident; the court can therefore make an order against such a person provided that he has a sufficient connection with England for it to be just and proper to make the order against him despite the foreign element.[16]

2. *Gifts*

The provision relating to gifts would appear to be unnecessary since all gifts, by definition, would fall into the class of transactions covered by the third limb, that is, where the value consideration received by the debtor is significantly less than the value of that which he furnished. Conversely, the fact that a transaction was not a gift would not be enough to avoid the application of the section if there was a substantially imbalanced exchange of valuable consideration. Thus, where a debtor transfers a mortgaged property in return for an indemnity against liability under the mortgage, it is unnecessary to consider whether the indemnity constitutes valuable consideration so that the transaction could not be classified as a gift; the substantive question is whether the consideration furnished by debtor was significantly in excess of the consideration received by him.[17] However, the issue of whether a transfer is an outright gift is obviously still relevant when the court is exercising its power to restore the parties to the pre-transaction position.[18]

[14] S 2(1) BA95.

[15] See *Arbuthnot Leasing International Ltd* v *Havelet Leasing Ltd (No 2)* [1990] BCC 636 at 644G, a decision on the similarly worded s 423 IA86.

[16] *Re Paramount Airways Ltd* [1992] 3 All ER 1.

[17] *Re Kumar* [1993] 1 WLR 225.

[18] See the discussion of the scope of the court's powers in making such orders, *infra*, at notes 175-190 and the accompanying main text.

3. *'Consideration'*

The term 'consideration' would appear to bear the same meaning as it is used in the law of contract. Accordingly, a detriment suffered by the debtor can constitute good consideration,[19] though it is unclear whether such a detriment, if not actually part of the bargain and unaccompanied by a corresponding benefit to the other party, can be treated as part of the consideration for the purposes of the section.[20]

A compromise of a claim to a provision in matrimonial proceedings is capable of being consideration,[21] as is a bank's forbearance from calling in an overdraft and other facilities.[22] Where a husband grants his wife a lease of his mortgaged farm at the market rent, the consideration supplied may transcend the immediate rights granted by the tenancy; the consideration supplied to the wife may include other benefits like allowing her to safeguard the family home from foreclosure by the mortgagee, enabling her to carry on the family farming business and a surrender value.[23] On the other hand, a letter from an insolvent company instructing a bank, to which it had earlier assigned certain receivables, to allocate in a certain way the money received under the receivables between the bank and another secured creditor is not a transaction by which the company provided any consideration, as the letter does not create any security but merely regulates the priorities between the bank and the other secured creditor.[24]

If there is a hope of obtaining planning permission for a property which would increase its value considerably, the court may take into account such 'hope' value in determining the value of the consideration.[25]

4. *'Significant undervalue'*

There is no significant undervalue where the consideration provided by the debtor substantially matches in value the consideration provided by the counter-party to the transaction or reduces to insignificance any disparity in value which otherwise exists.[26] A transfer of the equity of redemption of a mortgaged property worth £19,000 for the discharge of a debt of not

[19] *Agricultural Mortgage Corporation plc* v *Woodward* [1995] 1 BCLC 1, a decision on the similarly worded s 423 IA86.
[20] See *ibid*, where the Court of Appeal declined to decide the question.
[21] *Re Kumar*, *supra*, note 17.
[22] *Re MC Bacon Ltd* [1990] BCLC 324.
[23] *Agricultural Mortgage Corporation plc* v *Woodward*, *supra*, note 19.
[24] *Menzies* v *National Bank of Kuwait SAK* [1994] BCC 119, a decision on the similarly worded s 423 IA86.
[25] *Pinewood Joinery* v *Starelm Properties Ltd* [1994] BCC 569.
[26] *Re Kumar*, *supra*, note 17, at 235H.

more than £11,000 is a transaction at an undervalue,[27] as is an assignment by a company of the benefits of leasing agreements as well as its capital assets in return for only the right to receive quarterly-in-arrears payments paid by the lessees under the leasing agreements.[28]

A more controversial approach, propounded by Millett J (as he then was) in *Re MC Bacon*,[29] is that the provision requires a comparison between the value obtained by the debtor for the transaction and the value of the consideration provided by the debtor, and that both values must be measurable in money or money's worth and are to be considered from the bankrupt's point of view. Applying this approach, the learned judge held that the creation of a security over the assets of an insolvent company to secure an existing debt would not be the giving of any value by the company, since it only involves the appropriation of certain of its assets to meet its liabilities to the other party. There would be no depletion of its assets. Such an appropriation is not capable of valuation in monetary terms and is not customarily disposed of for value.

Millett J's view that the provision envisages a comparison between the respective values of the consideration provided by each party may be accepted without qualification. However, apart from this, there are three objections to his approach.

Firstly, it cannot be correct that the respective values of the consideration exchanged is to be judged from the perspective of the debtor. Taking this approach would mean that the provision is operative only where the debtor *knows* or perhaps, *ought to know*, that what he is receiving under the transaction is significantly less valuable than what he is giving. This would be almost equivalent to imposing a *'mens rea'* requirement on the section and would run counter to its wording which contemplates an objective inquiry. It would also offend the policy behind the provision of protecting the creditors of the debtor from not only dishonest but also imprudent and extravagant transactions. The crux of the matter is that the transaction has been entered into at a time when the debtor is already insolvent[30] and the consideration in excess of the fair value which the debtor is supplying in

[27] *Chohan* v *Saggar* [1992] BCC 306, 750, reversed in part at [1994] BCC 134.

[28] *Arbuthnot Leasing International Ltd* v *Havelet Leasing Ltd (No 2)*, *supra*, note 15. Contrast *Pinewood Joinery* v *Starelm Properties Ltd*, *supra*, note 25, where the undervalue was not proved by the evidence.

[29] *Supra*, note 22, at 340g-341c. Millett J's reasoning was approved by Balcombe LJ in *Menzies* v *National Bank of Kuwait SAK*, *supra*, note 24, at 128H-129G and by Sir Christopher Slade in *Agriculture Mortgage Corp* v *Woodward*, *supra*, note 19, at 5h-6h. Both are decisions on the similarly worded s 423 IA86.

[30] See s 100(2) BA95 and the discussion, *infra*, notes 123-125 and the accompanying main text.

respect of the transaction rightfully belongs to his creditors. Corporate insolvency jurisprudence has recognised that when a company becomes insolvent the interests of its creditors take precedence over the interests of the company and its shareholders and, consequently, the company is not at liberty to deal with its assets so as to prejudice the creditors' interests.[31] The same reasoning no doubt applies, *mutatis mutandis*, to the bankruptcy context and the power to set aside or otherwise impugn transactions at a significant undervalue is an important statutory mechanism designed to enforce this principle. Accordingly, when a person is insolvent, the court should impute to him the judgment and values of a reasonable person who is under a duty to ensure that the transactions into which he enters would not deprive his creditors of any value in his bankruptcy which they would otherwise be entitled to, for that is the standard which he should abide by and which his creditors can expect from him. Indeed, it has been said that where an individual is insolvent but thinks that he may be able to overcome this if he continues trading, he should nevertheless disclose this to his creditors, who will have to bear the loss in case his calculations are wrong, and leave it to them to determine whether his proposed course of action should be proceeded with.[32]

While some argument can be made that the other party to the transaction, who may have entered into it in good faith, should not be prejudiced simply on the basis that he has obtained terms more favourable than those to which would be agreed by a more prudent counter-party, this is not *per se* sufficient to override the interests of the bankrupt's other creditors. In a bankruptcy context, the interest in the security and certainty of receipts and the sanctity of contract must give way to the public interest in having a bankruptcy regime which is capable of effectively protecting the creditors. Furthermore, the extent of any such prejudice to an innocent third party would be limited to him being put back to the position as if the transaction had never been entered into; this may often translate into a deprivation of his gain rather than the cause of any actual loss. It is thus submitted that it is the *objective* value which must be attributed to the relevant consideration.

The second objection to Millett J's approach is that it adopts an unduly restrictive view of the type of consideration which is measurable in money

[31] *Walker* v *Wimborne* (1976) 137 CLR 1; *Nicholson* v *Permakraft (NZ) Ltd* [1985] 1 NZLR 242; *Kinsela* v *Russell Kinsela Pty Ltd* (1986) 4 NSWLR 722, 10 ACLR 395; *Winkworth* v *Edward Baron Development Co Ltd* [1986] 1 WLR 1512, [1987] BCLC 193; *West Mercia Safetywear Ltd* v *Dodd* [1988] BCLC 250, (1988) BCC 30; *Jeffree* v *NCSC* (1989) 7 ACLR 556; *Sycotex Pty Ltd* v *Baseler* (1994) 13 ACSR 766. Contrast *Kuwait Asia Bank* v *National Mutual Nominees* [1990] 3 WLR 297 and *Re Welfab Engineers Ltd* [1990] BCLC 833. See also s 339(3) CA.

[32] See Cave J in *Re Stainton* (1887) 4 Morr 242 at 251. See also s 144 BA95.

or money's worth. The phrase 'in money or money's worth' in the provision is surely not intended to map the boundaries of the category of transactions which are caught but merely sets out to state the basis on which the consideration exchanged by the parties is to be evaluated and compared by the court. It should be read as a direction to the court to place a monetary value on the consideration, as best as it can, for the purpose of comparison, and not as a statutory prescription that certain categories of transactions are not amenable to the operation of the section. To ascribe a monetary value to things which are not normally exchanged for value or commonly perceived as having pecuniary worth is a task to which the court is well-accustomed, especially in bankruptcy and corporate insolvency situations. Even where the court is faced with more complex forms of consideration such as where the debtor assumes a contingent liability, for example, if he gives an indemnity or guarantee or compromises a claim for unliquidated damages, the court should be no less able or willing to perform the valuation exercise. The legislation recognises, in the context of proof of debts, that the court may have to estimate the value of a contingent claim which does not bear a certain value or even certain claims for unliquidated damages, as long as the value thereof is capable of being fairly estimated.[33] Difficulty in accurately estimating the value of such claims is no reason for excluding them from proof.[34] Similarly, the court can value contingent claims for the purposes of bankruptcy or insolvency set-off.[35] It is submitted that the court can adopt the same approach with regard to the valuation required by section 98(3)(c) BA95. Indeed, the degree of exactitude to which the court is required to meet in the context of the provision is considerably less than in the case of proof of debts or set-off, as the court does not need to reach any exact or conclusive figure but only has to decide whether any disparity between the respective quanta of consideration is significant. It is only in the rare situation where the nature of the consideration is such as to deny the possibility of any fairly accurate valuation that the court should decline to find that any significant undervalue has been established.

That this is indeed the correct approach derives some support from *Agricultural Mortgage Corporation plc* v *Woodward*.[36] In this case a husband had granted his wife a lease of his mortgaged farm at the best rent reasonably obtainable in the market in order to deplete the value of his assets available

[33] Ss 87 BA95. The same rules are made applicable to companies in winding-up by virtue of s 327 (2) BA95.

[34] *Hardy* v *Fothergill* (1888) 13 App Cas 351.

[35] See *Re Charge Card Services Ltd* [1987] Ch 150, [1986] 3 All ER 289 and the cases cited therein. See also Hoffman LJ in *MS Fashions Ltd* v *BCCI* [1993] 3 All ER 769 at 778a-c.

[36] *Supra*, note 19.

for his creditors, in particular the mortgagee. The Court of Appeal held that the transaction was at a significant undervalue as it conferred on the wife enhanced benefits beyond the rights granted by the tenancy itself; it allowed her to safeguard the family home from foreclosure by the mortgagee, enabled her to carry on the family farming business and gave a surrender value to the lease. The court did not burden itself with calculations of any form but merely propounded that when the transactions were viewed as a whole the benefits which the husband thereby conferred on the wife were significantly and far greater in value, in money or money's worth, than the value of the consideration provided by her and that to hold otherwise would fly in the face of reality and common sense.[37]

Millett J's view that the granting of a security in respect of an existing debt and the forbearance to sue are not types of consideration which are capable of being valued in monetary terms and are not customarily disposed of for value[38] would therefore appear to be questionable. A logical and relatively simple method of valuation would be to treat the value of the grant of the security as the value of the secured debt minus the value of the debt if it had remained unsecured, and the value of the forbearance to call in the loan would be the cost to the debtor of arranging for alternative financing. Furthermore, if the learned judge's view were to be accepted, the granting of security over one's assets to secure another's debt, such as where a subsidiary grants security in respect of the debts of the parent company, may be incapable of being a transaction at an undervalue. Such a state of affairs would surely be highly objectionable.

The third objection relates to Millett J's view that the granting of a charge does not result in any depletion of the chargee's assets. It is submitted that this statement is misleading. Conceptually, it may be unobjectionable to say that a charge is simply an appropriation of specific property to the discharge of the debt or obligation without there being any change in ownership in either law or equity.[39] However, this does not mean that there is no 'depletion' of the assets comprised in the charge. By granting a charge, the chargor undeniably parts with important security rights over the charged property and the pecuniary worth of the charged assets to the chargor and, in his insolvency, to his creditors, is diminished correspondingly by the amount of the secured debt. While legal or equitable ownership to the assets

[37] See Sir Christopher Slade, *supra*, note 19, at 11f.

[38] It is not clear whether these two factors are intended to be read disjunctively or conjunctively but it is thought that they must be intended to be disjunctive as otherwise the even narrower scope of the latter factor would be an intolerably strict restriction on the provision.

[39] See Peter Gibson J in *Carreras Rothmans Ltd* v *Freeman Matthews Treasure Ltd* [1985] Ch 207 at 227. See also Slade J in *In re Bond Worth Ltd* [1980] 1 Ch 228 at 250E and Goode, *Legal Problems Of Credit And Security* (2nd ed, 1988), at 14.

may not have been parted with, some *value* in those assets will definitely have been given away to the chargee. It seems difficult to dispute the proposition that a charge does result in the assignment of some form of equitable interest in the charged assets.[40] Moreover, it may now be doubtful whether it is true of every charge that its creation involves no change in legal or equitable ownership but only an appropriation, especially in a charge which confers an express power to appoint a receiver,[41] presumably because the characteristics of such a charge approximate those of an equitable mortgage.

III. Section 99: Unfair Preferences

Section 99 BA95[42] applies where the debtor has, at the relevant time,[43] given an unfair preference to any person.[44] The Official Assignee may apply to the court for an order and the court shall make such order[45] as it thinks fit for restoring the position to what it would have been if the debtor had not given that unfair preference.[46] The debtor gives an unfair preference to another person if that person is a creditor, surety or guarantor of the debtor and the debtor does anything or suffers anything to be done which has the effect of putting that person into a position which in the bankruptcy will be better than the position he would have been in if that thing had not been done.[47] The word 'creditor' here probably refers to any person who has a provable debt against the debtor, including contingent creditors.[48]

[40] See *Lyford* v *Commonwealth Bank of Australia* (1995) 130 ALR 267 at 271. This is further supported by the fact that the crystallisation of a floating charge into a fixed charge effects an equitable assignment of the charged property to the chargee*: Biggerstaff* v *Rowatt's Wharf Ltd* [1986] 2 Ch 93; *NW Robbie & Co Ltd* v *Witney Warehouse Co Ltd* [1963] 1 WLR 1324; *George Barker (Transport) Ltd* v *Enyon* [1974] 1 WLR 462; *In re ELS Ltd* [1995] Ch 11. See also *Re Interview Ltd* [1975] IR 382 and *Re Tullow Engineering (Holdings) Ltd* [1990] 1 IR 452.

[41] See Ferris J in *In re ELS Ltd*, *supra*, note 40, at 24A-E.

[42] Modelled on s 340 IA86.

[43] See the discussion of the concept of the relevant time, *infra*, at notes 117-143 and the accompanying main text.

[44] 99(1) BA95.

[45] See the discussion of the scope of the court's powers in making such orders, *infra*, at notes 175-190 and the accompanying main text.

[46] Ss 99(1) and 99(2) BA95.

[47] S 99(3) BA95.

[48] *Re Blackpool Motor Car Co Ltd* [1901] 1 Ch 77; *Re JF Aylmer (Manildra) Pty Ltd* (1968) 12 FLR 337, 89 WN (Pt 1) (NSW) 79, [1968] 3 NSWR 330; *Re S & N (Nominees) Pty Ltd* (1986) 84 FLR 463, *sub nom Yeomans* v *Lease Industrial Finance Ltd* 5 ACLC 103; *Spedley Securities Ltd* v *Western United Ltd* (1992) 27 NSWLR 111, 7 ACSR 271, 10 ACLC 357; *Harkness* v *Potts* (1993) 10 ACSR 517, 11 ACLC 501.

The debtor must also have been influenced, in deciding to give the unfair preference, by a desire to produce in relation to that person the effect of the preference,[49] but this shall be presumed if the debtor gives the unfair preference to an associate.[50] The fact that something has been done in pursuance of a court order does not, without more, preclude that thing from constituting the giving of an unfair preference.[51]

1. *What constitutes an unfair preference*

By analogy with the position in the case of a transaction at an undervalue,[52] an unfair preference may be given to anyone whether resident in Singapore or not, as long as he has a sufficient connection with this country for it to be just and proper to make the order against him.

Unlike the position under the previous legislation,[53] there is no restriction in section 99(3) BA95 on the type of act which may constitute an unfair preference. The emphasis appears to be on the effect of the act in question and any act which has the effect of improving the position of a person in the bankruptcy of the person giving the preference is capable of being an unfair preference. Acts such as a payment[54] or the grant of security[55] in respect of an existing debt can obviously be unfair preferences. Apart from such clear cases, there is little English or local authority on the nature of a preference, as the key question in the cases under the previous legislation has mostly been with respect to the intention of the debtor, that is, whether he acted with a view to giving a preference.[56] If such intention was present, it was also usually the case that the physical act would amount to an act of preference; hence there was seldom a need to analyse the nature of a preference *per se*.

However, under section 99 BA95, the question of what constitutes an act of preference may be relevant in cases where the element of intention

[49] S 99(4) BA95.

[50] S 99(5) BA95. See the discussion on the concept of an associate, *infra*, at notes 144-155 and the accompanying main text.

[51] S 99(6) BA95.

[52] *Re Paramount Airways Ltd*, *supra*, note 16.

[53] S 53(1) of the Bankruptcy Act, *supra*, note 1, applied to every conveyance or transfer of property or charge thereon, every payment made, every obligation incurred and every judicial proceeding taken or suffered by the debtor.

[54] See, *eg*, *Re Beacon Leisure Ltd* [1992] BCLC 565 and *Re Ledingham-Smith* [1993] BCLC 635.

[55] See, *eg*, *Re MC Bacon Ltd*, *supra*, note 22 and *Re Fairway Magazines Ltd* [1993] BCLC 642.

[56] S 53(1) of the Bankruptcy Act, *supra*, note 1. See the discussion of the mental element for the giving of preferences, *infra*, notes 98-116 and the accompanying main text.

is presumed to exist.[57] In a case where the presumption operates, the party concerned might, instead of rebutting the presumption, seek to argue that the relevant act does not constitute an unfair preference at all. Useful guidance on this question may be obtained mainly from Australian authorities which have discussed what is an act 'having the effect of giving that creditor a preference, priority or advantage over other creditors' under the parallel preference provisions of the Australian bankruptcy and insolvency legislation.[58] This phrase requires a comparison to be made between the position of the recipient as a result of the challenged payment and the position of other creditors in relation to the subsequent winding up or bankruptcy,[59] and the general conception is therefore similar to the formula in section 99(3) BA95. Furthermore, the Australian provision focuses on the effect of the alleged preference rather than the intent of the actor[60] and the Australian courts have had more opportunities to grapple with the question of the nature of a preference.

There can be a preference only if, at the time that the preference is given, the debtor has creditors other than the person alleged to be preferred.[61] The payment must also be made to a creditor in his capacity as such,[62] and it is not enough that the person preferred only becomes a creditor by virtue of the preference, for example, where a guarantee is given.[63] The fact that a step by a third party is required in the conferring of the preference does not mean that the preference is not conferred by the debtor; thus, where an insolvent company pays money into its bank account and the bank exercises its right to combine accounts and uses the money to discharge a debt on another account, the disposition of the money into the first account is an act of preference by the company.[64] Similarly, payment made into

[57] See s 99(5) BA95 and the discussion of the mental element for the giving of preferences, *infra*, notes 98-116 and the accompanying main text.

[58] S 122, Bankruptcy Act (Cth), made applicable to companies by s 565 Corporations Law.

[59] *Harkness* v *Potts*, *supra*, note 48.

[60] This is a significant difference between the Australian and English preference provisions: *Ferrier* v *Civil Aviation Authority* (1994) 127 ALR 472 at 485; *Spedley Securities Ltd* v *Western United Ltd*, *supra*, note 48, at 115. See also the *Ferrier* decision at 485-7 for a consideration of the legislative history of the Australian provision.

[61] *Re Australian Co-Operative Development Society Ltd* [1977] Qd R 66, [1977] ACLC 29,054; *sub nom Re Australian Co-Operative Development Society Ltd*; *Rees* v *Queensland Credit Union League Ltd* (1976) 2 ACLR 207. Such other creditors must have that status at the time of the preference: see *Spedley Securities Ltd* v *Western United Ltd*, *supra*, note 48, and the cases cited therein.

[62] *Expo International Pty Ltd* v *Torma* (1985) 3 NSWLR 225, 10 ACLR 100, 3 ACLC 748. See also Rich, Dixon and McTiernan JJ in *Robertson* v *Grigg* (1932) 47 CLR 257 at 271 and *North West Construction Co Pty Ltd* v *Marian* [1965] WAR 205. Contrast *Re Clasper Group Services Ltd* (1988) 4 BCC 673.

[63] *Re Jacques McAskell Advertising Freeth Division Pty Ltd* [1984] 1 NSWLR 249.

[64] *Matthews* v *Geraghty* (1986) 43 SASR 576, 11 ACLR 229, 4 ACLC 727.

court pursuant to an order giving conditional leave to defend is capable of being a preference.[65]

A series of acts may, when viewed as a single transaction, constitute an act of preference, as where a company, whose debt to a bank is secured by charges over certain third parties' deposits with the bank, agrees to convert the deposits to debentures and allows the bank to apply the deposits towards the discharge of the debt.[66] But there is no preference where a third party pays off a debt of the debtor without using the moneys of the debtor and not in the capacity of an agent of the debtor,[67] even if the third party makes the payment under a contractual obligation to the debtor.[68]

There is no preference when the person alleged to be preferred is a secured creditor, since such a person would not be in a position better than the position he would have been in if the alleged act of preference had not been done. This is, provided of course that the sum paid does not exceed the value of his security. Accordingly, there cannot be a preference where the person alleged to be preferred has a lien over the property disposed of by the debtor[69] or a charge in respect of the debt discharged.[70] Similarly, payment to a garnishor under a garnishee order is not a preference because there is no creditor-debtor relationship and the garnishor has a lien upon the identified debt.[71] Where a bank has the right to combine a loan and a cheque account, a payment out of the cheque account into the loan account does not constitute a preference, since if the payment was not made the bank could have exercised its right of combination of accounts.[72] In exceptional circumstances, a secured creditor may be preferred where the debtor increases the value of the security. For instance, if a creditor has a floating charge, or a fixed charge over present and future property, the debtor may

65 *Commercial Banking Co of Sydney Ltd* v *Colonial Financiers of Australia Pty Ltd* [1972] VR 702.

66 *Re JF Aylmer (Manildra) Pty Ltd; Burgess* v *Spooner*, *supra*, note 48.

67 *Craftsman Modern Constructions Pty Ltd* v *National Bank of Asia Ltd* (1968) 87 WN (Pt 1) (NSW) 378, [1968] 2 NSWR 71; *Re CG Monkhouse Pty Ltd* (1968) 69 SR (NSW) 428, 88 WN (Pt 2) 238, [1968] 2 NSWR 664; *Ramsay* v *National Australia Bank Ltd* (1988) 13 ACLR 732, 6 ACLC 625.

68 *Ramsay* v *National Australia Bank Ltd*, *supra*, note 67. Equally, a payment out of assets which are not available for distribution to the general creditors cannot constitute a preference: *Re Thompson* (1903) 3 SR (NSW) 166, 20 WN 37.

69 *Hewett* v *Court* (1983) 149 CLR 639, 57 ALJR 211, 46 ALR 87, 7 ACLR 907, 1 ACLC 768; *Byland Nominees Pty Ltd* v *MacLean* [1985] WAR 352. Contrast *Re Jubilee Furniture Pty Ltd* (1981) 5 ACLR 762, [1981] ACLC 33,231.

70 See, *eg*, *Robertson* v *Grigg*, *supra*, note 62. If the charge turns out to be void, the creditor would be an unsecured creditor and any repayment in respect of the charge would be a preference: *Court* v *Versteeg* (1986) 4 ACLC 650. Contrast *Re Millar* (1952) 16 ABC 49.

71 *Melsom* v *Vanpress Pty Ltd* (1990) 3 WAR 39, 3 ACSR 109, 8 ACLC 1,266.

72 *Hamilton* v *Commonwealth Bank of Australia* (1992) 10 ACLC 1,586, 9 ACSR 90.

'fill up' the security[73] by ordering goods or by trading with credit by other creditors and hence improve the position of the secured creditor.

It has also been held, in both the Australian High Court[74] and, *semble*, the Singapore High Court,[75] that there is no preference where a bank which has a lien over a cheque receives payment from the paying bank in discharge of the lien, on the basis that a payment received in discharge of a valid security cannot be a preference.[76] However, a valid inquiry might be why the act of depositing the cheque into an overdrawn account did not constitute in itself the granting of a preference, since the result of that act was that the bank obtained security in respect of an existing debt and improved its position over the other creditors.[77]

If no security rights are present, the repayment of a debt would be a preference even if the debt had been of great benefit to the company.[78] Thus, reduction of a bank overdraft or loan account would be a preference, whether the payments were made directly[79] or indirectly by substantially and foreseeably affecting the position of the bank as creditor, for instance, where the payments give rise to a right of set-off in favour of the bank, although the right is not actually exercised but merely prevents subsequent payments to the bank from being set aside as preferences.[80]

2. *The 'running account' principle*

An interesting question is whether payments made by the bankrupt into a 'running account' maintained with a creditor would constitute a preference. On one view, each payment may be treated as a preference in so far as it discharges existing indebtedness. The alternative view developed by the Australian courts is that where a particular payment is an integral part of an entire transaction, the whole transaction must be considered in determining whether there is a preference.[81] Each individual payment cannot then be

[73] This phrase was coined by the Committee on Law Amendment 1926 in describing one of the situations to which what is now s 340(1) CA is directed at. See (1934) 50 LQR 405 at note 2.

[74] *National Australian Bank* v *KDS Construction Services Pty Ltd* (1987) 12 ACLR 663.

[75] *Re Kim San Engineers Pte Ltd*, *supra*, note 5.

[76] See *National Australian Bank* v *KDS Construction Services Pty Ltd*, *supra*, note 74, at 660.

[77] See the reasoning in *Matthews* v *Geraghty*, *supra*, note 64 and *Hamilton* v *Commonwealth Bank of Australia*, *supra*, note 72.

[78] *Taylor* v *Freeway Mutual Pty Ltd* [1978] Qd R 474, *sub nom Freeway Mutual Pty Ltd* v *Taylor* (1978) 22 ALR 281, *sub nom Freeway Mutual Pty Ltd* v *Hamilton View Pty Ltd* 3 ACLR 726; *Re Hamilton View* [1979] ACLC 32,036.

[79] See, *eg*, *Re Maran Distributors Pty Ltd* (1992) 8 ACSR 653, 11 ACLC 167.

[80] *Hamilton* v *Commonwealth Bank of Australia*, *supra*, note 72.

[81] It appears to have been first recognised by the High Court of Australia in *Richardson* v *The Commercial Banking Company of Sydney* (1951-52) 85 CLR 111. The principle has

isolated as a preference. There is no preference where payments are inseparably connected with counter-payments as part of an arrangement for the continuation of the debtor-creditor or other business relationship for the benefit of both parties, and it is the ultimate effect of the whole course of dealings which has to be considered. The distinction, therefore, is between a payment made with a view to terminating the 'running account' or reducing the level of the outstanding balance and a payment which is paid as pursuant to a mutual assumption of the continuance of the debtor-creditor relationship. The only preference is only with respect to the ultimate decrease in the indebtedness of the bankrupt as a result of the payments and counter-payments in respect of the running account.[82] Payments into a 'running account' cause the creditor to allow the debtor to make subsequent payments out of the account, and the latter are a *pro tanto* restoration of the loss of the bankrupt's assets caused by the former.[83]

Some support that the same approach is applicable in the context of section 99 BA95 may be found in the decision in *Re Ledingham-Smith*.[84] A firm of accountants were the creditors of the debtor firm in the region of £23,000 and the debtor firm were required to clear the debt if they wanted the accountants to continue rendering services to them. An agreement was reached whereby the accountants would raise weekly invoices for the work done in that week and the debtor firm would pay the firm £5,000 every week. This sum would be used to pay the weekly invoice first and the balance if any would be applied to reduce the outstanding sum owing by the debtor. During the relevant statutory period before the debtor firm was adjudged

been considered and applied in numerous subsequent cases: see the High Court decisions of *Rees* v *Bank of New South Wales* (1964) 111 CLR 210 and *Queensland Bacon Pty Ltd* v *Rees* (1966) 115 CLR 266 and the extensive consideration of the case law by the Full Court of the Federal Court of Australia in *Ferrier* v *Civil Aviation Authority*, *supra*, note 59. Other authorities include *Re Weiss* (1970) ALR 654; *Re Hicks* (1980) 39 FLR 374; *Re Baronga Nominees Pty Ltd* (1983) 8 ACLR 265; *Re Toowong Trading Pty Ltd* (1988) 13 ACLR 121; *Petagna Nominees Pty Ltd* v *A E Ledger* (1989) 1 ACSR 547; *Re Siromath Pty Ltd (No 2)* (1991) 6 ACSR 226, 9 ACLC 1,583; *Starkey* v *APA Transport Pty Ltd* (1993) 12 ACSR 15; *Perkins* v *State Bank of South Australia* (1993) 61 SASR 246; *CSR Ltd* v *Starkey* (1994) 13 ACSR 321; *Rothmans Exports Pty Ltd* v *Mistmorn Pty Ltd* (1994) 15 ACSR 139. See also Goode, *supra*, note 39, at 171-2.

82 It could be argued that each payment into the account is connected only with *subsequent* payments out of the account since it could not have caused the creditor to have allowed any *preceding* payments out of the account. This is fallacious as the making of payments out of the account is not caused by any particular payments into the account but by *the underlying assumption or arrangement* between the parties that as long as the debtor made payments into the account the creditor would continue to permit payments out of the account. No issue of chronology, it is contended, is involved.

83 Goode, *supra*, note 39, at 171.

84 *Supra*, note 54.

bankrupt, they managed to pay about £12,000 by virtue of three payments of £4,000 over six weeks, but the fees for the work done by the accountants in that period came up to almost £10,000.

On an orthodox analysis, each payment of £4,000 would be a preferential payment regardless of which debts were discharged by it. Each payment would be paying off an existing debt and would improve the accountants' position in the event of the bankruptcy of the debtors. However, without much discussion of the point, Morritt J held that any possible preference arose only in relation to the difference of £2000 or so. He further opined that the preference provision predicated that the effect of a preference is that the position of the preferred creditor, surety or guarantor would be better, not might be. Accordingly, even in respect of the sum of £2,000, there was no preference because at the time the payments were made it could not be said with certainty that the accountants would inevitably be benefited by that sum, as negotiations were still continuing and fees for services rendered were still being incurred.

Morritt J's first conclusion is clearly consistent with the application of the 'running account' principle. However, the second part of his holding cannot be justified even by that principle. The principle merely dictates that a transaction which is an integral part of a series of transactions cannot be viewed at in isolation; viewing the payments by the debtor firm and the work rendered by the accountants as a whole transaction, there would clearly be a preferential payment of the difference between the payments and the fees payable for the work rendered. It is also a misconception to rely on the relevant provision's declaration that the effect of the preference must be that the creditor's position 'in the event of the individual's bankruptcy ... will be better'. The simplest and most logical way to apply that expression must be to examine the position of the particular creditor on the hypothesis that there is a bankruptcy *immediately after* the payment, and not with reference to the actual bankruptcy. Whether an act is a preference must be capable of being ascertained at the moment of its commission, and not only after the whole course of events has unfolded.

In any event, it is contended that the 'running account' principle itself does not fit in at all neatly with the wording of section 99(3) BA95 which envisages that the test is to be applied at the point in time when the preference is given. Subsequent events appear to be immaterial for the purposes of the provision. As the 'running account' principle does not require that there be any contractual obligation on the creditor, as opposed to a mutual assumption or arrangement, to allow the debtor to make subsequent drawings from the account, it follows that in a strict legal analysis the position of the creditor is indeed improved in the bankruptcy of the debtor. Furthermore, problems could arise as to the exact point in time at which the preference is given

for the purposes of determining whether the preference was given at the relevant time.[85]

While the rationale for the 'running account' principle is sound, it need not be applied to section 99(3) BA95 for the simple reason that an order under section 99 BA95 must be one which the court thinks is fit for restoring the position to what it would have been if the bankrupt had not given the unfair preference.[86] In a situation of a true 'running account', the court would necessarily have to take into consideration the payments out of the account permitted by the creditor, as without the preferences given by the debtor he would not have allowed such payments to have been made. Consequently, in the making of the order, the court is obliged to restore the benefit of these payments to the creditor. The end result, in most if not all cases, would not differ from the result reached by applying the 'running account' principle. It is noteworthy that, unlike the position under section 99 BA95, the Australian provision renders all preferences void, and this may be a reason why the courts in that jurisdiction have had to develop the 'running account' principle.

On the facts of *Re Ledingham-Smith*,[87] therefore, the payments totalling £12,000 would be preferential payments. However, the order of the court should not prejudice the accountants in respect of the fees for the work done by them which they would not have rendered had the payments not been made by the debtor firm.[88]

3. *Preference and set-off*

This issue merits consideration mainly because of the decision of the Singapore High Court in *Re Kim San Engineers Pte Ltd*.[89] This was an application by the liquidators for a declaration that certain payments made by the company into an overdraft account were void on the ground that they were fraudulent preferences under section 53 of the Bankruptcy Act.[90] Lim Teong Qwee JC held that the bank was entitled to the statutory right of set-off under section 41 of the Bankruptcy Act[91] and, as such, the payments

[85] See s 100(1)(b) and (c) BA95. See further the discussion on the concept of the relevant time, *infra*, at notes 117-143 and the accompanying main text.

[86] S 99(2) BA95. See also s 102 BA95.

[87] *Supra*, note 54.

[88] It is not possible to work out the exact sums which should be ordered to be repaid given the limited facts stated in the judgment.

[89] *Supra*, note 5.

[90] Applicable to companies by virtue of s 329(1) CA.

[91] Made to apply to companies by virtue of s 327(2) CA.

could not be made void as fraudulent preferences. The question arises as to whether the same rule would apply in the context of a conflict between section 99 BA95 and the set-off provision in section 88 BA95.

It is respectfully suggested that there is no basis for such a rule, whether under pre- or post-BA95. The bank in *Re Kim San Engineers* was in effect pulling itself up by its bootstraps. Its alleged right of set-off arose only because of the preferential payments and surely the argument could not be made that these very same preferential payments could not be declared void because the right of set-off has arisen in respect of them. The result would be different if the right of set-off had arisen *before* the preferential payment and the preferential payment was made to discharge a debt in respect of which a right of set-off had already accrued to the creditor. In such circumstances, the creditor is in as good a position as a secured creditor and there would be no preference since his position would not be improved in any way. This was the situation in *Hamilton* v *Commonwealth Bank of Australia*.[92] The inferences drawn from *Re Washington Diamond Mining Co*[93] and *Re BP Fowler Ltd*,[94] on which Lim Teong Qwee JC relied in support of his decision, dealt with such cases and have no application to a situation where the preferential payment is itself relied on as a mutual credit, debt or dealing in respect of which the right of set-off arises.

On this latter question, the well-established position is that the right of set-off cannot prevail over the avoidance of the preference. In *Re a Debtor*[95] the provisional liquidator of a company made a preferential payment to the director of the company to discharge a judgment debt in favour of the director. The court rejected the argument that the director could avail himself of the statutory right of set-off and held that the payment was a fraudulent preference. To allow set-off in such circumstances, the court reasoned, would be to reduce the fraudulent preference provision to a 'nullity' or render it 'wholly impotent'.[96] *Re Washington Diamond Mining Co* was distinguished as a case of two totally separate debts or credits or debits. It is difficult to fault such obvious common sense. Moreover, this position has been consistently adopted by the Australian courts.[97]

92 See *supra*, note 72.
93 [1893] 3 Ch 95.
94 [1938] 1 Ch 113.
95 [1927] 1 Ch 410.
96 See Astbury J and Clauson J, *ibid*, at 416 and 420 respectively.
97 *Re Clements* (1931) ABC 255; *Re Grezzana* (1932) 4 ABC 203; *Re Smith* (1933) 6 ABC 49; *Re Armour* (1956) 18 ABC 69; *Calzaturifco Zenith Pty Ltd* v *NSW Leather and Trading Co Pty Ltd* [1970] VR 605.

4. *Desire to prefer*

Under the old law,[98] the preference had to be given with a view to giving the creditor or any surety or guarantor, for the debt due to the creditor, a preference over the other creditors. This was construed as requiring that the preference be given with the principal and dominant intention to prefer the creditor, surety or guarantor, and such intention will not be inferred from the mere fact that a preference was given.[99]

This approach may now be obsolete; the wording of the new provision is that the person who gave the preference must have been influenced in deciding to give it by a desire to produce in relation to the recipient the effect of the preference.[100] The language has been completely and deliberately changed from the previous legislation and the cases decided under the old law are of no assistance.[101] The words 'desire' and 'influenced' in section 99(4) BA95 are ordinary English words which are not susceptible of further useful definition; it is a question of applying them to the facts of the case.[102] In *Re MC Bacon*, Millett J opined that the old test of intention is objective while the test of 'desire' is subjective, and that the legal adage that a man is taken to intend the necessary consequences of his actions has no application in the new regime.[103] A man is not taken to desire all the necessary consequences of his actions; a desire to give the preference is therefore not enough and there must be a desire to improve the creditor's position in the event of a bankruptcy or an insolvent winding up. If the debtor or insolvent company is influenced by proper commercial considerations and not by a positive wish to improve the creditor's position, the requisite desire is absent.[104]

Such desire may be inferred from the circumstances of the case just as

98 S 53(1), Bankruptcy Act, *supra*, note 1.

99 *Re Jackson and Bassford* [1906] 2 Ch 467; *Re M Kushler Ltd* [1943] 1 Ch 248; *Re Cutts* [1956] 2 All ER 537; *Re Eric Holmes (Property) Ltd* [1965] Ch 1052; *Re FLE Holdings Ltd* [1967] 1 WLR 1409; *Re FP and CH Matthews Ltd* [1982] Ch 257; *Ho Mun-Tuke Don* v *Oslo Finans AS*, *supra*, note 5; *Re Kim San Engineers Pte Ltd*, *supra*, note 5; *Lin Securities Pte* v *Royal Trust Bank (Asia) Ltd*, *supra*, note 5.

100 S 99(4) BA95.

101 See Millett J in *Re MC Bacon*, *supra*, note 22, at 335b-e. See also Morritt J in *Re Ledingham-Smith*, *supra*, note 54, at 641c-g and Mummery J in *Re Fairway Magazines Ltd*, *supra*, note 55, at 649e.

102 See Morritt J in *Re Ledingham-Smith*, *supra*, note 54, at 641g.

103 *Supra*, note 22, at 335e-h. See also RAK Wright QC in *Re Beacon Leisure Ltd*, *supra*, note 54, at 568g, Mummery J in *Re Fairway Magazines Ltd*, *supra*, note 55, at 649e and Hoffman J and Glidewell LJ in *Barclays Bank plc* v *Homan* [1993] BCLC 680 at 685h and 696g respectively.

104 See Millett J in *Re MC Bacon Ltd*, *supra*, note 22, at 335h-336b and Mummery J in *Re Fairway Magazines Ltd*, *supra*, note 55, at 649g.

the dominant intention could be inferred under the old law.[105] The distinction may be small and, in many cases, the necessary desire would properly or perhaps even more readily be inferred in circumstances under which a predominant intention would previously have been inferred.[106] Furthermore, the desire to produce the effect of preferential treatment need not be the factor which tips the scales but only has to influence the decision to give the preference. It is enough if the desire is one of the factors which operate on the minds of those who make the decision and it need not be the only or decisive factor.[107]

The burden of proof is on the Official Assignee or Trustee in Bankruptcy to prove the necessary desire to prefer on the part of the debtor.[108] In cases where the alleged unfair preference has been given to an associate of the debtor, the desire to prefer is presumed and the burden falls on the recipient of the preference to show that such desire was absent.[109]

One issue that has not been considered in detail is to what extent it is concomitant with a desire to prefer that the person harbouring that desire must also know that he is insolvent. In *Re Beacon Leisure Ltd*,[110] the learned judge appeared to assume that there was no desire to prefer on the part of an insolvent company if the director concerned did not know that liquidation was imminent. A literal interpretation of section 99(4) BA95 would suggest that this approach is not entirely correct, since the desire to prefer relates to the producing of the effect of a preference and has nothing to do with knowledge of one's own insolvency. Admittedly, it is improbable that one would have a desire to prefer if he is ignorant of his own impoverished condition. On the other hand, it is very possible that a person will have a desire to prefer even if he is not absolutely sure that he is insolvent; it is totally plausible that he may entertain such a desire where he suspects or has reason to believe that his own insolvency is a real possibility. To this extent, therefore, it would appear that the approach in *Re Beacon Leisure* is too lenient.

All in all, the mental element evidently remains a very important one and will prove to be the most common stumbling block in applications under section 99 BA95. In spite of the judicial assertions that the new test is completely different from the old, it is probably the case that it is also not any wider. For instance, under the old 'dominant intention' test, there

[105] See Millett J in *Re MC Bacon Ltd*, *supra*, note 22, at 336b and Mummery J in *Re Fairway Magazines Ltd*, *supra*, note 55, at 649f.
[106] See RAK Wright QC in *Re Beacon Leisure Ltd*, *supra*, note 54, at 568g-h.
[107] See Millett J in *Re MC Bacon Ltd*, *supra,* note 22, at 336c-d.
[108] See Morritt J in *Re Ledingham-Smith*, *supra*, note 54, at 640c-d..
[109] S 99(5) BA95.
[110] *Supra*, note 54, at 568i-569g.

is no preference if the payment is made by the directors because of self-interest, pressure from the creditor or the need to maintain good relations with the creditor.[111] It would appear that little has changed, if the few decisions on the new 'desire' test is anything to go by. Where security is granted to the bank in respect of an existing debt, there is no desire to prefer if this is done to avoid the bank from calling in the overdraft which would have forced the company to cease trading.[112] Where a company borrows a sum from a director to repay an existing unsecured overdraft, which incidentally is also guaranteed by that director, and grants a floating charge to the director in respect of the sum advanced, there is no desire to prefer if the company has been solely influenced by commercial considerations, that is, the need to raise money from some source other than the bank in order to keep the business going while negotiations were in progress for the sale of its goodwill.[113] Even in the one situation where the new regime has definitely gone further than the old, namely, the presumption of a desire to prefer where the preference is given to an associate, in both cases where the presumption was invoked it was held that the presumption had been successfully rebutted.[114]

The above position is not easily justifiable. Admittedly, if the requirement of a mental element is removed altogether, every single payment to discharge an existing debt made by a person who is insolvent would amount to a preference and the effect would be to introduce a notional cessation of payments earlier than the commencement of the bankruptcy or insolvency.[115] This may lead to commercial chaos. On the other hand, it is difficult to think of any reason why the subjective state of mind of the debtor or insolvent company should determine whether a preferential payment or act should be avoided. Preference law is not concerned with wrongdoing or blameworthiness on the part of an insolvent debtor. Its only rationale is the protection of the interests of the creditors and the enforcement of an equitable pattern of distribution of assets. The sole counter-balancing factor is, of course, the public interest in the security and certainty of the receipt of payment, but again this is an interest which has less to do with the presence or absence of the bankrupt's desire to prefer than the state of mind of the *recipient* of the preference. In any event, in the special situation of bankruptcy, the former and more specific policy aims must take precedence over

[111] See, *eg*, *Sharp* v *Jackson* [1899] AC 410, 15 TLR 418; *Re FLE Holdings Ltd*, *supra*, note 99; *Lin Securities Pte* v *Royal Trust Bank (Asia) Ltd*, *supra*, note 5.

[112] *MC Bacon Ltd*, *supra*, note 22. See also *Re Beacon Leisure Ltd*, *supra*, note 54.

[113] *Re Fairway Magazines Ltd*, *supra*, note 55.

[114] *Re Beacon Leisure Ltd*, *supra*, note 54; *Re Fairway Magazines Ltd*, *supra*, note 55.

[115] See the reasoning of the *Report of the Review Committee on Insolvency Law and Practice* (Cmnd 8558) at paras 1251-4.

the latter and more general. Furthermore, the requirement of a desire to prefer would only encourage aggressive 'smash-and-grab' creditor tactics which are anathema to the objective of bankruptcy law to provide a fair and orderly system of distribution of the bankrupt estate. Banks and other creditors in a strong bargaining position would be in an advantageous position, as the more pressure the creditor is able to apply on the debtor, the less likely there will be a desire to prefer. There are thus strong grounds for preferring the more logical Australian position where all preferences are *prima facie* avoided unless it is shown that it was made in good faith and in the ordinary course of business.[116]

It is hoped that the local courts will not follow the English decisions for the above reasons. Though the requirement of a desire to prefer is statutory and the court cannot ignore it, it should be permissible for the court to be more ready to infer the presence of the desire to prefer. It is submitted that it should not be necessary that the requisite desire to prefer requires proof of a positive wish to benefit the creditor concerned, but only that the debtor *knows* that his act will confer a preference and persists in that act, *for whatever reason*. Additionally, emphasis should be laid on the low causative threshold, that is, the desire to prefer need only be one of the operative considerations in the decision to give the preference. The fear that too many *bona fide* payments made in the ordinary course of business and without pressure from the creditor concerned would be undermined is unfounded. Creditors who adopt a coercive attitude in order to obtain an undue advantage over other creditors do not deserve sympathy, while those who genuinely want to support a financially precarious individual or company by providing new value or assets can always contract for security or payment in advance or on delivery.

It may be asserted that in some circumstances an insolvent individual or company may have no alternative but to accede to a creditor's demands to discharge all existing debts in order to obtain much-needed funds, supplies or services. The premise of such an argument is that to encourage and facilitate the survival of a commercial enterprise is an objective which is invariably and intrinsically good. Clearly, such a premise is doubtful in the context of insolvent individuals or companies who can carry on business only by injuring the interests of its creditors. On balance, the better view is that such individuals or companies should be compelled, in the interests of creditor protection and economic efficiency, to submit to the bankruptcy or corporate insolvency regimes.

[116] S 122 of the Bankruptcy Act (Cth). It is further provided in the section that a payment is not made in good faith unless the creditor knew or had reason to suspect that the debtor was insolvent and that the effect of the payment would be to give him a preference, priority or advantage over other creditors.

IV. The Relevant Time

What constitutes the relevant time for the purposes of sections 98 and 99 BA95 is defined in section 100 BA95.[117] In the case of a transaction at an undervalue, the transaction is entered into at a relevant time if it took place in the period of five years ending with the day of the presentation of the bankruptcy petition on which the debtor is adjudged bankrupt.[118] In the case of the giving of an unfair preference which is not a transaction at an undervalue, the unfair preference must have been given, if given to an associate,[119] within two years ending with the day of the presentation of the bankruptcy petition, or, if given to any other person, within six months ending with that day.[120] Additionally, in both cases, the debtor must have been insolvent at the time of entering into the transaction or giving the unfair preference, or he must have become insolvent in consequence of the transaction or the preference.[121] In the case of a transaction at an undervalue only, this requirement is presumed to be satisfied if the transaction is entered into by the debtor with an associate.[122]

1. *The requirement of insolvency*

Section 100(4) BA95 defines 'insolvent' as being unable to pay one's debts as they fall due or where the value of one's assets is less than the amount of one's liabilities, including contingent and prospective liabilities. This echoes the two tests for corporate insolvency in sections 254(1)(e) and 254(2)(c) CA,[123] which may be conveniently termed the cash flows test and the balance sheet test respectively. The point that may be made here is that these tests may be too wide; there is no compelling reason why a preferential payment to a creditor or a transaction at an undervalue should be set aside when at the time of the alleged preference or transaction, although the debtor could not immediately meet all his creditors' demands for payment, his assets nevertheless exceeded his liabilities. In such a scenario, the creditors have no legitimate claim to the avoidance of the alleged preference or the transaction at an undervalue for the simple reason

[117] Modelled on s 341 IA86.
[118] S 100(1)(a) BA95.
[119] See the discussion on the concept of an associate, *infra*, at notes 144-155 and the accompanying main text.
[120] S 100(1) BA95.
[121] S 100(2) BA95.
[122] S 100(3) BA95.
[123] See, *inter alia*, *Re Sunshine Securities (Pte) Ltd* [1978] 1 MLJ 57, *Byblos Bank SAL* v *Al-Khudairy* [1987] BCLC 232 at 246e-249g, *Re Great Eastern Hotel (Pte) Ltd* [1989] 1 MLJ 161 and *Re Sanpete Builders (S) Pte Ltd* [1989] 1 MLJ 393 at 400-401.

that they would not be prejudiced in a notional bankruptcy.[124] It is therefore suggested that the insolvency requirement in this context should be satisfied only where the bankrupt's liabilities exceed his assets. Unfortunately, the statutory formula is otherwise, and one can only hope for legislative reform.[125]

2. *The case of an unfair preference which is also a transaction at an undervalue*

It will be noted that section 100(1) BA95 defines the relevant time only for a transaction at an undervalue and an unfair preference which is *not* a transaction at an undervalue. In other words, where an unfair preference is also a transaction at an undervalue, the Official Assignee or Trustee in Bankruptcy must necessarily proceed on the ground that it is a transaction at an undervalue and cannot challenge it on the ground that it is an unfair preference, for the relevant time requirement is not defined for the latter situation. To a certain extent, this is logical as it is generally less onerous to proceed on the ground of a transaction at an undervalue than an unfair preference.[126]

However, it may be that, in certain circumstances, it will be more desirable to challenge the transaction as an unfair preference rather than as a transaction at an undervalue. This is because the basic object of the court order in each case may be different. In the case of a transaction at an undervalue, the main aim of the court order may be achieved by ordering the restoration to the bankruptcy estate of the amount by which the consideration supplied to the debtor falls short of fair value, while in the case of an unfair preference, the court must order what it thinks fit for removing the effect of the unfair preference. It is therefore conceivable that there might be circumstances

[124] Adopting the reasoning of the *Report of the Review Committee on Insolvency Law and Practice*, *supra*, note 115, in a different but analogous context, at para 1557. See also, in a different context, the observations of Richardson J and Somers J in *Nicholson* v *Permakraft (NZ) Ltd*, *supra*, note 31, at 254 and 255-6 respectively, where, in considering when the directors of a company should take into account the interests of the creditors, it was stated that the duty would arise only where the company is insolvent *in the sense that its liabilities exceed its assets*.

[125] Admittedly, this is an unlikely prospect because the use of the cash flows test in connection with preferences is well-established. Under s 53(1) of the Bankruptcy Act, *supra*, note 1, the corresponding insolvency requirement was simply that the debtor should at the time of giving the preference be 'unable to pay his debts as they become due from his own money' This formula contemplated the cash flows test being the *sole* test, though this was not always observed by the courts: see, *eg*, *Re Kim San Engineers Pte Ltd*, *supra*, note 5, at 753F-I where apparently the balance sheet test was applied.

[126] The relevant time for a transaction at an undervalue is for the longer time period of 5 years before the presentation of the bankruptcy petition (s 100(1)(a) BA95) and, in certain cases, the insolvency of the debtor will be presumed (s 100(3) BA95).

under which to challenge the transaction as an unfair preference would be more advantageous to the bankrupt's estate than to challenge it as a transaction at an undervalue. Consider the example of a debtor who, at the relevant time, transfers his property worth $800,000 to his creditor for the release of a $500,000 debt. If this transaction is challenged as a transaction at an undervalue, the court may well order the creditor to pay the bankruptcy estate $300,000. On the other hand, if it is capable of being challenged as an unfair preference, it is probable that the court will unwind the transaction and order the re-transfer of the property coupled with permitting the creditor to submit a proof for his claim of $500,000.

It is therefore anomalous that section 100(1) BA95 makes no provision for the relevant time in respect of an unfair preference which is also a transaction at an undervalue.

3. *The point in time at which the unfair preference is given*

Because of the statutory time periods in section 100 BA95, the court may have to determine exactly when an alleged transaction at an undervalue or unfair preference took place. Presumably, transactions at an undervalue are to be treated as having occurred when the debtor enters into a binding contract to carry out the transaction or, in the case of a gift, when he unequivocally parts with the property in the gift or completes the performance of the service or undertakes the liability, as the case may be.

The issue is more complicated in the case of unfair preferences. One controversial view is that where the grant of security is attacked as an unfair preference, the relevant time in respect of that transaction is the time when the decision to grant it was made.[127] It is contended that this cannot be correct since until the security is actually granted or a legally binding obligation is assumed to grant it, no preference has come into existence as the position of the would-be recipient over the creditors has not been improved in any way.[128] Furthermore, what of a case where a decision to grant security was made but ultimately not carried out? Would there be a preference in the interim period?

Some further guidance on the question may be obtained from the authorities. Where a company pays money by cheque into a bank account and the bank uses the money to discharge a debt on another account of the company, it is the disposition of the cheque by the company that confers the preference.[129] Such disposition takes place when the cheque is deposited and

[127] See Millett J in *Re MC Bacon*, *supra*, note 22, at 336d-e.

[128] See *Re Fairway Magazines Ltd*, *supra*, note 55, at 649h where Mummery J purported to follow Millett J's view but in fact holds that the relevant date is that on which the *agreement* to grant the security was made.

[129] *Matthews* v *Geraghty*, *supra*, note 64.

not when the proceeds of the cheque are made available to the bank.[130] However, where a payment by cheque is made to a creditor which is not a bank, the relevant date is the date on which the cheque is given and not when the proceeds of the cheque are made available to the creditor.[131]

Where a contract confers on the creditor the right to repossession and a lien and is entered into before the statutory period, the exercise of that right within the statutory period does not amount to a preference, as the right to repossession and the lien arises on the making of the contract and not on the exercise of that right.[132] Similarly, the giving of an equitable mortgage which becomes enforceable before the commencement of the statutory period by virtue of the doctrine of part performance is not a preference, even though the completed form of the mortgage bears a date within that period.[133] If a company's moneys is deposited into a guarantee account with the bank in order to provide security for the repayment of the company's debts to the bank, no act of preference takes place should the bank resort to the money in the account to satisfy its claim; the only conceivable act of preference would have taken place at the time the money was deposited.[134] However, if no security rights are created and there is a mere agreement to pay an existing debt, it appears that the preference does not take place upon the agreement being entered into, but only when payments are actually made pursuant to the agreement.[135]

If a creditor realises security and retains the proceeds outside the statutory period and subsequently the security is found to be void, the retention of the proceeds does not constitute a preference.[136]

4. *A lacuna?*

As stated above, the relevant time is calculated with reference to the time period *preceding* the day of the presentation of the bankruptcy petition on which the individual is adjudged bankrupt. It follows that any transaction at an undervalue or unfair preference does not take place at the relevant

[130] *KDS Constructions Pty Ltd* v *National Australia Bank Pty Ltd* (1986) 11 ACLR 403, 86 FLR 398; *Guthrie* v *Chandler* (1991) 5 ACSR 387, *sub nom Re Transconsult Australia Pty Ltd* (1991) 9 ACLC 1,052.

[131] *KDS Constructions Pty Ltd* v *National Australia Bank Pty Ltd*, *supra*, note 130; *Guthrie* v *Chandler*, *supra*, note 130.

[132] *Re Trendent Industries Pty Ltd* (1983) 8 ACLR 115, 1 ACLC 980, following *George Barker (Transport) Ltd* v *Enyon*, *supra*, note 40.

[133] *Australian and New Zealand Banking Group Ltd* v *Widin* (1990) 26 FCR 21, 102 ALR 289.

[134] *Derek Randall Enterprises Ltd* v *Randall* [1991] BCLC 379 at 383b-h.

[135] See *Re Ledingham-Smith*, *supra*, note 54, at 640g-i.

[136] *Re Millar*, *supra*, note 70.

time if they take place *after* a petition is presented.[137]

In most situations this may not pose any problems because section 77 BA95 provides that, where a person is adjudged bankrupt, any disposition of property, including payments in cash or otherwise, made by him between the presentation of the bankruptcy petition and the making of the bankruptcy order shall, except with leave of court, be void.[138] Section 259 CA provides for a similar rule with respect to companies in winding up.

However, there is a lacuna in certain situations because transactions at an undervalue and unfair preferences *do not necessarily involve dispositions of property*. For example, if after the presentation of the bankruptcy petition the debtor undertakes liability such as granting an indemnity or giving a guarantee for no consideration or for consideration at a significant undervalue, there would be no disposition of property to be rendered void.[139] Similarly, there would be no disposition of property if the debtor orders and takes delivery of goods or receives services from another party on credit,[140] although such goods or services are supplied at a significant overvalue. Another situation would be where a company gives a preference to a floating chargee by 'filling up' the floating security[141] with goods obtained by credit; again there is arguably no disposition of property by the company.[142] Furthermore, if one were to accept Millett J's view[143] that the granting of a charge does not constitute any depletion of assets, the granting of a charge in respect of an existing debt after the presentation of the bankruptcy petition

[137] A similar position exists in the context of the Australian preference provision: see *Tellsa Furniture Pty Ltd* v *Glendave Nominees Pty Ltd* (1987) 9 NSWLR 254; *National Acceptance Corporation Pty Ltd* v *Benson* (1988) 13 ACLR 1; *Sheahan & Magill Constructions* v *Piber Contractors Pty Ltd* (1990) 3 ACSR 405; *Re Rampton Holdings Pty Ltd* (1990) 3 ACSR 594, 9 ACLC 220; *Hamilton* v *National Australia Bank Ltd* (1991) 5 ACSR 432, 9 ACLC 1,065; *Sheahan* v *Workers Rehabilitation & Compensation Corporation* (1991) 9 ACLC 1,303, 6 ACSR 11. Contrast *Putnin* v *Energy Trucking Pty Ltd* (1990) 2 ACSR 43.

[138] S 259 CA provides for a similar rule with respect to the winding up of companies.

[139] Admittedly, this proposition is by no means well-settled. There is *dicta* that a guarantee and indemnity is a disposition of a contingent interest in personal property: see *Re Pacific Projects Pty Ltd* [1990] 2 Qd R 541 at 543 and *Lyford* v *Commonwealth Bank of Australia*, *supra*, note 40, at 272. On the other hand, it has been held that the grant of a guarantee is not 'an act relating to property': *Re Jacques McAskell Advertising Freeth Division Pty Ltd*, *supra*, note 63.

[140] Clearly, the mere extension of credit or the lending of money by a party to the debtor is not a disposition of property: see the reasoning in *Re Loteka Pty Ltd* (1989) 1 ACLR 620 at 626; *Tasmanian Primary Distributors Pty Ltd* v *RC and MB Steinhardt Pty Ltd* (1994) 13 ACSR 92 at 97; *Re Barn Crown Ltd* [1995] 1 WLR 147 at 156F.

[141] See *supra*, note 70.

[142] Unless one were to accept the doubtful argument that there is a *scintilla temporis* during which the property in the goods vests in the company before falling within the floating charge.

[143] See the discussion, *supra*, at notes 39-41 and the accompanying main text.

may not qualify as a disposition of property. However, at the same time, all of these transactions would not be caught under sections 98 or 99 BA95 because they would not have taken place at the relevant time.

Hopefully, the problem will be addressed in the near future by providing that the relevant time should be calculated backwards from the date of the bankruptcy order or winding up order, as the case may be.

V. Associates

The concept of an associate is widely and probably exhaustively defined in section 101 BA95[144] to mean the bankrupt's spouse and former spouses,[145] the bankrupt's and his spouse's relatives and the spouses and former spouses of such relatives,[146] the bankrupt's partners and their spouses, former spouses and relatives,[147] the trustees of a trust of which the debtor is a beneficiary or which confers a power which can be exercised[148] for the benefit of the debtor or his associate,[149] and the bankrupt's employers (including a company[150] of which the debtor is a director or officer[151]) or employees.[152]

It is also provided that a company, which is defined as including any body corporate wherever incorporated,[153] is an associate of the debtor if the debtor, alone or together with his associates, has control of the company.[154] Pursuant to section 101(8) BA95, an individual is treated as having control of a company if the directors of the company or of another company which has control of it are accustomed to act in accordance with his directions or instructions, or if he is entitled to exercise or control the exercise of one-third or more of the voting power at any general meeting of the company or of another company which has control of it.[155] However, to the extent that the provision speaks of a company having 'control' over another company, it is unclear what 'control' refers to. The definition of 'control' applies only to an *individual's* control of a company and not control exerted by a company. It would follow that the word 'control' when referring to corporate control must be given its ordinary meaning and must be established as a

[144] Modelled on s 435 IA86.
[145] Ss 101(2) and 101(7) BA95.
[146] *Ibid*. See the definition of the term 'relatives' in s 101(7).
[147] S 101(3) BA95.
[148] There is no requirement that such a power must be conferred on the trustee and not on some other person.
[149] S 101(5) BA95.
[150] See the definition of 'company' in s 101(9) BA95 (modelled on s 435(11) IA86).
[151] The terms 'director' and 'officer' are not defined in the BA95.
[152] S 100(4) BA95.
[153] S 101(9) BA95.
[154] S 101(6) BA95.
[155] S 101(8) BA95.

fact; the mere fact that a company exercises or controls the exercise of one-third or more of the voting power of another company would probably be insufficient to establish control in this sense.

VI. Section 103: Extortionate Credit Transactions

Section 103 BA95[156] applies where the debtor is or has been a party to a transaction for or involving the provision to him of credit.[157] The court may, on the application of the Official Assignee, make an order with respect to the transaction if it is or was extortionate and was entered into within three years before the commencement of the bankruptcy.[158] Probably, the transaction may be entered into with any person, wherever resident, as long as he has a sufficient connection with Singapore for it to be just and proper to make the order against him.[159] In contrast with the position in relation to transactions at an undervalue and unfair preferences, there is no requirement that the debtor be insolvent at the time of entering into the transaction.

The transaction is presumed to be extortionate unless the contrary is proved.[160] A transaction is extortionate if, having regard to the risk accepted by the creditor, its terms require grossly exorbitant payments to be made in respect of the provision of credit or it is harsh and unconscionable or substantially unfair.[161] This does not appear to be an exhaustive definition of an exortionate transaction and ultimately, the question is one of fact. However, some reference to case law on similar expressions in other legislation may be useful.

1. *'Extortionate'*

Whether a transaction is 'extortionate' is a question of degree and fact; accordingly, whether a rate of profit is extortionate must depend on con-

[156] Modelled on s 343 IA86.

[157] S 103(1) BA95.

[158] S 103(2) BA95. Note that the time at which the extortionate credit transaction must have taken place is within three years before the commencement of the bankruptcy, which is the date of the bankruptcy order: s 75(a) BA95. This is in contrast to the concept of the relevant time in respect of ss 98 and 99 which measures the relevant time period from the date of the presentation of the petition of bankruptcy.

[159] By analogy with the reasoning in *Re Paramount Airways Ltd*, *supra*, note 16.

[160] S 103(3) BA95.

[161] *Ibid*. It is interesting to note that the phrase 'harsh and unconscionable or substantially unfair' does not appear in the English legislation; the corresponding expression in s 343(3)(b) IA86 is 'grossly contravened ordinary principles of fair dealing'. While couched in widely differing terms, it is unlikely that the two formulas will give rise to different conclusions in most conceivable situations.

sideration of the circumstances of the case.[162] The word 'extortionate' is to be contrasted with 'unwise' and there must at least be a substantial imbalance in bargaining power of which one party has taken advantage.[163] Extortion necessarily involves unfairness or oppression or similar conduct of a blameworthy character and the word 'extortionate' connotes an exaction which has been obtained either by an illegal method, such as force or fear or fraud, or by taking unfair advantage of an unequal situation in which the parties may find themselves.[164]

There is no extortionate bargain where the bargain is on its face a proper commercial bargain and the lenders acted in the way that an ordinary commercial lender could be expected to act.[165] Accordingly, a loan is not extortionate if the borrower was cautioned about the cost of the credit and if the rate of interest charged is justified by the lender's risk and is not out of line with that charged by other lending bodies.[166] Neither will the undue influence of a third party cause an otherwise unobjectionable transaction to become extortionate.[167]

2. *'Grossly exorbitant'*

The word 'exorbitant' means 'exceeding ordinary or proper bounds; excessive; outrageously large' and 'grossly' means 'excessively; flagrantly', although it is not clear what weight the latter adds to the former.[168]

3. *'Harsh and unconscionable'*

The phrase 'harsh and unconscionable' is found in section 1 of the Moneylenders Act 1900 which empowers the court to give relief where the interest on a loan is excessive and the transaction is harsh and unconscionable. The court must be satisfied that the transaction is unreasonable and not in accordance with the ordinary rules of fair dealing, or that there is an inequality so strong, gross and manifest that a man of common sense

[162] *Jones* v *Johnson* (1942) 86 Sol Jo 120, a decision on s 10 of the Increase of Rent and Mortgage Interest (Restrictions) Act 1920.

[163] See Sir John Donaldson MR in *Wills* v *Wood* [1984] CCLR 7 at 15, a decision on s 138 of the Consumer Credit Act 1974.

[164] See the Lord Justice-General and Lord Fleming in *Binnie* v *Morris* 1944 SLT 58 at 59 and 60 respectively, another decision on s 10 of the Increase of Rent and Mortgage Interest (Restrictions) Act 1920.

[165] See Oliver LJ in *Coldunell Ltd* v *Gallon* [1986] 1 All ER 429 at 441d-e, dealing with the meaning of 'extortionate bargains' n ss 137 and 138 of the Consumer Credit Act 1974.

[166] *Davies* v *Directloans Ltd* [1986] 1 WLR 823, a decision on s 138 of the Consumer Credit Act 1974.

[167] *Coldunell Ltd* v *Gallon, supra*, note 165.

[168] See Edward Nugee QC in *Davies* v *Directloans Ltd*, *supra*, note 166, at 836H-837B.

would exclaim at the inequality of it.[169] A transaction may be harsh and unconscionable because of the borrower's extreme necessity and helplessness, or because of the relation in which he stands to the lender or because of his situation in other ways.[170]

An excessive rate of interest can be of itself evidence that the transaction is harsh and unconscionable, particularly if unexplained.[171] If an excessive rate of interest is obtained through the folly or weakness of the borrower or his urgent necessity, real or imaginary, with the knowledge on the part of the lender, then the transaction is harsh and unconscionable.[172] However, a high rate of interest does not necessarily render the transaction harsh and unconscionable if it is in fact a reasonable rate, having regard to the risk and to all the circumstances of the case including the fact that the borrower understood the transaction and without any misrepresentation or pressure by the lender voluntarily agreed to pay the interest paid.[173]

The factors which the court should consider are firstly, the status of the contracting parties in terms of disparities of age, intelligence, education or capacity; secondly, whether there was any trickery, overreaching, undue pressure or other reprehensible conduct not necessarily amounting to fraud or misrepresentation and the extent to which it influenced the other party; thirdly, whether each party understood the contract and appreciated the obligations undertaken and the consequences if the contract was fulfilled or breached; and fourthly, the nature of the contract and the relevant circumstances in which it was entered into.[174]

VII. Powers of the Court

1. *Transactions at an undervalue and unfair preferences*

When the requirements of a transaction at an undervalue or a unfair preference have been established, the court 'shall' make 'such order as it thinks fit' for restoring the position to what it would have been if the transaction had not been entered into or the unfair preference had not been given.[175] Despite the use of the word 'shall', the phrase 'such order as it

[169] See Lord Macnaghten in *Samuel* v *Newbold* [1906] AC 461 at 470. See also Lord Atkinson, *ibid*, at 477.
[170] Lord Loreburn LC, *ibid*, at 467.
[171] See also Lord Macnaghten, *ibid*, at 470, Lord James at 473, Lord Atkinson at 477 and *Verner-Jeffreys* v *Pinto* [1929] 1 Ch 401.
[172] See Joyce J in *Part* v *Bond* (1905) 93 LT 49. See, *eg*, *Wells* v *Joyce* [1905] 2 KBD 134; *Halsey* v *Wolfe* [1915] 2 Ch 330 and *Kruse* v *Seely* [1924] 1 Ch 136.
[173] *Carringtons Ltd* v *Smith* [1906] 1 KB 79.
[174] See Eve J in *Kruse* v *Seely*, *supra*, note 163, at 141-2.
[175] Ss 98(2) and 99(2) BA95.

thinks fit' is apt to confer on the court an overall discretion which is wide enough to enable the court to make no order.[176] However, it is likely that the courts will adopt the stand that they must set their faces against transactions at an undervalue and unfair preferences and should make an order unless they are satisfied that any possible order will be otiose.[177]

It would appear that the court has a general and unfettered power to make any orders which it thinks fit pursuant to its jurisdiction under sections 98 and 99 BA95. However, section 102 BA95[178] seeks to remove all doubt by making clear that the court's armoury includes a wide range of orders which may direct the vesting of property in or the payment of sums of money to the Official Assignee, the release or discharge of security, the imposing or revival of obligations on the bankrupt's sureties or guarantors, the provision for security for the discharge of obligations imposed by the court, and the variation of rights of proof.[179] It has also been held that where the property of the debtor has been transferred to a third party transferee in breach of section 98 BA95, the court has jurisdiction to grant to a creditor a *Mareva* injunction against the third party as ancillary to the relief sought against the debtor.[180]

Section 102 BA95, however, goes on to qualify the power of the court by providing that an order under sections 98 and 99 BA95 shall not affect the interests of third parties in two situations. Firstly, the order cannot prejudice any interest in property which was not acquired from the debtor and which was acquired in good faith, for value and without notice of the relevant circumstances, or prejudice any interest deriving from such an interest.[181] Secondly, the order cannot require a person who received a benefit from the transaction at an undervalue or unfair preference in good faith, for value and without notice of the relevant circumstances to pay a sum to the Official Assignee, except where he was a party to the transaction or the payment is in respect of an unfair preference given to that person.[182] The relevant circumstances referred to are the circumstances by virtue of which an order under section 98 or 99 BA95 could be made if the debtor were adjudged bankrupt within the particular period after the transaction is entered into or the unfair preference given and, if that period has expired,

[176] See Sir Donald Nicholls VC in *Re Paramount Airways Ltd*, *supra*, note 16, at 11j.
[177] See Scott J in *Arbuthnot Leasing International Ltd* v *Havelet Leasing Ltd (No 2)*, *supra*, note 15, at 645A-B and Edward Evans-Lombe QC in the High Court and Nourse LJ in the Court of Appeal in *Chohan* v *Saggar*, *supra*, note 26, at 755B and 141C-E respectively.
[178] Modelled on s 342 IA86.
[179] S 102(1) BA95.
[180] *Aiglou Ltd and L'aiglon SA* v *Gau Shan Co Ltd* [1993] 1 Lloyd's Rep 164.
[181] S 102(2)(a) BA95.
[182] S 102(2)(b) BA95.

the fact that the debtor has been adjudged bankrupt within that period.[183] There is a potential conflict between the requirement that the court order must restore the position to the pre-transaction or pre-preference position and the requirement that the accrued rights of innocent third parties must be respected; the latter is to prevail over the former and the court order should restore the position only so far as possible.[184]

It appears that the general guiding principle, therefore, is that the transaction at an undervalue or unfair preference should be reversed whilst preserving as far as possible the accrued rights of innocent third parties, either directly by restoring the position to that which it was prior to the transaction or providing in the order for some equivalent compensation by way of payment or charge or otherwise.[185]

Where no rights of third parties are involved, the order may be simply to reverse the transaction, for example, by setting aside a transfer.[186] The order will not be so straightforward where third parties have acquired interests as a result of the transaction. In *Arbuthnot Leasing International Ltd* v *Havelet Leasing Ltd (No 2)*[187] the business and assets of an insolvent company had been transferred to another company at an undervalue, and the transferee company had carried on its business with them. The court ordered that the transferee company held the business and assets on trust for the transferor company but without prejudice to the claims of the creditors of the transferee company who had become creditors since the date of the transfers.[188] *Chohan* v *Saggar*[189] provides another illustration. In this case, the debtor transferred his property to the first defendant, a protected tenant of the property, purportedly for £50,000 but the first defendant paid only £31,000 by raising £25,000 by granting a charge over the property to a building society and another £6,000 in cash. The property was worth £75,000 if sold with vacant possession, that is, without the protected tenancy. The first defendant later declared that she held the house on trust for the second defendant, one of the bankrupt's creditors, and the trust deed recited that the second defendant had provided the remaining £19,000. However, the debtor owed the second defendant not more than £11,000. The court held that the transfer should not be set aside as this would prejudice the interest of the chargee but that

[183] S 102(4) BA95.
[184] By analogy with the reasoning in *Chohan* v *Saggar*, *supra*, note 27, at 753H-754A (High Court) and 140B (Court of Appeal).
[185] By analogy with the reasoning in *Chohan* v *Saggar*, *supra*, note 27, at 754A-B (High Court).
[186] See, *eg*, *Re Kumar*, *supra*, note 17.
[187] *Supra*, note 15.
[188] The order was made pursuant to ss 423 and 425 IA86, a provision which bears substantial similarities to ss 98 and 102 BA95.
[189] *Supra*, note 27. This is another decision on ss 423 and 425 IA86.

the trust deed should be set aside. Furthermore, the beneficial interest in the equity of redemption was to be held by the debtor and the first defendant in shares of 19/75 and 56/75 respectively, but the amount owing under the charge would be debited wholly against the second defendant's 56/75 share. The court reasoned that the transaction had deprived the debtor of £19,000 and that the order would restore the asset lost without prejudicing the chargee's interest. At the same time, as the first defendant's position could not be restored, the order would also provide some compensation for the loss of the first defendant's protected tenancy.

2. *Extortionate credit transactions*

The court's order may contain provisions setting aside the whole or part of any obligation created by the transaction, varying the terms of the transaction or upon which any security is held, requiring any party to the transaction to pay any sums received by him to the Official Assignee, requiring any person to surrender any security to the Official Assignee and directing accounts to be taken between persons.[190]

VIII. The Proceeds of Recovery

A question which merits consideration is whether the assets recovered by virtue of the avoidance provisions should be applied solely for the benefit of the unsecured creditors or whether a secured creditor can claim to be entitled to them if the assets would have been covered by his security had they not been wrongfully transferred away.[191]

With respect to unfair preferences and transactions at an undervalue, section 102(3) BA95 states that any sums required to be paid to the Official Assignee in accordance with an order under sections 98 or 99 BA95 shall be comprised in the bankrupt's estate. In the case of extortionate credit transactions, section 103(5) similarly provides that any sums or property[192] required to be paid or surrendered to the Official Assignee in accordance with an order under section 103 BA95 shall be comprised in the bankrupt's estate. The bankrupt's estate is the property of the bankrupt which is divisible

[190] S 103(4) BA95.

[191] This is an issue which usually arises in the context of corporate liquidation but in certain circumstances it may be relevant in judicial management where the purpose of the judicial management order is to effect a compromise or arrangement under s 210 CA (see s 227B(1)(b)(ii)).

[192] It is somewhat curious that the phrase used here is 'sums *or property*' while s 102(3) BA95 refers simply to 'sums', but it is suggested that nothing turns on this; the disparity in language can probably be traced to the different terms in which the court's powers are enumerated in ss 102(1) and 103(4) BA95.

among his creditors[193] and does not include property with which a secured creditor is entitled to deal pursuant to his security rights.[194] Thus the assets recovered pursuant to the powers contained in the avoidance provisions would seem to be available for distribution to the unsecured creditors to the exclusion of any secured creditor.

This is consonant with the position under the old legislation with respect to fraudulent preferences. Property recovered as a fraudulent preference accrued for the benefit of the unsecured creditors, the reason being that the statutory right of recovery is vested in the Official Assignee or liquidator (as the case may be) and could not be property subject to a charge.[195] Furthermore, if a secured creditor releases moneys to pay the bankrupt's other creditors and this payment is set aside as a preference, the moneys recovered accrue to the benefit of the bankrupt's estate; the secured creditor has given up his rights by consenting to the payment and the recovery of the moneys does not revive the security interest.[196]

It has been said, however, that the position is otherwise if the preference consisted of the disposition of specific and identifiable property subject to a charge which has been validly created and which has attached prior to the time of the disposition.[197] With respect, this cannot be supported for two reasons. Firstly, if the right to recover the assets rests in the statute and is a right vested in the office of the Official Receiver or liquidator, a chargee cannot under any circumstance be entitled to the fruits of recovery pursuant to the exercise of that right. Secondly, one may raise the broader concern that the bankruptcy and winding up processes are carried out for the sole benefit of the unsecured creditors and secured creditors who have elevated themselves above the unsecured creditors and out of these regimes by obtaining security should not be entitled to claim any benefit under it.[198]

[193] S 78(1) BA95.

[194] This may be inferred from ss 76(1) and 76(3) BA95.

[195] *Re Yagerphone* [1935] 1 Ch 392. See also Russell LJ in *NW Robbie & Co Ltd* v *Witney Warehouse Co Ltd*, *supra*, note 40, at 1338; *Re Quality Camera Co Pty Ltd* (1965) 83 WN (Pt 1) 226; *NA Kratzmann Pty Ltd* v *Tucker* (1965) 123 CLR 295; *Bibra Lake Holdings Pty Ltd* v *Firmadoor Australia Pty Ltd* (1992) 7 ACSR 380, 10 ACLC 726; *Bayley* v *National Australia Bank Ltd* (1995) 16 ACSR 38. In *Re Yagerphone*, Bennett J based his reasoning partly on the fact that the assets did not form part of the company's assets when the floating crystallised. However, as a matter of principle, this part of the reasoning may be misconceived; like a fixed charge, a crystallised floating charge is capable of catching assets acquired by the chargor even after crystallisation (see *Siebe Gorman & Co Ltd* v *Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142).

[196] *Re Miles* (1988) 85 ALR 216.

[197] *NA Kratzmann Pty Ltd* v *Tucker*, *supra*, note 194, at 301-2.

[198] That the bankruptcy and winding-up regimes are intended only for the benefit of unsecured creditors is apparent from the scheme of both regimes. It may also be pointed out that a creditor is not entitled to vote in respect of a secured debt at creditors' meetings: see r 164

While the property which has been disposed of may have been validly charged, the fact of it being wrongfully disposed of gives rise to the chargee's right under the general law to trace against the disponee and nothing more. The rights and remedies of secured creditors are conferred by the general law and they are not to be reinforced by statutory provisions designed to provide an equitable debt collection system for unsecured creditors. Of course, any right of a secured creditor which exists at general law would override any right of the liquidator or trustee in bankruptcy to proceed against the assets by virtue of any statutory provision, as the latter cannot be in a better position than the company or bankrupt, as the case may be. It follows that if a secured creditor has the right to recover the assets transferred away in breach of his security rights and the liquidator or trustee in bankruptcy recovers the assets pursuant to the statutory provisions, any recovery by the latter must be held for the benefit of the former in so far as they would have been recoverable by the secured creditor.

The same retorts may be made against the proposition, recently judicially-endorsed,[199] that assets recovered as a void disposition after the commencement of bankruptcy or winding-up,[200] as the case may be, become subject once more to any charge which affected them before the impugned disposition and hence may be claimed by a secured creditor. Moreover, such a proposition creates an anomaly in that the recovery of property disposed of *before* the presentation of the bankruptcy or winding-up petition by virtue of the avoidance provisions fall to be distributed to the unsecured creditors, but the avoidance of dispositions of property *after* the petition would accrue to the benefit of secured creditors, even though they may be identical transactions. Surely there is a more urgent need for the protection of unsecured creditors in the period after the petition is presented than before. The proposition appears to be based on the reasoning that a disposition which is rendered void by statute cannot be in the ordinary course of business and would be in breach of the debenture; therefore it is not anomalous that a floating chargee is entitled to its recovery.[201] As pointed out earlier, this type of reasoning confuses the distinct regimes which exist separately for the benefit of unsecured and secured creditors respectively. Moreover, it is certainly fallacious to say that dispositions made after the presentation of the petition are never made in the ordinary course of business. Indeed, one of the most important factors which the court will consider in determining

Bankruptcy Rules 1995, and r 126 Companies (Winding Up) Rules (1990 Rev Ed). Furthermore, a secured creditor cannot petition for the bankruptcy of the debtor unless he agrees to surrender his security for the benefit of the other creditors: s 63 BA95.

199 *Bayley* v *National Australia Bank Ltd*, *supra*, note 194; *Campbell* v *Michael Mount PPB* (1995) 16 ACSR 296.

200 Under s 77(1)(a) BA95 and s 259 CA respectively.

201 See *Campbell* v *Michael Mount PPB*, *supra*, note 199, at 300.

whether to prospectively or retrospectively validate a disposition is whether the disposition is made in the ordinary course of business.[202]

IX. Applying the Avoidance Provisions to Companies

The discussion so far has dwelt on the general terms and scope of the application of the avoidance provisions as they appear in the BA95. Consideration will now be directed to the peculiar difficulties which would be encountered when they are imported into the judicial management and winding up regimes by virtue of the 'piggy-back' provisions in sections 227T(1) and 329(1) CA ('the importation provisions').

Slight amendments to sections 227T(1) and 329(1) CA were made by the BA95,[203] purportedly to cater to the application of the avoidance provisions to companies. The amended section 227T(1) CA now reads:

> *Subject to this Act and such modifications as may be prescribed*, a settlement, a conveyance or transfer of property, a charge on property, a payment made or an obligation incurred by a company which if it had been made or incurred by a natural person would in the event of his becoming a bankrupt be void as against the Official Assignee *under sections 98, 99 and 103 of the Bankruptcy Act 1993 (read with sections 100, 101 and 102 thereof)* shall, in the event of the company being placed under judicial management, be void as against the judicial manager.[204]

Similar amendments were made to section 329(1) CA which now reads:

> *Subject to this Act and such modifications as may be prescribed,* any transfer, mortgage, delivery of goods, payment, execution or other act relating to property made or done by or against a company which, had it been made or done by or against an individual, would in his bankruptcy *be void or voidable under sections 98, 99 or 103 of the Bankruptcy Act 1995 (read with section 100, 101 and 102 thereof)* shall in the event of the company being wound up be void or voidable in like manner.[205]

[202] See, *eg*, *Re Gray's Inn Construction Ltd* [1980] 1 WLR 711; *Tellsa Furniture Pty Ltd* v *Glenave Nominees Pty Ltd*, *supra*, note 137; *Denney* v *John Hudson Ltd* [1992] BCLC 901.

[203] By virtue of s 167(4) and paragraphs 3(a) and (b) of the Second Schedule, BA95.

[204] The italicized words are inserted by the BA95.

[205] The italicized words are inserted by BA95. The first insertion in the opening words of the provision are new while the second amendment in the latter part of the provision are inserted to replace the words 'under the law of bankruptcy be void or voidable'.

In addition to the above amendments, the Regulations[206] were enacted to provide the modifications referred to in the two importation sections. Regulation 3 of the Regulations provides that, for the purposes of the importation sections, the avoidance provisions are to be read subject to the modifications set out in the Regulations and 'such textual and other modifications as may be necessary' for their application to a company in judicial management or winding-up, as the case may be. The scheme which is apparently intended is that the avoidance provisions should be applied to a company in judicial management and winding up as though it is an individual who has been adjudged bankrupt. Presumably, then, every reference to an individual in the avoidance provisions is to be read as a reference to the company in judicial management or winding up, as the case may be. The Regulations further make it clear that the application of the avoidance provisions is without prejudice to the availability of other remedies.[207]

Even with the modifications which the Regulations seek to introduce, it will be seen that the transitional adjustment and molding necessary for the difficult change of context from bankruptcy to corporate insolvency are lacking. Furthermore, it is also unfortunate that the puzzling differences in wording in the two importation provisions are not addressed, especially since the purposes which they are expected to serve are so similar. What follows is an analysis of the effect of the importation provisions and the Regulations and the problems which may be encountered in their application.

1. *The requirement of the transaction being void or voidable*

The importation provisions bring in the application of the avoidance provisions only in so far as they would render a particular transaction *void*, in the case of judicial management, or *void or voidable*, the case of winding up, if the transaction had taken place in the bankruptcy context. This is pre-BA95 nomenclature which has unfortunately been retained. It would appear that this has been done without the realisation that the wording of the avoidance provisions in the BA95 do not use the words 'void' or 'voidable' at all. While the avoidance provisions give the court a wide power to do what it thinks just for nullifying the effect of the transaction successfully impugned, there is no express power in the court to declare a transaction void or voidable. It is not expressed as a power to set aside a transaction and where the transaction is made up of more than one component the power may be exercised by setting aside one component and not the other or others.[208]

[206] *Supra*, note 7.
[207] Reg 9.
[208] See Nourse LJ in *Chohan* v *Saggar*, *supra*, note 27, at 140-1.

It is baffling what the practical result of the above should be. One can think of two possibilities, both of which are clearly unsatisfactory.

Firstly, it may be that the importation of the avoidance provisions into the companies regime fails *in limine* since the type of transaction which the importation provisions are referring to can never exist. There would be no *locus standi* to make any application under the avoidance provisions unless the transaction to which the application relates would be void, in the case of judicial management, or void or voidable, in the case of winding up, a condition which can never be satisfied. This is a result which is the most supportable and obvious in terms of statutory interpretation, but it is not likely to endear itself to a court as its acceptance would render the importation provisions totally ineffective and create an embarrassing gap in the legislation.

The second possibility is that the importation provisions are referring to a transaction which, if it had taken place in bankruptcy and an application under the avoidance provisions had been made, the court would have made an order which would have the *practical effect* of rendering the transaction void, or void or voidable, as the case may be. This would mean that the range of orders that the court can make would be drastically cut down as compared to the orders that the court can make in a parallel situation in bankruptcy. It is also to be noted that the only order which the court can make in judicial management would be one having the effect of rendering the transaction void, while in winding up, for some unfathomable reason, the court can make an order having the effect of rendering the transaction either void or voidable. Furthermore, the court cannot make an order which would have the effect of rendering the transaction void or voidable if this would prejudice any property interests acquired by third parties for value without notice or require an innocent person who has received a benefit from the transaction in good faith, for value and without notice to pay a sum to the Official Assignee.[209] All these anomalies are indefensible fetters on the remedial power of the court and would probably reduce it to insignificance in this context.

There is a third solution, if one can call it that, which is to ignore all the above difficulties and treat the court as having exactly the same powers as if it were dealing with a bankruptcy case. While this is the most practically appealing course, it is also the most difficult to support as it cannot be justified by any stretch of the statutory language no matter how imaginative or creative.

[209] S 102(2) BA95.

2. *Associates and persons connected with the company*

The concept of an associate when applied to companies has been subsumed under the wider concept of a 'person connected with a company' by virtue of the Regulations. Regulation 4 provides that a reference to an associate in the avoidance provisions, *except section 101 BA95*, is to be read as a reference to a person connected with the company in judicial management or winding-up, as the case may be. A 'connected person' is then defined as an associate, director or shadow director of the company or an associate of such director or shadow director.[210] The term 'shadow director' receives its definition from section 149(8) CA;[211] under this provision, a shadow director is a person in accordance with whose directions or instructions the directors of a company are accustomed to act, unless this is by reason only that the directors act on advice given by him in a professional capacity. The word 'associate', on the other hand, refers to an associate as determined in accordance with section 101 BA95 as modified by regulation 5.[212] It is convenient to consider the position under section 101 BA95 and then the effect of regulation 5 on that section.

The scheme of section 101 BA95 is that it lists certain situations in which a *person* or a *company* is an associate of an *individual*. It is clear that the word 'individual' here, as in the other relevant provisions, refers to the debtor who is subsequently adjudged a bankrupt. Presumably, then, when it is sought to apply the section to companies, the word 'individual' must be taken to mean a reference to the company which is being wound up or under judicial management, as the case may be.

Upon an examination of section 101 BA95, one will quickly discover that it is impossible to apply the whole concept of an 'associate' as defined in that section to the winding up and judicial management of companies. Certain parts are wholly inapt to apply to companies, with its references to spouses, relatives, lineal descendants, lineal ancestors and so forth.[213] Disregarding those parts, the picture which emerges is this. A person is an associate of the company if they are in partnership,[214] and so is a person who employs the company or who is employed by the company, including a director or other officer.[215] A trustee, whether incorporated or an individual, is also an associate of the company if the company is a beneficiary of the trust.[216]

[210] Reg 2 of the Regulations. Modelled on s 249 IA86.
[211] *Ibid*. See also s 251 IA86.
[212] *Ibid*.
[213] Ss 101(2) and 101(7) BA95 are clearly inapplicable, as is the latter part of s 101(3) BA95.
[214] S 101(3) BA95.
[215] S 101(4) BA95.
[216] S 101(5) BA95.

Practically, the most important is section 101(6) BA95, pursuant to which a company[217] is an associate of the insolvent company if the latter has control of it, whether by itself or together with its associates.[218] Control exists if any of the directors of the former company or of another company which has control of it are accustomed to act in accordance with the latter company's directions or instructions, or if the latter company controls the exercise of one-third or more of the voting power at any general meeting of the company or of another company which has control of it.[219]

It will be seen that the scope of section 101(6) BA95 alone is excessively narrow for the corporate context. The concept of control refers only to direct control and companies which are owned or controlled by the same person or which are related companies in the same corporate group would not be associates of each other, since the requisite element of direct control *vis-à-vis* the two companies would be absent. This is where regulation 5 plays a vital role. It provides that, in addition to section 101 BA95, a company is to be regarded as an associate of another company in three situations:[220] firstly, where the same person has control[221] of both companies;[222] secondly, where a person who has control of one company and his associates, or he and his associates, have control of the other company;[223] and lastly, where a group of two or more persons has control of each company and such groups either consist of the same persons or could be regarded so by treating a member of either group as replaced by a person of whom he is an associate.[224] An associate in the context of these three situations means an associate as determined in accordance with section 101 BA95 as modified by regulation 5 itself.[225] Two consequences follow from this. Firstly, the reach of the 'associate' concept is dramatically increased because, theoretically at least, regulation 5 can be invoked innumerable times; two companies who are controlled by persons with the most tenuous links may nevertheless find that they are associates of each other by virtue of the repeated application of regulation 5. However, it is doubtful if it is intended that the regulation is to have such a pervading effect and the court may not be disposed to permitting its multiple application. Secondly, the meaning of associate in regulation 5 does not include the wider definition of "a person connected

[217] See the extended definition of 'company' in s 101(9) BA95.
[218] S 101(6) BA95.
[219] S 101(8) BA95.
[220] Modelled on certain parts of s 435 IA86.
[221] 'Control' here is undefined and it is very doubtful that the definition in section 101(8) is applicable here.
[222] Reg 5(a) of the Regulations.
[223] *Ibid.*
[224] Reg 5(b) of the Regulations.
[225] Reg 2 of the Regulations.

with the company" found in regulation 4. It follows that a director or shadow director of a company or the associate of such director or shadow director would not be an associate of the company for the purposes of determining who is an associate under regulation 5.

The resulting picture is somewhat complicated and it may be useful to attempt a summary.

(i) A person, *whether an individual or a company*, will be a person connected with a company if:

(a) he is in partnership with the company;[226]

(b) he is in partnership with the director or shadow director of the company, or with the spouse or relative[227] of such director or shadow director;[228]

(c) he employs the company;[229]

(d) he employs the company's director or shadow director;[230]

(e) he is employed by the company, including being employed as its director or officer;[231]

(f) he is employed by the company's director or shadow director;[232]

(g) he is a trustee of a trust of which the company is a beneficiary;[233] or

(h) he is a trustee of a trust of which the director or shadow director is a beneficiary.[234]

(ii) In addition, an *individual* will be a person connected with a company if:

(a) he is a director or shadow director of the company;[235]

(b) he is the spouse or relative of such director or shadow director;[236]

[226] S 101(3) BA95.
[227] See s 101(7) BA.
[228] S 101(3) BA95 read with regs 2 and 4.
[229] S 101(4) BA95.
[230] S 101(4) BA95 read with regs 2 and 4.
[231] S 101(4) BA95.
[232] S 101(4) BA95 read with regs 2 and 4.
[233] S 101(5) BA95.
[234] S 101(5) BA95 read with regs 2 and 4.
[235] Regs 2 and 4.
[236] S 101(2) BA95 read with regs 2 and 4.

(c) he is the relative of the spouse of such director or shadow director;[237] or

(d) he is the spouse of the relative of the director or shadow director or the spouse of the relative of the spouse of the director or shadow director.[238]

(iii) A *company* will also be a person connected with another company if:

(a) it is controlled by the latter company;[239]

(b) it is controlled by the latter company and its associates,[240] the meaning of an 'associate' here being defined in paragraphs 1(a), (c), (e), (g) and 3(a), (b), (d), (e), (f) of this summary;

(c) it is controlled by a director or shadow director of the latter company;[241]

(d) the same person controls both companies;[242]

(e) a person has control of one company and his associates, or he and his associates together have control of the other company,[243] the meaning of an 'associate' here being defined in paragraphs 1(a), (c), (e), (g) and 3(a), (c), (d), (e), (f) of this summary (if the principal is also a company) or section 102 BA95 (if the principal is an individual); or

(f) each company is controlled by a group of two or more persons and such groups can be regarded as consisting of the same persons by treating any member as being replaced by a person of whom he is an associate,[244] the meaning of an 'associate' being that stated in paragraph 3(d) of this summary.

3. *Making the application to court*

When it is sought to apply the avoidance provisions to the companies, it is unclear whether an application to court needs to be made and, if so, who is to make it. The importation provisions simply deem transactions

[237] *Ibid*.
[238] *Ibid*.
[239] Ss 101(6) and (8) BA95. Note the deeming provision in the latter sub-section relating to the meaning of 'control'.
[240] *Ibid*.
[241] Ss 101(6) and (8) BA95 read with regs 2 and 4.
[242] Reg 5(a).
[243] *Ibid*.
[244] Reg 5(b).

which are void or voidable in bankruptcy to be similarly void or voidable in winding up or judicial management, as the case may be. Nothing is said about the necessity of making an application to court to determine that the transaction is actually objectionable.[245] It is therefore arguable that as long as the liquidator or the judicial manager forms the view that the relevant transaction is one which, had it taken place in bankruptcy and had an application under the avoidance provisions been made in respect of it, would have been rendered void or voidable, he can treat it as so. If any property of the company had been wrongfully transferred away by virtue of the transaction, he may take steps to recover such property; but if no such proceedings are necessary, for example, where the transaction is executory, it is for the party who is prejudiced to apply to court to challenge his decision.[246] This would in fact echo the position in relation to the provisions in the CA providing for the setting aside of floating charges granted for past consideration[247] and transactions with connected persons in which the company provided excessive consideration,[248] for which no application to court is necessary.

Even if the correct view is that an application is required to be made, there is uncertainty as to who is the proper party to make it. In the bankruptcy context, it is the Official Assignee who makes the application to court. Presumably, then, it is the equivalent of the Official Assignee in the companies winding up context who should have the *locus standi* to make the application and this would be the Official Receiver. This is further supported by section 4(1) CA which defines the Official Receiver to mean the Official Assignee or his deputy or assistant. But it is questionable if this should be the position in judicial management, as the Official Receiver is not involved in judicial management and has no control over the judicial manager.[249] It is submitted that surely the party to make the application should logically be the judicial manager and section 227T(1) CA should be read as to have this effect, no matter how incongruous the language used might be. Such a reading may be justified as incorporating a necessary modification of regulation 3(b) of the Regulations.

[245] It may be argued that the phrase 'in like manner' in s 329(1) CA indicates that an application is necessary. However, the phrase does not appear in s 227T(1) CA and, if the argument is correct, it would mean that an application need not be made if the company is in judicial management but must be made if the company is in winding up. This result, it is submitted, would lead to more disharmony and arbitrariness.

[246] Under s 227R CA for a company in judicial management and s 315 CA for a company in winding up.

[247] S 330 CA.

[248] S 331 CA.

[249] Other than reporting to the court, the judicial manager is only required to lodge certain documents with the Registrar of Companies; he has no official duties *vis-à-vis* the Official Receiver.

In the context of winding up, it is unobjectionable and indeed expected that the Official Receiver should have the *locus standi* to make the application, but there may be an issue as to whether a liquidator should also have the same power. In the bankruptcy context, a Trustee in Bankruptcy has the power to make an application because he is expressly conferred the powers of the Official Assignee.[250] There is no parallel provision in the CA conferring on a liquidator the general powers of the Official Receiver; the powers of a liquidator are all expressly provided for in the statute[251] and the subsidiary legislation.[252] There is therefore some ground for saying that a liquidator has no *locus standi* to make the requisite application and that in every case where the assistance of the avoidance provisions is sought the liquidator has to persuade the Official Receiver to lend his name to an application. But it is suggested that practical sense would prevail and the likely stand that the court will take is that a liquidator does possess the necessary *locus standi*, in spite of the fact that this is not supported by the ordinary meaning of the words in section 329(1) CA. Again, regulation 3(b) of the Regulations may be called in aid for this purpose.

4. *Determining the relevant time*

In respect of transactions at an undervalue and unfair preferences, section 100 BA95 defines the relevant time with reference to the date of presentation of the bankruptcy petition and sections 227T(2) and 329(2) CA make it clear that the equivalent of this date in the companies context is the date of the presentation of the judicial management petition or the winding up petition,[253] as the case may be.

However, with respect to extortionate credit transactions, section 103 BA95 catches transactions entered into within 3 years before *the commencement of the bankruptcy*, which is defined to be the date of the bankruptcy order.[254]

Section 329(1) CA does not indicate what is the equivalent of the commencement of bankruptcy in the context of the winding up regime.[255] One possible date is that of the date of the commencement of the winding up, since this would appear to be the equivalent of the date of the com-

[250] S 36(1)(b) BA95.

[251] See, *eg*, ss 273, 288, 305 and 306 CA.

[252] The Companies (Winding up) Rules. See, *eg*, the rules which deal with the acts enumerated in s 288 CA.

[253] If a resolution for voluntary winding up has been passed prior to this, then it is the date of the resolution which corresponds with the date of presentation of the bankruptcy petition: s 329(2)(a) CA.

[254] S 75(a) BA95.

[255] S 329(2) CA only deals with the date which corresponds with the date of the presentation of the bankruptcy petition.

mencement of bankruptcy. But unlike the commencement of bankruptcy, the commencement of winding up is from the date of the presentation of the winding up petition[256] and not from the date of the winding up order. The question that arises is which of the two dates equates with the commencement of bankruptcy. That the date of the presentation of the winding up petition is the relevant date is supported by the position in judicial management, where section 227T(2) CA states that it is the date of the presentation of the petition for judicial management which corresponds with the date of the bankruptcy order. However, it is submitted that the preferable date is that of the winding up order. Otherwise there would be a gap with respect to the period between the date of the presentation of the winding up petition and the date of the winding up order and an extortionate credit transaction entered into during this period would not be liable to be challenged under section 103 BA95. At the same time, it may also not be rendered void by section 259 CA since, as discussed earlier, entering into an extortionate credit transaction would probably not be such a disposition of property.[257]

Unfortunately, the same solution cannot be adopted for companies in judicial management because, as stated above, section 227T(2) CA expressly states that the date on which a person is adjudged bankrupt corresponds with the date on which a petition for a judicial management order is made. Thus, an extortionate credit transaction entered into in the time period between the presentation of the petition and the making of the judicial management order cannot be set aside by the judicial manager.

5. *Section 329(1) CA applies only to acts relating to property*

In contrast to section 227T(1) CA, section 329(1) CA applies only to 'any transfer, mortgage, delivery of goods, payment, execution or other act relating to property' and this would exclude transactions in which the company does not deal with its property in any way but simply incurs an obligation. This is an inescapable effect of the clear wording of the provision. Indeed, the corresponding Australian provision has been held not to cover the incurring of an obligation but only transactions or acts involving a dealing with or relating to property, and hence the giving of a guarantee could not

[256] S 255(2) CA. If a resolution for voluntary winding up has been passed the commencement of the winding up is deemed to have commenced on the date of the passing of the resolution: s 255(1) CA.

[257] Possibly unless some security interest is given as part of the transaction. Even in such a case, it would only be the security which would be rendered void; arguably, the transaction itself would not be avoided.

[258] *Re Jacques McAskell Advertising Freeth Division Pty Ltd*, *supra*, note 63.

be set aside as a preference.[258]

It follows that certain types of transactions will not attract the application of section 329(1) CA and, consequently, the avoidance provisions. An extortionate credit transaction, at any rate one which is unsecured,[259] is the incurring of liability by the company and section 329(1) CA would therefore not bring in the application of section 103 BA95 in such cases. Similarly, the giving of an indemnity or the granting of a guarantee by the company which would otherwise be a transaction at an undervalue would not be liable to be impugned under section 98 BA95. The rather drastic consequence is that the scope of the avoidance provisions in its application to companies in winding up will be significantly curbed and, more importantly, the type of transactions caught by the avoidance provisions will come to be restricted by boundaries set not by legal or commercial logic but by an unfortunate lapse in drafting.

6. *Section 227T(1): transaction void only against the judicial manager*

A peculiar feature of section 227T(1) is that it provides that a transaction which would be caught by the avoidance provisions if it had taken place in bankruptcy 'shall, in the event of the company being placed in judicial management, be void as against the judicial manager'. A literal interpretation suggests that the transaction is not void as against the company. An analogy may be drawn with section 131(1) CA which renders an registrable but unregistered charge 'void against the liquidator and any creditor of the company'; such a charge however remains valid between the chargee and the company.[260] Is it therefore possible to contend that the transaction may be 'revived' when the judicial management order is discharged, since the company would not be entitled to treat the transaction as void?

If the relevant transaction is wholly or partially executed and the judicial manager has taken active steps to avoid it by invoking the avoidance provisions, it is clear that the transaction cannot be resurrected on the discharge of the judicial management order. The transaction must be treated as unwound once and for all. Ludicrous and unworkable consequences would clearly ensue if the efforts of the judicial manager may be reversed by the other party to the transaction once the judicial management order is discharged, not to mention that such a chaotic state of affairs could not have

[259] Even if the transaction is secured, the argument may be made that s 329(1) CA brings in the application of s 103 BA95 only to the extent of avoiding the security; there would be no power vested in the court to set aside the entire transaction since it is not an act relating to property.

[260] *Mercantile Bank of India Ltd* v *Central Bank of India* [1937] 1 All ER 231; *Re Row Dal Construction Pty Ltd* [1966] VR 249; *Slavenburg's Bank* v *International Natural Resources* [1980] 1 All ER 955.

been contemplated by the statute.

However, the position is not that clear where the relevant transaction is one which is executory and the judicial manager does not declare it to be void under the avoidance provisions. The judicial manager may simply ignore the transaction if, for example, the counter-party does not seek to assert the claim and does not file any proof of debt in the judicial management. In such a situation, it is a plausible argument that the transaction remains valid and binding between the parties and, if the judicial management order is discharged, it may still be enforceable against the company.

Such a result should not be permitted. A company which successfully emerges from judicial management as a going concern should not be suddenly and immediately saddled with a liability which could aggravate its precarious position and undo the benefits of the judicial management. It may be true that, in the alternative scenario where a company goes into liquidation immediately or shortly after the discharge of the judicial management order, the liquidator will probably challenge the transaction in any event. However, in mounting such a challenge, the period of the judicial management would have to be taken into account in determining whether the transaction took place at the relevant time and this may substantially prejudice the chances of the transaction having taken place at the relevant time. It should be noted that the normal minimum period for judicial management is 6 months,[261] a period which is not insubstantial. Indeed, the relevant time for a unfair preference which is not a transaction at an undervalue is any time within 6 months ending with the date of the presentation of the winding up petition.[262] In cases involving this type of transaction, therefore, the interposition of the judicial management period would effectively mean that the transaction would not have taken place at the relevant time.

7. *Exemption for bona fide transactions in the interests of the company*

Regulation 6 of the Regulations provides that no order in respect of a transaction at an undervalue shall be made if the court is satisfied that the company which entered into the transaction does so in good faith and for the purpose of carrying on its business and that at the time it did so there were reasonable grounds for believing that the transaction would benefit the company.[263] This regulation will exempt a transaction at an undervalue where it is a *bona fide* arm's length transaction which is reasonably perceived by the company to be a profitable contract but which in fact turns out to

[261] S 227B(8) CA.
[262] S 100(1)(c) BA95.
[263] Modelled on s 238(5) IA86.

be a disadvantageous deal. In such a situation, the loss to the company is due to bad business judgment or pure misfortune and it would not be right to penalise the other party to the transaction. The regulation is also probably intended to protect the sanctity of genuine business transactions which, although resulting in an immediate loss of value to the company, are entered into with the hope and for the purpose of obtaining future benefits for the company. This is based on the recognition that in the commercial world it may sometimes make business sense to submit to temporary loss-making activities in order to obtain an opportunity to achieve profit in the long run. Regulation 6 thus provides a necessary and desirable exemption.

8. *The avoidance provisions and section 331 CA*

Section 331 CA applies where any property, business or undertaking of a company has been acquired from or sold to a director of that company, or a company with which such a director also holds a directorship, for cash consideration[264] within two years before the commencement of winding-up. In such a case, the liquidator may recover from the director or company concerned any excess value[265] which has been supplied by the company as a result of the transaction.

Curiously, regulation 7 of the Regulations provide that *section 99 BA95* shall not prejudice the operation of section 331 CA. Section 99 BA95 deals with unfair preferences. It is difficult to see in what way it may prejudice the operation of section 331 CA. The types of transactions which are covered by the two sections are, for the most part, mutually exclusive. The giving of an unfair preference generally requires the discharge of a pre-existing obligation while that is not a requirement for a transaction under section 331 CA; on the other hand, a transaction under section 331 CA is one at an undervalue, and no undervalue is required for an unfair preference.[266]

It is suggested that there has been a drafting mistake in regulation 7 and that reference should have been made to *section 98 BA95*, not section 99 BA95. A reference to section 98 BA95 would be unsurprising since there are substantial similarities between that section and section 331 CA. Both provisions are concerned with transactions which cause a net loss of

[264] This means consideration payable other than by the issue of shares in the company : s 331(4) CA.

[265] The relevant excess value is to be judged according to the time of the acquisition or sale, as the case may be, and includes the value of any goodwill or profits which might have been made: see ss 331(1), (2) and (3) CA.

[266] Exceptionally, of course, there could be a situation where a transaction under s 331 CA is entered into for the purpose of using the excess value to discharge a pre-existing debt; in such a situation, there may be an unfair preference.

value to the company. There are of course a few notable differences, the most important of which is that for the purposes of section 331 CA there is no requirement that the company be insolvent at the time of the acquisition or sale. Further differences are those relating to the relevant time frame[267] and the identity of the counter-party to the transaction.[268]

9. Orders under sections 102 and 103 BA95

Sections 102(1)(a) and (g) BA95 make it clear that the court has the power, in making an order under sections 98 and 99 BA95, to make two types of orders. The former sub-section provides that the court may require any property transferred as part of the transaction or in connection with the giving of the preference, to be vested in the Official Assignee. The latter sub-section provides, *inter alia*, that the court may vary the extent of the right of proof of any person whose property is ordered by the court to be vested in the Official Assignee.

Regulation 8 of the Regulations states that the references in those two sub-sections to the Official Assignee shall each be read as a reference to the company in judicial management or winding-up, as the case may be. This is probably thought to be necessitated by the principle that, unlike in the case of bankruptcy, when a company is placed in judicial management or winding-up, the company's property does not vest in the judicial manager or liquidator but continues to be vested in the company.[269] However, because regulation 8 expressly mentions the two sub-sections to which it is to apply, the necessary implication is that a reference to the Official Assignee in any other similar provision is generally not to be read as a reference to the company in judicial management or winding-up. The fact that there are other provisions dealing with the type of orders which the court can make and which also make a reference to the Official Assignee appears to have been overlooked.

At least two problem areas are likely to arise because of this.[270] One

[267] Compare the two-year period under s 331 CA to the five-year period under s 98 BA95.

[268] Under s 99 BA95, the transaction may be entered into with any person while under s 331 CA the transaction must be entered into with a director of the company or another company of which such a director is also a director.

[269] Although, in a winding-up, the court may specifically order that all or any part of the property of the company shall best in the liquidator: see s 269(2) CA.

[270] Ss 102(1)(d), 102(3) and 103(5) BA95 are other provisions which refer to the Official Assignee in connection with an order made by the court. With respect to s 102(1)(d) BA95, it is likely that no problem arises since s 102(1) BA95 merely clarifies the type of orders which the court can make and does not restrict the court's power in any way. With respect to ss 102(3) and 103(5) BA95, the non-application of Reg 8 may apparently have some bearing on the destination of any proceeds of recovery pursuant to the court order, but,

problem area relates to section 102(2)(b) BA95 which provides that a court order under sections 98 or 99 BA95 shall not require a person who received a benefit from the transaction or unfair preference in good faith, for value and without notice of the relevant circumstances *to pay a sum to the Official Assignee*, except if he was the immediate counter-party to the transaction or unfair preference. It is plausible that because of regulation 8 the benefit of this restriction on the court's powers will not apply to orders requiring the payment of sums to a company in judicial management or winding-up, as the case may be. The second area of difficulty arises in relation to sections 103(4)(c) and (d) BA95. These provisions provide that, in respect of an extortionate credit transaction, the court can make an order requiring a party to the transaction to pay sums received by him to the Official Assignee and to surrender to the Official Assignee any property held by him as security for the purposes of the transaction. Unlike section 102(1) BA95, section 103(4) BA95 appears to be an *exhaustive* list of the types of orders which the court can make. The presence of regulation 8 may thus render these orders unavailable when section 103 BA95 is sought to be applied to companies in judicial management or winding-up.

In the light of the above, one view which would not be unjustified is that regulation 8 should never have been enacted in the first place as it creates more difficulties than it solves. By singling out sections 102(1) and (g) BA95 for its application, regulation 8 may effectively prohibit substituting a reference to the Official Receiver with a reference to the company in judicial management or winding-up in any other provision. As shown above, this may result in undue restrictions on the scope of the court's powers. If regulation 8 did not exist, whatever substitution needed can safely be left to the wisdom of the court in applying the necessary textual and other modifications for the application of the avoidance provisions to a company in judicial management or winding-up, as the case may be.[271]

X. Concluding Remarks

The introduction of the avoidance provisions into the bankruptcy legislation is timely and will no doubt herald a system of more comprehensive and effective protection for a bankrupt's creditors. With the exception of the few instances highlighted above, it is likely that the avoidance provisions

as discussed *supra*, at notes 191-202 and the accompanying main text, that issue really rests on the point of principle that an action pursuant to the avoidance provisions vests in the liquidator or judicial manager and the proceeds of recovery thereunder should in most cases be made available only to the unsecured creditors.

[271] As provided for under reg 3(b).

will achieve their intended purposes satisfactorily.

The same cannot be said of the application of the avoidance provisions to companies in winding up and judicial management. It is probably fair to say that the position is confused and convoluted. This is not due to any objection to the rationale of the avoidance provisions, but rather with the mechanics of rendering those provisions applicable to the corporate context. The deficiencies of the present mode of importing the avoidance provisions by means of sections 227T(1) and 329(1) CA would appear to be sufficiently serious to erase much of the attendant advantage of rendering those provisions applicable to companies. In this connection, the need for urgent legislative reform, and relatively uncomplicated reform at that, cannot be over-emphasised.

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