

In with running accounts and out with peak indebtedness

Bryant v Badenoch Integrated Logging Pty Ltd
[2023] HCA 2



Rocco Fazzari



Erasmus Lovell-Jones
Banco Chamber

The High Court has continued its tradition of welcoming a new judge in *Bryant v Badenoch Integrated Logging Pty Ltd* [2023] HCA 2. In Justice Jagot's first judgment, the balance of the High Court agreeing in separate judgments, the High Court has confirmed that the peak indebtedness rule is not incorporated in s 588FA(3) of the *Corporations Act 2001* (Cth).

Section 588FA(3) is the statutory embodiment of the 'running account principle', which provides that if a

transaction is part of a continuing business relationship, the series of transactions during the relation-back period is treated as a single transaction. The purpose of the provision is to limit the value of a liquidator's preference claim in circumstances where a debtor is making payments to a creditor who is supplying goods or services of value as part of a continuing business relationship.

The peak indebtedness rule permits a liquidator to choose the starting point within a relevant prescribed period to prove the existence, and extent, of an unfair

preference. Practically, if incorporated by the *Corporations Act*, the peak indebtedness rule would permit a liquidator to maximise the amount recoverable from a creditor and may also be determinative of an assessment by a liquidator of whether a particular transaction was voidable, by selecting the point in time that the company owed the most to the relevant creditor as the starting date for an assessment of whether there was an unfair preference.

Justice Jagot determined three significant questions regarding the proper operation of s 588FA(3) of the *Corporations Act*. *First*, that determining whether the peak indebtedness rule is a part of s 588FA(3) is a question of statutory construction and that, read as a whole and having regard to the legislative history of the provisions, it is not incorporated by Part 5.7B of the *Corporations Act*. *Second*, that the determination of whether a transaction is, for commercial purposes, an integral part of a continuing business relationship involves an objective factual inquiry. However, what one or both of the parties intended, while relevant, is not itself determinative. Rather, the characterisation of the 'business character' of the relevant transaction involves an objective assessment. Finally, her Honour found that the Full Court of the Federal Court did not err in its evaluation of the facts.

Facts

The appellants were the liquidators of Gunns Limited and its wholly owned subsidiary Auspine Limited (together Gunns). The respondent (Badenoch) is a creditor and former supplier of services to Gunns. Badenoch entered into an agreement with Gunns in 2003 for Badenoch to supply Gunns with timber. From 2010 Gunns suffered declines in its revenue and in March 2012 it announced a halt in the trading of its shares. Badenoch continued to supply Gunns during this time despite payment frequently being late, or only receiving partial payment, and took steps to protect its financial position from Gunns' increasing indebtedness. In August 2012 Badenoch and Gunns agreed to terminate the agreement on the basis that Badenoch would continue to supply some services for a short period of time to enable another contractor to get 'up to speed'.

In September 2012 Gunns appointed liquidators who then made an application to have a series of payments made by Gunns to Badenoch declared to be voidable transactions. Gunn's insolvency date was determined to be 30 March 2012 and on that basis the liquidators contended that the

payments from that date were voidable. The liquidators also contended, as there was a continuing business relationship between Gunns and Badenoch, that they were entitled by the peak indebtedness rule to choose the starting date within the period to prove the existence of an unfair preference. Accordingly, the liquidators chose the date on which Gunns' indebtedness to Badenoch peaked, in May 2012, rather than the start of the relevant transactions on 30 March 2012.

The proceedings

The primary judge held that the peak indebtedness rule continued to apply under s 588FA(3) and that the liquidators were therefore entitled to determine the date of the first transaction within the relationship for the purpose of assessing whether the transaction was an unfair preference. The Full Court found that the peak indebtedness rule was inconsistent with the running account principle and the doctrine of ultimate effect such that it was not a part of s 588FA(3) of the *Corporations Act*.

Peak indebtedness

In determining that the peak indebtedness rule was not a part of s 588FA(3) Justice Jagot had regard to the legislative history of the provisions, including the references to the Harmer Report in the Explanatory Memorandum, as supporting the view that although the legislature had intended to incorporate the running account principle, it could not be inferred that it had also intended to incorporate the peak indebtedness rule.

In doing so, her Honour found that the running account principle did not necessarily include the peak indebtedness rule and nor was it the case that they were necessarily irreconcilable. Rather, consistent with the reasoning of Barwick CJ in *Rees v Bank of New South Wales* (1964) 111 CLR 210, her Honour found that there is policy choice available between the selection of the relevant starting points. The first choice, the peak indebtedness rule, maximises the potential for there to be an unfair preference and the amount recoverable as a result. The second choice permits the particular facts in a given matter to determine whether there is an unfair preference, and if so, the relevant amount. Her Honour found that the language of the provisions, read as a whole, indicates that the legislature had made the second choice when enacting Part 5.7B of the *Corporations Act*.

Continuing business relationship

Further, the statutory task of determining whether a transaction forms a part of a continuing business relationship remains one of characterisation and requires an objective assessment of the evidence. Although it may be relevant that there was a mutual assumption between the parties, or indeed that one or more of the parties understood the transaction as falling outside the scope of that assumption, the subjective understanding of the parties themselves is not determinative of a transaction's character.

Accordingly, this means, as occurred in this case, that a creditor may now receive the benefit of earlier dealings within a continuing business relationship, as part of the consideration of whether they have received an unfair preference. Further, whether a particular transaction amounts to an unfair preference should be determined objectively (although, what one or both of the parties to the transaction intended (if ascertainable) may still be relevant to the statutory question).

Result

In the result, the High Court found that to be an unfair preference, the deemed single transaction under s 588FA(3), being all of the transactions forming part of the relationship during the relevant period, was required to reduce the indebtedness of Gunns to Badenoch over that period. Because the net indebtedness of Gunns to Badenoch increased over the relevant period, there could be no unfair preference. Of the 11 payments in issue, only the last 7 were unfair preferences which were subject to claw back, which payments were made once the continuing business relationship between the parties had ceased to exist. BN



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