

IN THE SUPREME COURT OF NEW ZEALAND

I TE KŌTI MANA NUI

**SC 87/2018
[2019] NZSC 86**

BETWEEN ROBT. JONES HOLDINGS LIMITED
 Appellant

AND ANTHONY JOHN MCCULLAGH AND
 STEPHEN MARK LAWRENCE
 Respondents

Hearing: 30 April 2019

Court: Glazebrook, O'Regan, Ellen France, Arnold and Kós JJ

Counsel: D G Chesterman and R P Nolan for Appellant
 B P Keene QC, L M Van and R A Idoine for Respondents

Judgment: 9 August 2019

JUDGMENT OF THE COURT

- A The appeal is dismissed.**
- B The appellant must pay the respondents costs of \$25,000 plus usual disbursements.**
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REASONS
(Given by O'Regan J)

Introduction

[1] This appeal raises for consideration the interpretation of s 292 of the Companies Act 1993 (the Act), which provides that an insolvent transaction entered

into by a company within a period of two years prior to the liquidation of the company is voidable by the liquidator.¹

[2] In the present case, the transaction in issue was a payment made to the appellant, Robt. Jones Holdings Ltd (RJH) on behalf of Northern Crest Investments Ltd (Northern Crest)² by an Australian subsidiary of Northern Crest, MSH No 2 Pty Ltd (MSH2).³ We will call this the “MSH2 payment”. The MSH2 payment was made within the period of two years prior to the liquidation of Northern Crest.

[3] The liquidators argue that the MSH2 payment was an insolvent transaction for the purposes of s 292(2) and was voidable under s 292(1). They filed a notice to set aside the transaction in the High Court under s 294 seeking an order that RJH pay to the liquidators an amount equal to the amount RJH received from MSH2 on behalf of Northern Crest.⁴ They were successful in the Courts below.

[4] Section 292(1) provides that a transaction is voidable by the liquidator if it is an “insolvent transaction” and it “is entered into within the specified period” (the period of two years before the liquidator is appointed).⁵ Under s 292(3) a “transaction” includes “paying money” and “anything done or omitted to be done for the purpose of entering into the transaction or giving effect to it”.⁶ Section 292(2) defines an “insolvent transaction”:

- (2) An **insolvent transaction** is a transaction by a company that—
- (a) is entered into at a time when the company is unable to pay its due debts; and
 - (b) enables another person to receive more towards satisfaction of a debt owed by the company than the person would receive, or would be likely to receive, in the company’s liquidation.

¹ All references to section numbers are to sections of the Companies Act 1993 unless otherwise stated.

² Northern Crest was previously called Blue Chip Financial Solutions Ltd.

³ As discussed below at n 15, there were in fact eight payments, but, as the same considerations apply to all of them, we will for convenience refer to them as a single payment.

⁴ Section 295(a).

⁵ Section 292(5).

⁶ Section 292(3)(e) and (f).

[5] It is now accepted by RJH that the MSH2 payment was a transaction entered into by Northern Crest,⁷ was made at a time when Northern Crest was unable to pay its due debts,⁸ occurred during the specified period⁹ and that RJH received more than it would have received in the liquidation of Northern Crest (unsecured creditors received nothing).¹⁰ So the payment was an insolvent transaction and would, if no more were required, be voidable by the liquidators triggering the power of the Court to make an order under s 295 requiring RJH to pay to Northern Crest an amount equal to the amount it received from MSH2 on Northern Crest's behalf. There is no suggestion that RJH could invoke the bona fide exchange for value without notice defence available under s 296(3).¹¹

[6] However, RJH argues that because of the way in which the MSH2 payment was made, it did not bring about any diminution of the assets of Northern Crest available to the unsecured creditors in Northern Crest and, therefore, the transaction was not voidable under s 292. The essence of RJH's argument is that, in addition to the requirements specified in s 292 itself, it is a requirement (founded in the common law) that a payment that would otherwise be an insolvent transaction must have the effect of diminishing the pool of assets available to the unsecured creditors of the company in liquidation, and that no such diminution occurred in this case.

[7] The liquidators argue that s 292 requires only that the recipient of the payment receives more than it would have received in the liquidation. Alternatively, they argue that if the recipient receives more than it would have received in the liquidation, a diminution of the assets available to creditors in the liquidation is deemed to have occurred. In effect, the liquidators say any payment made by Northern Crest (as the MSH2 payment was deemed to be) must have "come from Northern Crest's coffer". Thus, any such payment is treated as resulting in a diminution of the assets of Northern Crest.

⁷ Section 292(3)(e) and (f).

⁸ Section 292(2)(a).

⁹ Section 292(1)(b) and (5).

¹⁰ Section 292(2)(b).

¹¹ For a full discussion of the statutory scheme and the legislative history, see the decision of this Court in *Allied Concrete Ltd v Meltzer* [2015] NZSC 7, [2016] 1 NZLR 141 at [16]–[53].

[8] The essential issue on the appeal is, therefore, whether there is a requirement for such diminution in addition to the statutory requirements in s 292 itself.

[9] The reason that RJH says there was no diminution in the assets available to the unsecured creditors of Northern Crest is that, on RJH's view of the case, the effect of the MSH2 payment was that:

- (a) MSH2 was deemed to have advanced the sum paid to RJH to Northern Crest;
- (b) MSH2 was deemed to have then paid on Northern Crest's behalf that sum to RJH; and
- (c) that meant that the sum owing to RJH ceased to be a debt owed by Northern Crest to RJH, but Northern Crest immediately incurred a debt for exactly the same amount to MSH2 and the assets available to the creditors of Northern Crest remained the same.¹²

[10] The Court of Appeal observed that the nature of the deemed payment by MSH2 to Northern Crest was either a loan by MSH2 to Northern Crest or a payment of licence fees owed by MSH2 to Northern Crest.¹³ If the latter alternative is the correct position, then the "no diminution" argument advanced by RJH would fail, since the payment of the licence fee by MSH2 to RJH would diminish the assets of Northern Crest because the payment would involve the use of an asset of Northern Crest (the receivable relating to the licence fee) to fund the payment to RJH.

[11] So, if RJH is successful in relation to the diminution issue, it will be necessary to determine which of the alternative characterisations of the MSH2 payment is correct. This Court indicated in its leave judgment that it did not propose to address that issue unless it became necessary to do so, in which case further submissions would be sought and, possibly, a further hearing would be convened.¹⁴

¹² Accounting experts gave evidence to this effect in the High Court.

¹³ *Robt Jones Holdings Ltd v McCullagh* [2018] NZCA 358 (Cooper, Winkelmann and Williams JJ) [*Robt Jones* (CA)] at [120].

¹⁴ *Robt Jones Holdings Ltd v McCullagh* [2018] NZSC 120 at [2]–[3].

[12] In the rest of this judgment, we assume, without deciding, that the MSH2 payment was a loan by MSH2 to Northern Crest.

Factual background

[13] Northern Crest was the lessee of a property owned by RJH but fell into arrears in its payment of rent. Northern Crest and RJH entered into various settlement agreements under which they agreed on the amount necessary to satisfy Northern Crest's liability to RJH under the lease. Between January 2010 and November 2010, payments totalling \$751,941.12 were made to RJH to discharge Northern Crest's obligations under the settlement agreements. \$489,183.07 was paid on behalf of Northern Crest by Columbus Property Marketing Pty Ltd (Columbus). The remaining \$262,758.05 was paid by MSH2.¹⁵

[14] Both the High Court and the Court of Appeal found that the payments by Columbus and MSH2 were insolvent transactions and ordered RJH to pay an amount equal to the sum of those payments to the liquidators.

[15] RJH no longer contests its obligation to pay to the liquidators a sum equal to the amount paid to it by Columbus, and we say no more about that aspect of the case.¹⁶ The question we need to determine is whether RJH must pay to the liquidators an amount equal to the \$262,758.05 paid to it by MSH2 on behalf of Northern Crest.

Statutory history

[16] We will begin by giving a short account of the history of voidable transactions provisions. This will assist comprehension of the argument advanced by RJH, which draws on that history.

¹⁵ Eight payments were made between 7 September 2010 and 5 November 2010, totalling \$262,758.05.

¹⁶ In the High Court, Gordon J found that the payments made by Columbus were made with Northern Crest's knowledge and consent and were a redirection of licence fees owed by Columbus to Northern Crest: *McCullagh v Robt Jones Holdings Ltd* [2017] NZHC 2182, [2018] NZCCLR 8 [*Robt Jones* (HC)] at [147]. This finding was upheld by the Court of Appeal: *Robt Jones* (CA), above n 13, at [106].

[17] The early voidable preference provisions were focused on the intention of the debtor. The origins of this approach lie in the decisions of Lord Mansfield. In *Alderson v Temple*, his Lordship stated that the purpose of the rule against fraudulent preferences was to prevent the bankrupt from defeating the equality introduced by the statutory scheme.¹⁷ The bankrupt could not be permitted to impose his own scheme of distribution. Under this approach, it was the debtor's act of giving the preference that was viewed as wrongful, not the preference itself.¹⁸

[18] The first comprehensive statutory preference provision in New Zealand was s 75 of the Debtors and Creditors Act 1875.¹⁹ This provided:

Every conveyance or transfer of property, or charge thereon made, every payment made, every obligation incurred, and every judicial proceeding taken or suffered by any person unable to pay his debts as they become due from his own moneys, in favour of any creditor, or any person in trust for any creditor, with a view of giving such a creditor a preference over the other creditors, shall, if the estate of the person making taking paying or suffering the same be placed in liquidation within three months after the date of making taking paying or suffering the same, be deemed fraudulent and void as against the trustee of the debtor appointed under this Act; but this section shall not affect the rights of a purchaser payee or encumbrancer in good faith and for valuable consideration.

[19] This provision was largely restated in s 64 of the Debtors and Creditors Act 1876, although the proviso to the section protecting good faith purchasers was omitted.

[20] Section 64 of the Debtors and Creditors Act 1876 was replaced by s 78 of the Bankruptcy Act 1883. This provided:

Every conveyance or transfer of property or charge thereon made, every payment made, every obligation incurred, and every judicial proceeding taken or suffered, whether the act be voluntary or under pressure from a creditor, by any person unable to pay his debts as they become due from his own moneys, in favour of any creditor, ... shall, if the person making, taking, paying, or suffering the same be adjudicated a bankrupt under this Act within three months ... be deemed fraudulent and void as against the Assignee.

¹⁷ *Alderson v Temple* (1768) 4 Burr 2235 at 2240, 98 ER 165 (KB) at 168.

¹⁸ Paul Heath and Michael Whale (eds) *Heath and Whale on Insolvency* (online ed, LexisNexis) at [24.11].

¹⁹ Frederick Campbell Spratt *The Law and Practice of Bankruptcy in New Zealand* (Butterworth & Co, Wellington, 1930) at 194.

[21] This provision was broader than the equivalent provision in the Bankruptcy Act 1869 (UK) in that it captured payments made “under pressure from a creditor”.²⁰ However, the provision was amended in 1884 to mirror the United Kingdom section. The new section provided:²¹

Every conveyance or transfer of property, or charge thereon made, every payment made, every obligation incurred, and every judicial proceeding taken or suffered by any person unable to pay his debts as they become due from his own money, in favour of any creditor, ... with a view of giving such creditor a preference over the other creditors, shall, if the person ... is adjudged bankrupt within three months ... be deemed fraudulent and void as against the Official Assignee.

[22] This provision was replicated in s 79(1) of the Bankruptcy Act 1892. Section 56 of the Insolvency Act 1967 was cast in similar terms but extended the scope of the provision to transactions occurring within two years of bankruptcy.

[23] Historically, the preference provisions of the Bankruptcy and Insolvency Acts were imported into company liquidations.²² But in 1980, s 309 of the Companies Act 1955 (the 1955 Act) was amended to set out a company-specific preference provision that mirrored s 56.²³ It provided:

- (1) Every conveyance or transfer of property, ... every payment made ... by any company unable to pay its debts as they become due from its own money, shall be voidable as against the liquidator, if—
 - (a) It is in favour of any creditor ... with a view to giving that creditor ... a preference over the other creditors; and
 - (b) The making, suffering, paying, or incurring of the same occurs within 2 years before the commencement of the winding-up of the company.

²⁰ Bankruptcy Act 1869 (UK) 32 & 33 Vict c 71, s 92.

²¹ Bankruptcy Act 1883 Amendment Act 1884, s 27. This was modified slightly by s 13 of the Bankruptcy Act 1883 Amendment Act 1885. The words “whether the act be voluntary or under pressure from a creditor” were added after “suffered”.

²² See Companies Act 1882, s 225; Companies Act 1903, s 247; Companies Act 1908, s 247; Companies Act 1933, s 259; and Companies Act 1955, s 309 (as enacted).

²³ Companies Amendment Act 1980, s 24.

[24] Debtor intention remained the focus until s 292 was enacted in 1993.²⁴ The Act was preceded by a report of the New Zealand Law Commission.²⁵ The Law Commission drew heavily upon a report of the Australian Law Commission in 1988 for the insolvency related part of its report.²⁶

[25] The New Zealand Law Commission stated that one of the primary goals of the reform was to make company law simpler and more intelligible.²⁷ It stated that “this is no less critical in relation to liquidation than elsewhere” and that in the context of liquidations, “[a] major criticism has been the requirement that a liquidator must refer matters to the Court frequently”.²⁸ This goal of simplification was acknowledged in the explanatory note to the Companies Bill.²⁹ It is also reflected in the long title to the Companies Act, which includes as one of the purposes of the Act the following:

- (e) to provide straightforward and fair procedures for realising and distributing the assets of insolvent companies

[26] In relation to the voidable transactions regime, the Law Commission observed that under the pre-1980 s 309, the focus was on the intention of the debtor company. This meant that where a creditor was preferred through no voluntary action of the debtor, the transaction could not be attacked. The Commission noted:³⁰

This leads to the unsatisfactory situation where creditors may be treated differently according to the quirks of their circumstances. The purpose of a voidable transactions regime is to avoid this, yet the present law permits it.

[27] The Commission observed that its proposal, which is substantially replicated in s 292, emphasised the *effect* of the transfer. It noted:³¹

Any system which creates a regime rendering some transactions void has to choose between competing interests. In this case, some measure of commercial certainty is sacrificed in favour of fairness to all creditors.

²⁴ An equivalent provision was inserted into the 1955 Act at the same time: Companies Act 1955, s 266. The 1955 Act continued to apply to every winding up and liquidation commenced before 30 June 1997: Companies Act 1993, s 399(1).

²⁵ Law Commission *Company Law: Reform and Restatement* (NZLC R9, 1989).

²⁶ At [309] and [649]. The relevant Australian report is Australian Law Reform Commission *General Insolvency Inquiry* (ALRC R45, 1988), often referred to as the Harmer Report. We will also refer to it by that name.

²⁷ At [27] and [121]–[126].

²⁸ At [642].

²⁹ Companies Bill 1990 (50-1) (explanatory note) at ix.

³⁰ At [649].

³¹ At [696].

[28] The Law Commission maintained this approach in its subsequent report.³²

High Court and Court of Appeal decisions

[29] RJH's argument that diminution was a requirement additional to those in s 292 itself failed in the High Court and in the Court of Appeal.

High Court

[30] In the High Court, Gordon J cited the decision of the Court of Appeal in *Levin v Market Square Trust*³³ (discussed below) and concluded, consistently with that case, that there was no reason to depart from the plain meaning of the text of s 292(2)(b) by imposing an additional diminution requirement.³⁴ She did however make a finding that the MSH2 payment was a loan to Northern Crest.³⁵

[31] In *Levin v Market Square Trust*, the Court of Appeal had rejected the proposition that s 292(2)(b) was augmented by a diminution requirement. Chambers J, delivering the judgment of the Court, said:

[35] The first interpretative issue is whether the liquidator must prove only that the creditor has likely received more than would otherwise have been the case in the liquidation or whether the liquidator must in addition prove that the general body of creditors has been disadvantaged as a result of the treatment afforded to one of their number.

...

[37] We turn to the first of these interpretive conundrums. Ms Cameron submitted it was "a strain on the plain meaning of the words to read the section as requiring the general body of creditors to be worse off". She urged us to approve those High Court decisions holding that the paragraph meant what it said, without the gloss placed upon it by some Judges. Even if she was wrong in that submission, however, she said the liquidator in this case had satisfied either test. Mr Greer, on the other hand, urged the other interpretation. He submitted we should apply "the underlying philosophy behind s 292 which is to ensure that the general body of creditors is not disadvantaged as a result of the treatment afforded one of their number".

[38] We are clear Ms Cameron's submission is correct. All the liquidator must show in order to satisfy s 292(2)(b) is that the creditor received a greater

³² Law Commission *Company Law Reform: Transition and Revision* (NZLC R16, 1990) at Appendix, cl 225.

³³ *Levin v Market Square Trust* [2007] NZCA 135, [2007] 3 NZLR 591.

³⁴ *Robt Jones* (HC), above n 16, at [201].

³⁵ At [163].

payment than he or she would otherwise have received in the liquidation. In that regard we approve the High Court decisions of *Chatfield v Mercury Energy Ltd* (1998) 8 NZCLC 261,645 and *Cobb & Co Restaurants Ltd v Thompson* (2004) 9 NZCLC 263,638.

...

[41] We agree with the approach adopted by Randerson J [in *Chatfield*] and Associate Judge Lang [in *Cobb & Co*]. It is consistent with the position in Australia. ...

[42] This approach is also consistent with the plain wording of s 292(2)(b), which requires a comparison between the amount the creditor actually received from the company and the amount that creditor would have received as part of the general body of creditors in the liquidation had the payment not been made.

Court of Appeal

[32] In the present case, the Court of Appeal was asked to overrule the decision in *Levin v Market Square Trust*. It declined to do so.³⁶ It considered *Levin v Market Square Trust* was rightly decided, in that it conformed with the plain wording of s 292.³⁷ It did not consider there was any good policy reason to tack an additional requirement on to the provisions of s 292, which it regarded as a code intended to simplify the law.³⁸ The Court of Appeal viewed the policy of the voidable transaction regime as ensuring equality of treatment of creditors and thereby ensuring fairness among them. This was seen as also avoiding sharp practices such as paying a creditor by borrowing money and thereby substituting one creditor for another.³⁹

[33] In the Court of Appeal RJH argued that in *Allied Concrete Ltd v Meltzer*, this Court said a key purpose of the voidable transaction regime is to protect creditors as a whole against diminution of the assets available to them.⁴⁰ RJH submitted that this supported its position that diminution was a requirement under s 292 but the Court of Appeal rejected that submission. That argument is repeated in this Court and we will address it later.

³⁶ *Robt Jones* (CA), above n 13, at [130].

³⁷ At [130].

³⁸ At [132].

³⁹ At [133].

⁴⁰ *Allied Concrete*, above n 11, at [1(a)].

[34] The Court of Appeal accepted that one of the objectives of the voidable transaction regime was that the pool of assets available to the general body of creditors not be diminished by preferential payments, but it saw the words of the Act as the best guide as to how this should be achieved.⁴¹ It did not see Australian authority as requiring it to reconsider *Levin v Market Square Trust*.⁴² We will also come back to the Australian cases later.

RJH's argument

[35] The central thesis of the case for RJH is that there is established authority to the effect that a diminution requirement applied in relation to the predecessor to s 292, s 309 of the 1955 Act, and that this additional non-statutory requirement continues to apply in relation to s 292. Its counsel, Mr Chesterman, argued that the Court of Appeal erred in a number of respects:

- (a) It wrongly found that the 1993 Act was a code (and therefore left no room for a common law add-on to s 292). Mr Chesterman said the wording of s 292 does not exclude the diminution requirement.
- (b) It wrongly concluded that a diminution requirement would conflict with the policy and purpose of s 292. Mr Chesterman said that Parliament had not intended to remove the diminution requirement and the requirement did not raise any such conflict. In fact, he argued, the *pari passu* principle and the diminution requirement had existed alongside each other since the inception of the law relating to voidable transactions.
- (c) It wrongly relegated diminution to an “objective” that need not be given effect.
- (d) It wrongly refused to overrule its earlier decision in *Levin v Market Square Trust*. Mr Chesterman submitted *Levin v Market Square Trust* was wrongly decided.

⁴¹ At [136].

⁴² At [139]–[145].

[36] We will deal with these specific criticisms later. Before doing so we will evaluate the essential thesis of the argument advanced on RJH's behalf.

[37] The starting point for Mr Chesterman's analysis was the proposition that there was a common law diminution requirement that applied in cases under s 309 of the 1955 Act and its statutory predecessors. His authority for this proposition was the decision of the Judicial Committee of the Privy Council in *Lewis v Hyde*.⁴³

[38] Mr Chesterman set out the detailed history of the provisions on which s 309 was based, including those in the early bankruptcy legislation of the United Kingdom. This history is summarised in the judgment of in *Lewis v Hyde*.⁴⁴ We accept that *Lewis v Hyde* is authority for the proposition that s 309 required that an actual preference be provided to the relevant creditor and that the judgment in that case includes an observation on the part of the Judicial Committee to the effect that diminution is also required. Mr Chesterman was critical of the Court of Appeal for not referring to *Lewis v Hyde* in its judgment.

[39] It is, however, important to understand the context in which the observations of the Judicial Committee were made in *Lewis v Hyde*. In that case, Mr Hyde had deposited three sums with a building society, the Prudential Building and Investment Society of Canterbury (Prudential). He had done this under false names. Prudential was managed by a management company of which Mr Hyde's brother-in-law was a director.

[40] Mr Hyde became aware that there may be a change of management for Prudential and this prompted him to call at the offices of Prudential and seek immediate repayment of his deposits. However, the deposits had been made on terms that required seven days' notice of repayment. Mr Hyde then approached his brother-in-law who arranged for the immediate repayment of the deposits by way of bank cheques (normally repayments were made by cheques drawn on Prudential's bank account).

⁴³ *Lewis v Hyde* [1998] 1 NZLR 12 (PC) at 16–18.

⁴⁴ At 17–18.

[41] Some three weeks after the repayment occurred, an application to wind up Prudential was filed and a provisional liquidator was appointed. Prudential ceased trading. However, between 2 February and 21 February Prudential had continued to trade in the ordinary way, so that even if Mr Hyde had been required to wait for seven days for repayment of his deposits, and another period for a cheque drawn on Prudential's bank account to clear, he would still have received the full amount owed to him. Thus, *Lewis v Hyde* is a case where there was an intention to prefer Mr Hyde, but, as it transpired, he received no preference because others who sought to withdraw deposits at the same time as him were also paid in full.

[42] The liquidators of Prudential sought to recover the deposits repaid to Mr Hyde as voidable preferences under s 309 of the 1955 Act. Under that section, a payment made by a company unable to pay its debts as they became due from its own money was voidable against the liquidator if it was made in favour of one creditor with a view to giving that creditor a preference over the other creditors and occurred within two years before the commencement of the winding up. Thus, as noted in *Lewis v Hyde*, the focus of s 309 of the 1955 Act was on the intention with which the payment was made, which can be contrasted with the approach of s 292 which concentrates on the effect of the payment.⁴⁵

[43] The liquidators' case was that, as Prudential had intended to prefer Mr Hyde over its other creditors, s 309 was engaged, even if no actual preference had eventuated. The Judicial Committee rejected this. It found that the creditors in the liquidation of Prudential would have been in exactly the same position whether or not Mr Hyde's payment had been made on preferential terms.⁴⁶ It found that s 309 and the provisions that preceded it in New Zealand, the United Kingdom and other jurisdictions required an actual preference and not simply an intention to prefer.⁴⁷ This conclusion was supported by an analysis of decisions of the courts of England and Wales on sections of United Kingdom Bankruptcy Acts of the nineteenth century that were forerunners of s 309 of the 1955 Act.⁴⁸ Although s 309 (and the other provisions referred to) did not state that an actual preference was required, this was a "basic

⁴⁵ At 15.

⁴⁶ At 16.

⁴⁷ At 17–18.

⁴⁸ For example, *Sharp (Official Receiver) v Jackson* [1899] AC 419 (HL) at 421.

common law assumption” that survives in the common law alongside the statutory provision.⁴⁹

[44] That conclusion does not assist RJH in this case because, on any view of it, the payment made to RJH by MSH2 on behalf of Northern Crest effected an actual preference. RJH actually received \$262,758.05. Other unsecured creditors received nothing.

[45] However, RJH relies on an obiter observation by their Lordships as follows:⁵⁰

This result conforms with the common sense of the matter. There is no reason to set aside a transaction so as to bring assets into the pool of assets available for distribution amongst creditors in the insolvency unless the transaction so set aside has in fact diminished the pool which would otherwise have been available.

[46] Mr Chesterman argues that this represented the law under s 309 of the 1955 Act. That being the case, and in the absence of specific wording in s 292 excluding a diminution requirement, such a requirement must continue to apply in cases governed by s 292 in the same way as occurred in cases governed by s 309, Mr Chesterman argues.

[47] Counsel for the liquidators, Mr Keene QC, did not take issue with RJH’s position that a common law diminution requirement used to apply in cases that were governed by s 309 of the 1955 Act prior to its repeal and replacement by s 292. In the absence of argument on the point, we will accept for the purposes of the analysis that follows (but without deciding the point), that it is correct.

Does the diminution requirement continue to apply under s 292?

[48] The next step in RJH’s argument is the proposition that the common law diminution requirement that applied under s 309 continues to apply under s 292, because there is nothing in s 292 to indicate the contrary. That proposition fails to recognise the policy change that was made when s 292 was enacted. As stated earlier, the primary focus of s 292 is on the recipient of the payment (to determine whether

⁴⁹ At 18.

⁵⁰ At 18.

the effect on the recipient was that it received more than it would have received in a liquidation of the company). The primary focus of s 309 was on the company making the payment (to determine whether it intended to prefer the recipient of the payment).

[49] Mr Chesterman's argument is that, unless the voidable transactions provisions are a code, the only way that the common law rule requiring diminution could be "removed" from s 292 when it replaced s 309 is by express language to that effect in s 292. He cited as authority for this proposition *R (Rottman) v Commissioner of Police of the Metropolis*.⁵¹ We do not consider that case assists RJH.

[50] In *Rottman*, the House of Lords was considering the lawfulness of a search and seizure undertaken by police when arresting a man accused of a fraud in Germany, who was arrested under a warrant issued pursuant to the Extradition Act 1989 (UK). Their Lordships found that the statutory powers relied on by the police, ss 17, 18 and 19 of the Police and Criminal Evidence Act 1984 (UK) (the 1984 Act) applied only to domestic offences.⁵² But they held that there was nothing in the 1984 Act that evinced an intention to revoke the common law power of search and seizure.⁵³ As that power applied equally to an arrest warrant relating to extradition proceedings, the search and seizure operation was lawful.⁵⁴

[51] *Rottman* was about a stand-alone common law power remaining in force because Parliament had not revoked it, even though it had revoked a similar power applying to domestic offences and replaced it with a statutory power. It was not a case where a common law requirement affected the interpretation of a statutory provision covering broadly the same situation but dealing with it in a different way, as is the case in relation to s 292. We do not see *Rottman* as analogous to the present situation.

[52] In the present case, the Court of Appeal adopted an orthodox approach to statutory interpretation, beginning with the text and then considering purpose. It pointed out that there was nothing in the text of s 292 to indicate that diminution of

⁵¹ *R (Rottman) v Commissioner of Police of the Metropolis* [2002] UKHL 20, [2002] 2 AC 692.

⁵² At [3] per Lord Hope, at [66]–[67] per Lord Hutton and at [84] per Lord Rodger. Lord Nicholls and Lord Hoffmann agreed with Lord Hutton and Lord Rodger: see at [1]–[2].

⁵³ At [75] per Lord Hutton and at [113] per Lord Rodger.

⁵⁴ At [62]–[63] per Lord Hutton and at [106] per Lord Rodger.

net assets was required as an additional, unstated, requirement in addition to the requirements expressly referred to in the section.⁵⁵ We agree: there is nothing in the text to indicate that the definition of “insolvent transaction” in s 292(2) is other than a complete definition of that phrase. We do not see room for a further, common law, requirement.

[53] Mr Chesterman argued that the Court of Appeal’s approach could not be justified unless s 292 was a code. He referred to the decision of the High Court in *Benton v Priore* as authority for the proposition that Part 16 of the Act is not a code.⁵⁶ We do not consider the “code” argument assists RJH’s argument. The issue is one of statutory interpretation of s 292. We do not see that exercise as being controlled by whether or not the section is classified as a code.

Purpose of s 292

[54] Mr Chesterman argued that the real purpose of s 292 is that referred to at the commencement of the majority reasons in *Allied Concrete*.

[55] In *Allied Concrete* the majority observed:⁵⁷

... a key purpose of the voidable transaction regime is to protect an insolvent company’s creditors as a whole against a diminution of the assets available to them resulting from a transaction which confers an inappropriate advantage on one creditor by allowing that creditor to recover more than it would in a liquidation. The pari passu principle requires equal treatment of creditors in like positions ... and facilitates the orderly and efficient realisation of the company’s assets for distribution to creditors.

[56] But as the Court in *Allied Concrete* stated, this objective is not absolute:⁵⁸

... creditors who enter into transactions with companies which have reached the point of insolvency are entitled to protection in some circumstances. This acknowledges that considerations of fairness to individual creditors are engaged in this context and that there are risks to commercial confidence if what appear to be normal, everyday commercial transactions are re-opened long after the event.

⁵⁵ *Robt Jones* (CA), above n 13, at [130].

⁵⁶ *Benton v Priore* [2003] 1 NZLR 564 (HC) at [53].

⁵⁷ *Allied Concrete*, above n 11, at [1(a)] per McGrath, Glazebrook and Arnold JJ. The reasons of the majority were given by Arnold J.

⁵⁸ At [1(b)].

[57] Mr Chesterman said the “key purpose” of the voidable transactions regime that was highlighted in *Allied Concrete* reflected the common law requirement of diminution that applied in relation to the predecessor of s 292, s 309. He argued that the Court of Appeal was wrong in the present case to “downgrade” this key purpose to a “policy objective”.

[58] As the Court of Appeal noted, the observation made in *Allied Concrete* was made as part of a general outline of the policies behind the voidable transaction regime in a case that did not focus on s 292 itself, but rather on s 296(3)(c) (the bona fide exchange for value without notice defence).⁵⁹ It is drawing a long bow to suggest that this Court’s observation in *Allied Concrete* is authority for the proposition that the “insolvent transaction” definition in s 292(2) contains an unwritten, additional, diminution requirement. The Court’s observation must be read in its entirety. It simply indicates that where one creditor of a company has received more than it would have in the company’s liquidation, thus obtaining an inappropriate advantage, a diminution of assets available to the company’s creditors as a whole must follow.

[59] It is an oversimplification to say that protecting creditors from a diminution of assets is the objective of the voidable transactions regime. That is one purpose and, in most cases where clawbacks are sought, diminution is alleged. But there are other objectives. Equality among creditors is another obvious purpose of the regime.

[60] The learned authors of *Heath and Whale on Insolvency* describe three policy foundations for the regime for the avoidance of antecedent transactions:⁶⁰

- (a) debtor deterrence/debtor intention;
- (b) creditor equality; and
- (c) creditor deterrence.

⁵⁹ *Robt Jones (CA)*, above n 13, at [135].

⁶⁰ *Heath and Whale*, above n 18, at [24.11].

[61] They trace the debtor deterrence/debtor intention purpose to the decisions of Lord Mansfield on which Mr Chesterman for RJH placed considerable reliance. But, they say that, while this was a rationale for the regime that existed prior to the enactment of s 292, it has now been superseded by the creditor equality and creditor deterrence purposes.

[62] The rationale behind creditor equality is the principle of creditors sharing pro-rata after liquidation. As the Privy Council stated in *Countrywide Banking Corp Ltd v Dean*: “the policy of the voidable preference law is to secure the equal participation of creditors in such of the company’s property as is available in the liquidation”.⁶¹

[63] The deterrence purpose justifies voidable preference law by the need to deter a race on the part of creditors on the eve of insolvency to obtain payment and to push an ailing company into liquidation. If a creditor is protected against any preferential payments made to other creditors in the period leading up to insolvency, that creditor will be less likely to precipitate a liquidation in circumstances where a company may be able to trade out of its position.

[64] The need to ensure equality of treatment for creditors is reflected in the definition of insolvent transaction in s 292(2). It is clear that this provision reflects the policy intention of creditor equality, but subject to protections for creditors provided for in s 296, as interpreted by this Court in *Allied Concrete*. The fact that s 296 provides protection for creditors in the circumstances described in *Allied Concrete* makes it unnecessary to also have as a restraint on the scope of the voidable transactions regime a requirement that, in order to trigger the avoidance power, there must be a diminution in the assets available to creditors.

[65] The discussion in *Heath and Whale* as to the policy underpinning the avoidance regime makes no reference to a policy of ensuring no reduction in the pool of assets. Rather, its emphasis is on the need to ensure equal treatment of creditors ranking equally with each other in the liquidation. In fact, the authors of *Heath and Whale*

⁶¹ *Countrywide Banking Corp Ltd v Dean* [1998] 1 NZLR 385 (PC) at 395.

make this observation after reproducing the quotation from *Allied Concrete* set out above at [55].⁶²

Some previous judicial decisions attempted to place a gloss on the plain meaning of the words of [s 292] by reading in a requirement that the general body of creditors be worse off as a result of the transaction. This was incorrectly based on an assumption that the avoidance regime operates to maximise the assets available in the pool of assets for distribution in a liquidation. An inquiry of this nature is more appropriately redressed under s 297 as a transaction at under value as this section more aptly deals on the depletion of the asset base of the company.

[66] As discussed above, a primary objective of the 1993 reform was to simplify the law and provide straightforward procedures for realising and distributing the assets of a company in liquidation.⁶³ Given the complexity that an additional common law diminution requirement would introduce into the clawback regime, as explained further below, it is hard to see how the simplification objective can be reconciled with RJH's position.⁶⁴

[67] We do not find convincing Mr Chesterman's argument that the policy underpinning the voidable transaction regime is the protection of the asset pool available to creditors, and that this objective is such that it must be given effect to by reading into s 292(2) an additional requirement that the effect of an insolvent transaction must be a diminution in the assets available to creditors. The fact that Lord Mansfield saw this as an element in the fraudulent preference regime of the eighteenth century and that their Lordships in *Lewis v Hyde* observed in an obiter comment that such a requirement existed in relation to s 309 does not provide a proper basis for us to assume that protection of the asset pool remains the primary focus of s 292.

[68] As noted earlier, *Heath and Whale* consider that the debtor deterrence objective of the eighteenth century regime referred to in the decisions of Lord Mansfield, which, according to *Lewis v Hyde*, survived through to s 309 of the 1955 Act, was supplanted by the creditor equality and creditor deterrence objectives reflected in s 292. Even if that is not correct, it cannot be denied that protection of the asset pool is now only one objective of the voidable transactions regime, and not the most important one. That

⁶² Heath and Whale, above n 18, at [24.11] (footnotes omitted).

⁶³ See above at [25].

⁶⁴ See below at [109].

suggests to us that, if a common law diminution requirement applied in relation to s 309, there is no reason to believe that it continues to apply in relation to s 292.

[69] Mr Keene argued that the premise of Mr Chesterman’s argument (that s 292 itself contains no diminution requirement and needs to be supplemented by a common law principle) may itself be wrong. He argued that there is a diminution requirement embedded in s 292. Where a payment enables a creditor to receive more than it would in liquidation, a diminution in the assets available to creditors is in effect presumed because the funds available to the company to make the payment are seen as having been equally available to apply to the asset pool. This is consistent with the majority’s observation in *Allied Concrete*. But that does not change the practical outcome that all s 292 requires is that the liquidator establish that the transaction enabled the creditor to receive more than it would have in liquidation. Whether that is because there is no diminution requirement in s 292 or that there is a diminution requirement embedded in s 292 that is satisfied by the payment being made does not matter.

Australian law

[70] Mr Chesterman argued that the Court of Appeal in *Levin v Market Square Trust* had wrongly determined that its conclusion that there was no additional, extra-statutory diminution requirement in s 292 was consistent with Australian law. The Court in *Levin v Market Square Trust* cited a statement made in *Walsh v Natra Pty Ltd* to the effect that there was no diminution requirement in s 588FA of the Corporations Law as support for its view.⁶⁵ However, the passage in *Walsh* on which the Court relied was immediately followed by a statement: “I merely mention the possibility; I say nothing more about it. It does not fall for consideration on this appeal”.⁶⁶ We accept Mr Chesterman’s submission (as did the Court of Appeal)⁶⁷ that the statement relied on by the Court of Appeal in *Levin v Market Square Trust* was obiter and did not necessarily reflect the law in Australia on the point.

⁶⁵ *Levin v Market Square Trust*, above n 33, at [41], citing *Walsh v Natra Pty Ltd* [2000] VSCA 60, (2000) 1 VR 523 at [47] per Phillips JA. The Corporations Law (Cth) has been replaced by the Corporations Act 2001 (Cth). Section 588FA of the Corporations Act is identical to s 588FA of the Corporations Law.

⁶⁶ *Walsh*, above n 65, at [47].

⁶⁷ *Robt Jones* (CA), above n 13, at [141]–[144].

[71] This leads to two issues:

- (a) whether Australian law provides assistance in the interpretation of s 292; and
- (b) if it does, what the Australian law on the point is.

Does Australian law assist?

[72] As to the first, there is undoubted similarity between the relevant provisions of the Corporations Act 2001 (Cth) and the New Zealand provisions. The wording of the relevant part of s 588FA has obvious similarities to s 292(2)(b).⁶⁸ The argument in the Australian context broadly mirrors the argument advanced by RJH in this case.

[73] As noted earlier, the New Zealand Law Commission report drew heavily on the Harmer Report, which was the background to the insolvency reforms reflected in the Corporations Act.⁶⁹ This indicates some intention to draw on Australian experience though, as Mr Chesterman pointed out, there was no explicit statement that the New Zealand law should mimic that of Australia.

[74] Mr Chesterman said the Australian case law should not be regarded as providing guidance on the interpretation of s 292 because the case law did not follow the Harmer Report, which, he said, clearly intended that the diminution requirement be retained in Australia. We reject this argument. Even if Mr Chesterman's assertion about the Harmer Report is correct (which is debatable), the Australian cases interpret the relevant statutory provisions, not the antecedent law reform proposals. Given the similarity of the Australian and New Zealand provisions, it would be surprising if we did not obtain benefit from considering the Australian cases.⁷⁰

⁶⁸ Section 588FA(1)(b): "the transaction results in the creditor receiving from the company, in respect of an unsecured debt that the company owes to the creditor, more than the creditor would receive from the company in respect of the debt if the transaction were set aside and the creditor were to prove for the debt in a winding up of the company".

⁶⁹ See above at [24].

⁷⁰ See *Allied Concrete*, above n 11, at [77].

[75] Mr Chesterman also highlighted the differences between the Australian and New Zealand regimes.⁷¹ We acknowledge there are differences but we are not persuaded that these are such as to suggest that no assistance can be derived from consideration of the Australian cases.

[76] We conclude that the Australian cases assist us in the interpretation of s 292.

Australian cases

[77] Whether diminution is a requirement in relation to s 588FA(1) of the Corporations Act is a matter of some controversy. The analysis of the Australian cases needs to begin with a case under what was effectively the predecessor to s 588FA, s 122 of the Bankruptcy Act 1966 (Cth). Under s 122(1)(a), a liquidator could set aside payments that had “the effect of giving that creditor a preference, priority or advantage over other creditors”.

[78] In *Sheahan v Carrier Air Conditioning Pty Ltd*, Brennan CJ asked whether it was “sufficient to constitute a preference [under s 122] that an unsecured creditor is paid part of his debt and other unsecured creditors receive none when the other unsecured creditors’ position is not adversely affected”.⁷² He answered in the negative. This was because the purpose of s 122 was to recoup the money of a bankrupt that had been paid preferentially in order to replenish the pool of assets which the creditors are entitled to share rateably.⁷³ Kirby J dissented. He considered that an approach that required other creditors to be detrimentally affected placed “a considerable qualification upon the plain words of s 122(1)”.⁷⁴ He said “[t]he words ‘effect of’ require this Court to look beyond form to the substance of the consequences arising as a result of the payment in question.”⁷⁵ Accordingly, the fact recovery would

⁷¹ For example, the Australian regime applies in the six-month period before liquidation (four years for related companies): Corporations Act, s 588FE. The New Zealand regime applies (for both related and unrelated companies) in the two-year period before liquidation: s 292(5).

⁷² *Sheahan v Carrier Air Conditioning Pty Ltd* (1997) 189 CLR 407 at 424.

⁷³ At 424.

⁷⁴ At 459.

⁷⁵ At 460.

not result in a surplus for distribution to unsecured creditors was not determinative.⁷⁶ It was not necessary for the other judges to address this point.⁷⁷

[79] In *G & M Aldridge Pty Ltd v Walsh*, a bank took a fixed charge over certain assets and a floating charge over all other assets of the company.⁷⁸ The bank's charge crystallised, with the amount owing to the bank exceeding the value of the security so that no assets remained for the unsecured creditors. Despite this, the bank allowed money held on behalf of the company to be distributed to 12 unsecured creditors. The liquidator sought to recover these payments under s 122. The High Court of Australia held that the payments were voidable preferences. In doing so, the High Court rejected the proposition that no unsecured creditor has received a preference at the expense of the other unsecured creditors because the payments preferred those unsecured creditors over the bank as secured creditor only.⁷⁹

[80] Although decided under the earlier provision, *G & M Aldridge* suggests that a creditor may be preferred despite other unsecured creditors not being disadvantaged in any way, ie where there is no diminution of the assets available to unsecured creditors. But as RJH notes, the decision has been criticised.⁸⁰ The Court specifically contradicted the observation of Brennan CJ in *Sheahan* referred to above at [78].⁸¹ *G & M Aldridge* was cited as authority in relation to s 588FA in *Merrag Pty Ltd (in liq) v Khoury*.⁸² In that case, Palmer J noted (citing *G & M Aldridge*) that a transaction "may constitute a preference in favour of one creditor even if other unsecured creditors would have received no dividend in the liquidation had the transaction not occurred".⁸³ But it has rarely been cited in other cases under s 588FA.

⁷⁶ At 460.

⁷⁷ Dawson, Gaudron and Gummow JJ held that the payments in question, which were made by the receiver of the company, were not payments made by the company. The majority expressly declined to consider "the further issues concerning the existence of the requisite preferential effect of the payments": at 441.

⁷⁸ *G & M Aldridge Pty Ltd v Walsh* [2001] HCA 27, (2001) 203 CLR 662.

⁷⁹ At [22], [28] and [30].

⁸⁰ See Roy Goode *Principles of Corporate Insolvency Law* (4th ed, Sweet & Maxwell, London, 2011) at [13-89]. Goode argues that in the absence of any diminution in the fund available to distribute to unsecured creditors, the payment is not within the mischief of the preference provisions.

⁸¹ *G & M Aldridge*, above n 78, at [22].

⁸² *Merrag Pty Ltd (in liq) v Khoury* [2009] NSWSC 915 at [105].

⁸³ At [105].

[81] The decision of the Court of Appeal of Victoria in *VR Dye v Peninsula Hotels Pty Ltd (in liq)* provides support for RJH’s position.⁸⁴ It was decided before *G & M Aldridge* but under the new s 588FA. At issue in *VR Dye* was the prepayment of money on account of fees to be incurred on the performance of work by the company’s accountants in connection with its planned winding up. Despite the textual differences between s 122 of the Bankruptcy Act and s 588FA, the Court considered that the new statutory regime was not intended to change the law significantly.⁸⁵ The object of the legislation had always been to prevent existing creditors from being disadvantaged.⁸⁶ The Court held that to be avoided, the transaction must be looked at in its entirety and have the “ultimate effect” of decreasing the value of the assets that are available to meet the competing demands of the other creditors.⁸⁷ The Court did not say diminution of the asset pool available to unsecured creditors was a requirement but it cited with apparent approval a statement in *Airservices Australia v Ferrier* (a running account case) to that effect.⁸⁸ The Court held that the payments were not voidable under s 588FA as the ultimate effect was not to give an existing creditor a preference.⁸⁹

[82] *VR Dye* provides clear support for the proposition that diminution is required: the transaction must ultimately reduce the pool of assets available to the company’s creditors. But the context (prepayment) is important. We will come back to this.⁹⁰

[83] *VR Dye* was followed by the New South Wales Supreme Court in *Mann v Sangria Pty Ltd*, where Bryson J labelled the reasoning of Ormiston JA “highly persuasive”.⁹¹ The Judge held that payment and delivery were so closely connected that they amounted to a single transaction and no unfair preference arose.⁹² Diminution was not discussed. *VR Dye* was again endorsed by the New South Wales

⁸⁴ *VR Dye v Peninsula Hotels Pty Ltd (in liq)* [1999] VSCA 60, [1999] 3 VR 201.

⁸⁵ At [27] and [34].

⁸⁶ At [36].

⁸⁷ At [38].

⁸⁸ At [37], citing *Airservices Australia v Ferrier* (1996) 185 CLR 483 at 502 per Dawson, Gaudron and McHugh JJ.

⁸⁹ At [43] and [54]–[55]. The same result would be reached in New Zealand on the basis that there was no debtor-creditor relationship: see *Allied Concrete*, above n 11 at [18] and [186] and see below at [85]–[87].

⁹⁰ See below at [87].

⁹¹ *Mann v Sangria Pty Ltd* [2001] NSWSC 172, (2001) 38 ACSR 307 at [37].

⁹² At [41].

Court of Appeal in *Beveridge v Whitton*; where it was said the court must examine whether the ultimate effect of the transaction has been to decrease the value of the company's assets.⁹³ The Court said that in any event, it ought to follow the decision of its Victorian counterpart unless convinced that it is "plainly wrong".⁹⁴ It concluded that payments to an accountant that allowed the company to continue trading were not unfair preferences.⁹⁵ Otherwise, "no person assisting a company in financial difficulties could recover if that company goes into liquidation" if that person was aware of the company's insolvency.⁹⁶

[84] But, as noted in *Levin v Market Square Trust*, Phillips JA in an obiter comment in his judgment in *Walsh* questioned whether prejudice to the general body of creditors was a necessary requirement of s 588FA.⁹⁷

[85] In *McKern v Minister Administering the Mining Act 1978 (WA)*, Nettle JA commented that not all of the reasoning in *VR Dye* was entirely convincing.⁹⁸ In particular, the Court in *VR Dye* did not deal with the plain meaning of the provision nor the indications in the Harmer Report that the new regime was intended to be comprehensive, leaving no room for common law exceptions.⁹⁹ Nettle JA considered that the approach of the Court of Appeal of Victoria in *VR Dye* was strongly motivated by a concern that prepayments and cash on delivery transactions would otherwise be vulnerable to clawback.¹⁰⁰ He acknowledged the importance of insolvent companies being able to enter into such transactions. However, Nettle JA went on to say:¹⁰¹

It is also possible to envisage ways of accommodating [cash on delivery] transactions that may do less violence to the language of the section than the preservation of principles developed in the context of the previous regime.

⁹³ *Beveridge v Whitton* [2001] NSWCA 6 at [27].

⁹⁴ At [30]. This reflects the convention that intermediate appellate courts in Australia follow each other's decisions in the interpretation of commonwealth legislation unless the later court considers the decision of the earlier court is "plainly wrong": *Australian Securities Commission v Marlborough Gold Mines Ltd* (1993) 177 CLR 485 at 492. See also *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* [2007] HCA 22, (2007) 230 CLR 89 at [135].

⁹⁵ At [32].

⁹⁶ At [35].

⁹⁷ *Walsh*, above n 65, at [47]. See above at [70].

⁹⁸ *McKern v Minister Administering the Mining Act 1978 (WA)* [2010] VSCA 140, (2010) 28 VR 1 at [24].

⁹⁹ At [24]. This observation can be contrasted with Mr Chesterman's submission that the Harmer Report indicated the opposite.

¹⁰⁰ At [20].

¹⁰¹ At [24].

For example, *Ford*¹⁰² postulates that such transactions might be excepted on the basis that, because payment is made against delivery, there is never a point in time at which a debt exists. Perhaps, even that idea suffers from the logical defect that a debt arises upon delivery and exists, albeit only in *scintilla temporis*, until discharged by payment. But perhaps such fine theoretical distinctions should not be allowed to stand in the way of the rational operation of a regime which is intended to be essentially practical.

[86] In the result, Nettle JA held that the payments in question were made in respect of an existing debt, and that the effect of the payments was to give the creditor a preference.¹⁰³ Mandie JA, with whom Beach AJA agreed, held that *VR Dye* and the ultimate effect doctrine did not extend to a payment made in respect of a past debt that is not made to secure the continuing provision of goods or services. The payments were therefore voidable under the Corporations Act 2001.¹⁰⁴

[87] It is not entirely clear to us whether the Court in *VR Dye* was concerned that, absent a disadvantage requirement, cash on delivery and prepayment transactions would be vulnerable to challenge.¹⁰⁵ But in any case, the same concern does not exist in New Zealand. The alternative explanation offered by Nettle JA reflects the law under the Companies Act: a majority of the Supreme Court in *Allied Concrete* concluded that cash on delivery transactions are not within the scope of s 292 as the payment is not referable to a debtor/creditor relationship.¹⁰⁶ William Young J also expressed the view that s 292 did not apply to prepayments. The reason for this is that credit is not provided and there is no debt.¹⁰⁷ This view is shared by the authors of *Heath and Whale*, who state that where a prepayment is made in accordance with an underlying agreement, a debtor/creditor relationship does not exist between the parties and the payment is unlikely to be considered a preference.¹⁰⁸

¹⁰² RP Austin and IM Ramsay *Ford's Principles of Corporations Law* (13th ed, LexisNexis Butterworths, Chatswood (NSW), 2007) at [28.340].

¹⁰³ *McKern*, above n 98, at [29]–[30].

¹⁰⁴ At [125].

¹⁰⁵ For example, Ormiston JA cited *Re Lanpac International Pty Ltd (in liq)* [1998] VSC 9 and said that a cash on delivery transaction does not usually create a preference as the parties do not deal with each other as debtor and creditor: *VR Dye*, above n 84, at [39].

¹⁰⁶ *Allied Concrete*, above n 11, at [18] per McGrath, Glazebrook and Arnold JJ and [185]–[187] per William Young J. Elias CJ preferred to reserve her view given the point did not arise for consideration. She was not convinced “the policy of the legislation in preventing transactions with preferential effect is served if transactions by a supplier who knows its customer is insolvent are immune from the application of the avoidance provisions”: at [169].

¹⁰⁷ At [186]. Elias CJ again reserved her position: see at [169]. The majority did not express a view.

¹⁰⁸ *Heath and Whale*, above n 18, at [24.48]. However, the authors do caution that “There is danger in assuming that the operation of s 292 can easily be avoided by using a prepayment mechanism”: at [24.48], n 4.

[88] The most relevant Australian authority in the context of the present case is *Federal Commissioner of Taxation v Kassem*.¹⁰⁹ The facts of the case have some marked similarities to those of the present case. A company, Mortlake Hire, was indebted to the Commissioner to the sum of about \$650,000. Prior to liquidation, a subsidiary of Mortlake, Antqip, made two payments to the Commissioner totalling \$70,000. The trial judge found that the payments to the Commissioner were loans made by Antqip to Mortlake.¹¹⁰ This finding was upheld by the Full Federal Court on the basis that the payment by Antqip was made directly to the Commissioner in accordance with Mortlake's instructions as the borrower. The position was "no different from a drawing by Mortlake on an overdraft from its bank with a direction to the bank to pay the creditor directly".¹¹¹ However, in an argument that echoes RJH's position in this case, the Commissioner argued that the payments did not fall within s 588FA as there was no diminution in the value of assets available to meet the claims of creditors. Instead, one creditor had simply been substituted for another.¹¹²

[89] Although noting the criticisms made by Nettle JA in *McKern*, the Court considered that *VR Dye* was not plainly wrong and therefore ought to be followed.¹¹³ The Court purported to follow the decision and analyse the transaction in its entirety. Applying this approach, there were only two payments to be considered, each of which had the effect of "paying the Commissioner 100c in the dollar".¹¹⁴ The ultimate effect was to "prefer the Commissioner to other creditors".¹¹⁵

[90] The Court noted that *Airservices*, which was relied upon in *VR Dye* for the proposition that the transaction must ultimately reduce the assets available to creditors, was decided under the former statutory regime. In contrast, nothing in s 588FA expressly incorporates a requirement that the transaction must result in a diminution of the debtor's assets.¹¹⁶ However, it was not necessary for the Court to determine whether there must be a diminution in the value of the debtor's assets under s 588FA.

¹⁰⁹ *Federal Commissioner of Taxation v Kassem* [2012] FCAFC 124, (2012) 205 FCR 156.

¹¹⁰ At [16].

¹¹¹ At [41].

¹¹² At [4] and [38].

¹¹³ At [48]–[50].

¹¹⁴ At [54].

¹¹⁵ At [57].

¹¹⁶ At [59]. The Court noted the same approach had been taken by Gordon J in *Burness v Supaproducts Pty Ltd* [2009] FCA 893, (2009) 259 ALR 339 at [49].

This was because “the payments of \$70,000 were made out of Mortlake’s assets, thereby reducing the value of its net assets available to other creditors”.¹¹⁷ Thus, although the Court did not determine the point, its decision on facts that are very close to those of the present case was that there was no impediment to the setting aside of the payment under the equivalent of s 292.

[91] There is support in other Australian cases for the proposition that diminution is not required under s 588FA. In *Sheldrake v Paltoglou*, the Queensland Court of Appeal held that for there to be an unfair preference under s 588FA, it sufficed that “the respondent received more than she would receive were she left to prove in the winding up, and that was plainly the position here”.¹¹⁸ Similarly, in *New Cap Reinsurance Corp Ltd (in liq) v All American Life Insurance Co*, Gzell J stated that under s 588FA, “it is no part of the proof of an unfair preference to establish an affectation upon the assets of the insolvent company”.¹¹⁹ Although more recently, in *Hosking v Extend N Build Pty Ltd*, the New South Wales Court of Appeal expressly left open the issue of whether it is necessary for there to be a diminution in the debtor company’s assets under s 588FA.¹²⁰

[92] As this analysis illustrates, the Australian courts have taken diverging approaches as to whether a diminution in the company’s assets is necessary under s 588FA. It is notable, however, that the Full Federal Court in *Kassem* decided in favour of the liquidator in a case that is on all fours with the present case, even though it declined to authoritatively state that diminution is not required.

[93] We conclude that there is no consensus in the Australian cases that diminution is required in cases other than cases involving cash on delivery transactions and prepayments. These cases are treated as outside the scope of s 292 in New Zealand.¹²¹ And there is nothing in the Australian cases that would lead us to conclude that a

¹¹⁷ At [60]–[61].

¹¹⁸ *Sheldrake v Paltoglou* [2006] QCA 52 at [9]. See also *Tolcher v Capital Finance Australia Ltd* [2006] FCA 1804, (2006) 60 ACSR 584 at [42].

¹¹⁹ *New Cap Reinsurance Corp Ltd (in liq) v All American Life Insurance Co* [2004] NSWSC 366, (2004) 49 ACSR 417 at [15].

¹²⁰ *Hosking v Extend N Build Pty Ltd* [2018] NSWCA 149, (2018) 128 ACSR 555 at [111]. The point was also recently left open by the Federal Court in *Stone v Melrose Cranes & Rigging Pty Ltd* [2018] FCA 530, (2018) 125 ACSR 406 at [254].

¹²¹ See above at [87].

diminution requirement should be read into s 292 in a case involving antecedent debt, as this case does. In that respect, we agree with the Court of Appeal’s analysis.¹²²

[94] Mr Chesterman accepted this was the case, but, as mentioned earlier, argued the Australian cases were out of step with the Harmer Report and, to the extent they supported the interpretation of s 292 favoured by the Court of Appeal, they were wrongly decided.¹²³ We do not accept those submissions and they do not deflect us from the conclusion above.

Canadian law

[95] Mr Chesterman argued that *Kassem* should be considered along with a similar Canadian case, *Re Urbancorp Cumberland 2 GP Inc*, a decision of the Ontario Superior Court of Justice.¹²⁴ In both cases, payments were made directly from a related party of the debtor company to a creditor. In *Urbancorp*, Myers J held that the transaction was not voidable, in contrast to the outcome in *Kassem*.

[96] The relevant Canadian provision is s 95 of the federal Bankruptcy and Insolvency Act.¹²⁵ This provides that a payment made by an insolvent person to an arms-length creditor “with a view to giving that creditor a preference over another creditor” is void. A payment having the effect of giving a preference is deemed to have been made with a view to giving a preference unless the contrary is proved.¹²⁶ So the section retains an intention requirement, unlike s 292, but intention is presumed if a preferential effect is established unless the preferred creditor proves the contrary.

[97] Edge on Triangle Park Inc was part of the Urbancorp group, which was ultimately owned by a Mr Saskin. Edge owed nearly \$13 million in harmonised sales tax (HST) to the Canada Revenue Agency (CRA). Urbancorp borrowed \$10 million from Terra Firma Capital Corporation. The terms of the loan required Mr Saskin to contribute additional equity of \$2.25 million and to use the aggregate \$12.25 million to pay Edge’s tax liability. Edge’s counsel made two payments to the CRA totalling

¹²² *Robt Jones* (CA), above n 13, at [142]–[145].

¹²³ See above at [74].

¹²⁴ *Re Urbancorp Cumberland 2 GP Inc* 2017 ONSC 7156, (2017) 54 CBR (6th) 311.

¹²⁵ Bankruptcy and Insolvency Act RSC 1985 c B-3, s 95(1)(a).

¹²⁶ Section 95(2).

\$12 million. Myers J found that Urbancorp had either “loaned the funds to Edge or directed the use of them on Edge’s behalf”.¹²⁷ The Monitor of Edge applied to set the payments aside under s 95.

[98] Myers J observed: “The inter-company borrowing and payment to the CRA had no real effect on Edge. It replaced a tax liability on its balance sheet with a liability owing to its affiliate that had advanced it the money used to pay the CRA.”¹²⁸ However, “[t]he one key effect of the payment” was to reduce Mr Saskin’s statutory personal liability for HST under s 323 of the Excise Tax Act 1985.¹²⁹ While Mr Saskin also guaranteed the Terra Firma loan, a number of other entities also guaranteed that loan and provided mortgage security.¹³⁰

[99] The CRA argued that the money was subject to a deemed trust under s 222 of the Excise Tax Act such that it had priority and did not receive a preference. Myers J held that even if that argument was incorrect, the payments “could not have been a preference factually”:¹³¹

[32] As noted above, Edge’s payment to the CRA was economically neutral to Edge. It replaced one liability owing to one creditor with the exact same liability owing to another. The recovery of unsecured creditors was not prejudiced by \$1 by the inter-company loan of funds into Edge and the subsequent payment to the CRA.

[100] “At its most basic conceptualization”, a preference occurs when an insolvent debtor pays a creditor at the expense of other creditors.¹³² The loan from Terra Firma to Urbancorp was expressly conditioned on the funds being used to pay HST. Neither Edge nor its creditors had any basis to expect to benefit from the loan. Setting aside the transaction would not be remedying prejudice caused by a preferential payment. Rather, recovery would result in a windfall to the unsecured creditors at the expense of the CRA and Terra Firma.¹³³ Myers J concluded:¹³⁴

¹²⁷ At [16].

¹²⁸ At [20].

¹²⁹ At [20], citing Excise Tax Act RSC 1985 c E-15, s 323.

¹³⁰ At [21].

¹³¹ At [31].

¹³² At [33].

¹³³ At [34].

¹³⁴ At [35].

[The unsecured creditors] would suffer no prejudice that might lead them to race to judgment or otherwise to lose faith in the fairness of the bankruptcy system. Nor would the overall pot of assets or their respective shares of Edge's assets be diminished. Put simply, while the payment might have preferred the CRA in the vernacular and one might question the corporate appropriateness of the overall transaction whose purpose seems to have been to protect the shareholder rather than the companies, the transactions caused no prejudice to creditors and caused none of the mischief that preference regulation is designed to prevent.

[101] RJH submits that Canadian jurisprudence is relevant because, like s 292, s 95 makes a bare reference to "preference" and does not mention diminishment. This is not the case. Section 292 does not, in fact, use the term "preference". The Canadian provision is more closely aligned with past iterations of s 292. In addition, Myers J accepted that the payment might have preferred the CRA "in the vernacular".¹³⁵ Unlike s 95 of the Canadian legislation, s 292 defines a preference in the vernacular. That is, it provides that a transaction is an insolvent transaction if it is a transaction by the company and it enables the person who benefits from it to receive more than the person would receive in the company's liquidation.

United Kingdom law

[102] Mr Chesterman argued that the diminution requirement applied in relation to the equivalent United Kingdom provision. As the New Zealand provision had some similarities to the British provision and was based upon it, it could be assumed that the diminution requirement also applied in relation to s 292.

[103] The relevant United Kingdom provision is s 239 of the Insolvency Act 1986 (UK). Under s 239(4)(b), the giving of a preference by a company arises if "the company does anything or suffers anything to be done which (in either case) has the effect of putting that person into a position which, in the event of the company going into insolvent liquidation, will be better than the position he would have been in if that thing had not been done". This is broadly similar to the definition of insolvent transaction in s 292. However, the United Kingdom provision still includes an intention requirement, something which has, as noted earlier, been removed from s 292. Section 239(5) of the Insolvency Act (UK) provides:

¹³⁵ At [35].

The court shall not make an order under this section in respect of a preference given to any person unless the company which gave the preference was influenced in deciding to give it by a desire to produce in relation to that person the effect mentioned in subsection (4)(b).

[104] While this is obviously a substantial difference between the New Zealand and United Kingdom provisions, Mr Chesterman argued that nevertheless the fact that there was a diminution requirement in relation to s 239, when no reference to diminution is made in that section, supported his argument.

[105] Mr Chesterman referred to commentaries on insolvency law in the United Kingdom in support of his argument that a diminution requirement applies.¹³⁶ We accept that these commentaries express the view that payments that do not diminish the company's assets (or, to use their terminology, disadvantage the other creditors) are not preferences under s 239. But they are not supported by reference to cases where a clawback claim has failed on this basis.

[106] Mr Chesterman also referred to the observations made in cases dealing with s 239 that, he said, supported his argument. The first of these was the comment made by Lord Collins in *Rubin v Eurofinance SA* that the underlying policy of the voidable preference regime “is to protect the general body of creditors against a diminution of the assets by a transaction which confers an unfair or improper advantage on the other party”.¹³⁷ The second was a description of s 239 by Phillips LJ in *Re Exchange Travel (Holdings) Ltd (in liq) (No 3)* as:¹³⁸

... one of a number of sections which enables a liquidator, with the assistance of the court, to add to the assets of an insolvent company that are in existence at the time of the liquidation by recovering compensation for or recovery of wrongful diminution of the company's assets prior to liquidation from third parties responsible therefor.

[107] We see these judicial comments as similar to that made by the majority of this Court in *Allied Concrete*.¹³⁹ In both *Rubin* and *Exchange Travel*, the comments were

¹³⁶ Goode, above n 80, at 581–583; Rebecca Parry, James Ayliffe and Sharif Shivji *Transaction Avoidance in Insolvencies* (3rd ed, Oxford University Press, Oxford, 2018) at 164–166; and Andrew Keay *McPherson and Keay: The Law of Company Liquidation* (4th ed, Sweet & Maxwell, London, 2017) at 692–697.

¹³⁷ *Rubin v Eurofinance SA* [2012] UKSC 46, [2013] 1 AC 236 at [95].

¹³⁸ *Re Exchange Travel (Holdings) Ltd (in liq) (No 3)* [1997] 2 BCLC 579 (CA) at 585.

¹³⁹ See *Allied Concrete*, above n 11, at [1(a)].

made as part of a general description of the voidable transactions regime. In neither case did the comment form part of the reasoning. In neither case was the Court deciding whether a payment was voidable. We do not therefore consider these obiter statements provide compelling support for the interpretation of s 292 that RJH advocates for.

Consequences of adopting RJH approach

[108] The liquidators point out the potentially significant effect of adopting the approach for which RJH contends. Ms Van, who argued this part of the case for the liquidators, emphasised three points.

[109] The first was that the objective of simplicity in the regime, reflected not only in the Law Commission Report but also the long title to the Act, would be compromised by the adoption of RJH's approach to s 292. We have dealt with this above.¹⁴⁰ Ms Van emphasised that the regime for clawing back voidable payments was intended to be a summary and cost-effective process. She pointed to the very protracted discovery process in the present case as an indicator that the adoption of a regime requiring detailed information about the source of payments made linked to prolonged and costly litigation with disputes over discovery of the kind that delayed these proceedings for some years.¹⁴¹ She emphasised the need for a bright line test in s 292(2)(b) to avoid this complexity. We see considerable force in that submission.

[110] The second point emphasised by Ms Van was that the adoption of the approach put forward by RJH in the present case, where the payment to RJH was made by a third party would logically also apply to other similar, and potentially more common situations. The most problematic of these was the situation where a preferential payment is made to a creditor by writing a cheque drawn on an overdrawn account or otherwise debiting such an account. In that situation, the bank makes the payment on behalf of the paying company and the effect is to reduce the debt owing to the payee but contemporaneously increase the overdraft by the same amount, meaning that no diminution in assets occurs.

¹⁴⁰ See above at [25] and [66].

¹⁴¹ See *Robt Jones (CA)*, above n 13, at [47].

[111] Mr Chesterman accepted that on the approach he advocates, the payment in question would not be voidable because no diminution in assets would be affected by it. Ms Van pointed out the complexity this could cause where many payments are made from the same account which may be in credit at the beginning of the day and in debit by the end of the day, but it is not possible to identify which payments were made when the account was in credit and which ones were made when the account was in overdraft. Under this approach, it is also conceivable that a single payment could be partly preferential. If the account was in credit, but the payment made exceeded the credit balance, this part of the payment would be recoverable, but the component that took the account into overdraft would not.

[112] This problem would arise only if the overdraft itself was unsecured. Mr Chesterman accepted that if there were a secured overdraft, the effect of the payment from the overdrawn account would be to substitute a secured creditor for an unsecured creditor, which he considered would meet the diminution requirement for which he advocates.

[113] The third point raised by Ms Van was the artificiality of the diminution requirement. Ms Van contrasted the situation where the MSH2 payment was made directly to RJH (as actually happened) and what would have occurred if MSH2 had paid the money to Northern Crest, so that Northern Crest could make the payment of the amount it owed to RJH itself. Mr Chesterman accepted that in the latter situation, the payment by Northern Crest would be voidable. Ms Van argued that this showed the artificiality of requiring diminution. The economic effect of the two situations outlined above is exactly the same, the only difference being that because MSH2 has paid money to Northern Crest and, for the brief period that the money was in the possession of Northern Crest, the assets of Northern Crest increased before reverting to the level they had been before the MSH2 payment was made. There is no public policy reason for distinguishing these two situations. We accept that submission.

[114] Ms Van argued that the voidable regime includes specific defences in s 296(3) and s 292(4B). She argued that if a diminution requirement is added to the specified requirements of s 292, the focus of creditors will not be on bringing themselves within

those defences but on putting liquidators to proof in relation to the source of funds and whether there has been a diminution of assets.

[115] She said the addition of a diminution requirement would also allow directors to ensure that preferential payments are made to extinguish debts guaranteed by the directors, in preference to those in respect of which there is no guarantee and that sharp practices of the kind identified by the Court of Appeal would thereby be facilitated.¹⁴² We agree.

Was there diminution in fact?

[116] Mr Keene argued that, even if there were a diminution requirement, it was met in this case.

[117] Mr Chesterman accepted that if MSH2 had advanced money to Northern Crest and Northern Crest had then immediately paid that money on to RJH, the payment to RJH would have met the diminution requirement. This was because the payment by MSH2 to Northern Crest would have increased the assets of Northern Crest available to unsecured creditors, and the subsequent payment to RJH would have diminished that augmented pool.

[118] However, Mr Chesterman argued that the making of a direct payment by MSH2 avoided this consequence because, although in accounting terms the overall transaction was treated as an advance by MSH2 to Northern Crest and the payment by Northern Crest to RJH of the amount owing to RJH, the money never came into the coffers of Northern Crest and therefore no augmentation or diminution occurred.

[119] We accept that there is a degree of artificiality about distinguishing between the above situations. On Mr Keene's analysis, that artificiality can be avoided by concluding that any payment made "by [the] company" (in this case, Northern Crest) automatically involves a diminution in its assets. Alternatively, it can be argued that the artificiality provides justification for interpreting s 292 as not requiring diminution

¹⁴² *Robt Jones (CA)*, above n 13, at [133].

as a separate and additional requirement to the requirement in s 292(2) that the payment in issue be a payment “by [the] company”.

[120] Mr Keene said a diminution could have arisen in any event because MSH2 was a wholly owned subsidiary of Northern Crest and therefore any diminution in its value was, in effect, also a diminution in the value of the assets of Northern Crest. We do not intend to engage with this argument, given that it is not necessary to do so on our approach to the case. We think, however, there are some difficulties with it because on the information available to us it seems that MSH2 was itself insolvent, and thus had no value to Northern Crest as shareholder. So if the payment by MSH2 simply increased the level of MSH2’s insolvency, ie if the value of the shares held by Northern Crest in MSH2 were valueless before the payment to RJH and even more valueless after the payment to RJH, it is hard to say that the MSH2 payment has diminished the value of the assets of Northern Crest.

[121] Mr Keene also argued that, as s 292 focuses on the *payment*, not the overall transaction, the payment was, in fact, of the kind described in [117] above, involving both an advance by MSH2 to Northern Crest and a payment to RJH. Again, it is not necessary to engage with this argument. But we observe that there may be difficulties in severing the advance and the payment because if the MSH2 payment were not made, the resulting deemed loan to Northern Crest would not happen either.¹⁴³

Conclusion

[122] We conclude that the MSH2 payment, even if it amounted to a loan by MSH2 to Northern Crest, was an insolvent transaction in terms of s 292(2). It is not necessary for the liquidators to establish anything more than that the MSH2 payment was a payment by Northern Crest that met the statutory requirements in s 292(2)(a) and (b). That conclusion means it will not be necessary for the Court to determine whether the MSH2 payment was a loan by MSH2 to Northern Crest or the payment of licence fees owed by MSH2 to Northern Crest.¹⁴⁴

¹⁴³ See *Re Emanuel (No 14) Pty Ltd (in liq)* (1997) 147 ALR 281 (FCAFC) at 288.

¹⁴⁴ See above at [10].

Result

[123] The appeal is dismissed.

Costs

[124] The respondents are entitled to costs. RJH must pay the liquidators costs of \$25,000 plus usual disbursements.

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