
Is the voidable transaction under review an unfair preference, uncommercial transaction or both?

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Introduction

Under the Corporations Act 2001(Cth), when a company proceeds into winding up the voidable transactions provisions contained in Pt 5.7B, Div 2 of the Act become an important means of recovering property for the benefit of creditors in the winding up.

Under the voidable transactions provisions two transactions are of particular importance, namely, the unfair preference and the uncommercial transaction. When these transactions are referred to in the voidable transactions provisions they are generally identified as being separate and distinct transactions.

On occasions, the courts have been required to review the unfair preference and the uncommercial transaction side by side, deciding whether in the circumstances before the court both transactions are relevant, such that either or both may be invoked by the liquidator in seeking to avoid the transaction under scrutiny. In other cases, although the liquidator may be seeking to align the unfair preference and the uncommercial transaction, the court may be resistant to the suggestion, taking the position that they are separate and distinct voidable transactions and that in the matter before it one may be relevant but not the other.

Unfair preference compared with uncommercial transaction

Under s 588FA of the Corporations Act, a transaction is an unfair preference if: (1) a creditor of the company, at the time of the transaction, is party to that transaction, and (2) the transaction results in the creditor receiving more from the company in respect of an unsecured debt than it would have received from the company in respect of that debt if the transaction were set aside and the creditor were to prove for the debt in a winding up of the company.

By way of contrast, the uncommercial transaction as described in s 588FB, Corporations Act seeks to balance the interests of the unsecured creditors of a company being wound up and those persons who would otherwise

be the beneficiaries of pre-winding up transactions entered into by the company. The concern with those transactions is that they involve a bargain of such magnitude that they cannot be explained by normal commercial practice, rendering it impossible to balance in any reasonable way the benefit obtained by the party dealing with the company, and the detriment suffered by the company as a consequence of entering into the transaction.

At this stage, it will be useful to review recent cases involving attempts to align the unfair preference and the uncommercial transaction.

Setting aside a transaction on grounds that it is both an unfair preference and an uncommercial transaction

In the matter of *Ashington Bayswater Pty Ltd (in liq) (Ashington)*,¹ the court was required to address the issue whether the transaction under review amounted to both an unfair preference and an uncommercial transaction.

In the case, the court found that at a time when the company, Ashington, was insolvent it granted a comprehensive charge over its property in favour of a related entity, Bayswater Capital. The charge sought to secure the repayment of monies previously advanced to the company by Bayswater on an unsecured basis.

The liquidator contended that the grant of the charge was both an unfair preference under s 588FA of the Corporations Act and an uncommercial transaction under s 588 FB of the Corporations Act.

With respect to the unfair preference the court stated:²

I accept the liquidator's submission that the grant of the Charge converted an unsecured debt owed by the company to Bayswater Capital into a secured debt and thereby conferred an additional benefit on Bayswater Capital ... to that which it would have received had it submitted a proof of debt as an unsecured creditor ... The grant of the Charge was therefore a preference for the purposes of s 588FA of the Corporations Act.

As to whether the grant of the charge was also an uncommercial transaction, the liquidator submitted that

the charge lacked a commercial quality because the company did not receive any real benefit from the transaction.³

In accepting that position the court stated:⁴

... the effect of the Charge was that the company encumbered its assets so as to convert Bayswater Capital's loan from an unsecured interest to a secured interest, with no substantial corresponding commercial benefit. It seems to me that the detriment suffered by the Company in granting the Charge was disproportionate to any benefit obtained and this transaction involved a bargain for Bayswater Capital of such a magnitude that it cannot be explained by normal commercial practice. I therefore also consider that the entry into the Charge was an uncommercial transaction for the purposes of s 588FB of the Corporations Act.

As a consequence on grounds of both an unfair preference and an uncommercial transaction, the liquidator was entitled to an order under s 588FF of the Corporations Act setting aside the charge. *Note:* The transaction fell within the relation back period as specified under the Corporations Act so as to enable the liquidator to set aside the transaction.

Setting aside a transaction on grounds of an uncommercial transaction but not an unfair preference

The decision of the *New South Wales Supreme Court in Employ (No 96) Pty Ltd (in liq), Re*⁵ provides a further occasion on which a court was required to apply the legal principles of both the unfair preference and uncommercial transaction to a particular transaction before the court.

The transaction found not to be an unfair preference

In the case, the court was concerned with payments made to a creditor in exchange for services rendered to the company. By agreement between the parties, the services were charged out at double the rate ordinarily charged by the creditor. On the facts the court was unwilling to accept that the payments received amounted to unfair preferences solely as a result of the services having been charged out at "special rates." In the circumstances obtaining payment in exchange for services rendered had not bestowed on the creditor an advantage or preference over other creditors; and this conclusion stood irrespective of the rate at which the services had been charged out at.

Were the payments uncommercial transactions?

In the alternative, the liquidator contended that the payments made at "special rates" were uncommercial transactions. Submissions were made that the agreement with the company involved a bargain of such magnitude that it could not be explained by normal commercial practices.

In accepting these submissions, the court found that payments made under the agreement amounted to uncommercial transactions for the purposes of s 588FB of the Corporations Act.

As a result, the court ordered the creditor to repay half the amount it received for services provided under the "special rates" agreement.

The decision has the incidental effect of cautioning suppliers of goods or services who, having outstanding debt recoveries, seek to supply future goods or services to the debtor, possibly on a COD basis at rates higher than usual in an attempt to offset the premium received against the existing debt. In the event that the customer or client subsequently proceeds into winding up, such payments made at "special rates" may be challenged by the liquidator as uncommercial transactions.

Summing up

Traditionally, the unfair preference and the uncommercial transaction are seen as voidable transactions that are fundamentally different, designed to capture unrelated dealings that have produced adverse outcomes for creditors in a winding up.

In recent cases, the courts have had occasion to review these two transactions side by side recognizing that in certain circumstances the two transactions may equally apply, such that a particular transaction may amount to both an unfair preference and an uncommercial transaction as proposed under the Corporations Act.

In other cases, such as occurred in *Employ (No 96)* discussed above, although the liquidator may seek to argue the relevance of both forms of voidable transaction the court may conclude that one, for example the unfair preference, has not been satisfied, while finding that the elements of the other, the uncommercial transaction, are present such that on that basis the transaction under scrutiny may be avoided or modified.



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Footnotes

1. *Ashington Bayswater Pty Ltd (in liq), Re* (2013) NSWSC 1008; BC201311673.
2. Above, n 1, at [49].
3. Above, n 1, at [52].
4. Above, n 1, at [55].
5. *Employ (No 96) Pty Ltd (in liq), Re* (2013) 93 ACSR 48; [2013] NSWSC 61; BC201300864.