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The High Court's decision in *Bryant v Badenoch Integrated Logging Pty Ltd* [2023] HCA 2

The decision, anomalies and policy considerations

Badenoch decision (HCA): Key takeaways

Case concerned s 588FA *Corporations Act 2001* (Cth)

- No ‘peak indebtedness rule’ to determine if there has been a preference in favour of a creditor who was in a ‘continuing business relationship’ with the insolvent company
- ‘Starting point’ – to compare levels of indebtedness – will be later of (i) start of 6-mth period, (ii) date of insolvency or (iii) beginning of continuing business relationship
- Clarity on the test for a ‘continuing business relationship’
  - Objective factual inquiry’; objective ascertainment of the ‘business character’ of the relevant transaction
  - Consider whole of the evidence of the ‘actual business’ relationship between the parties

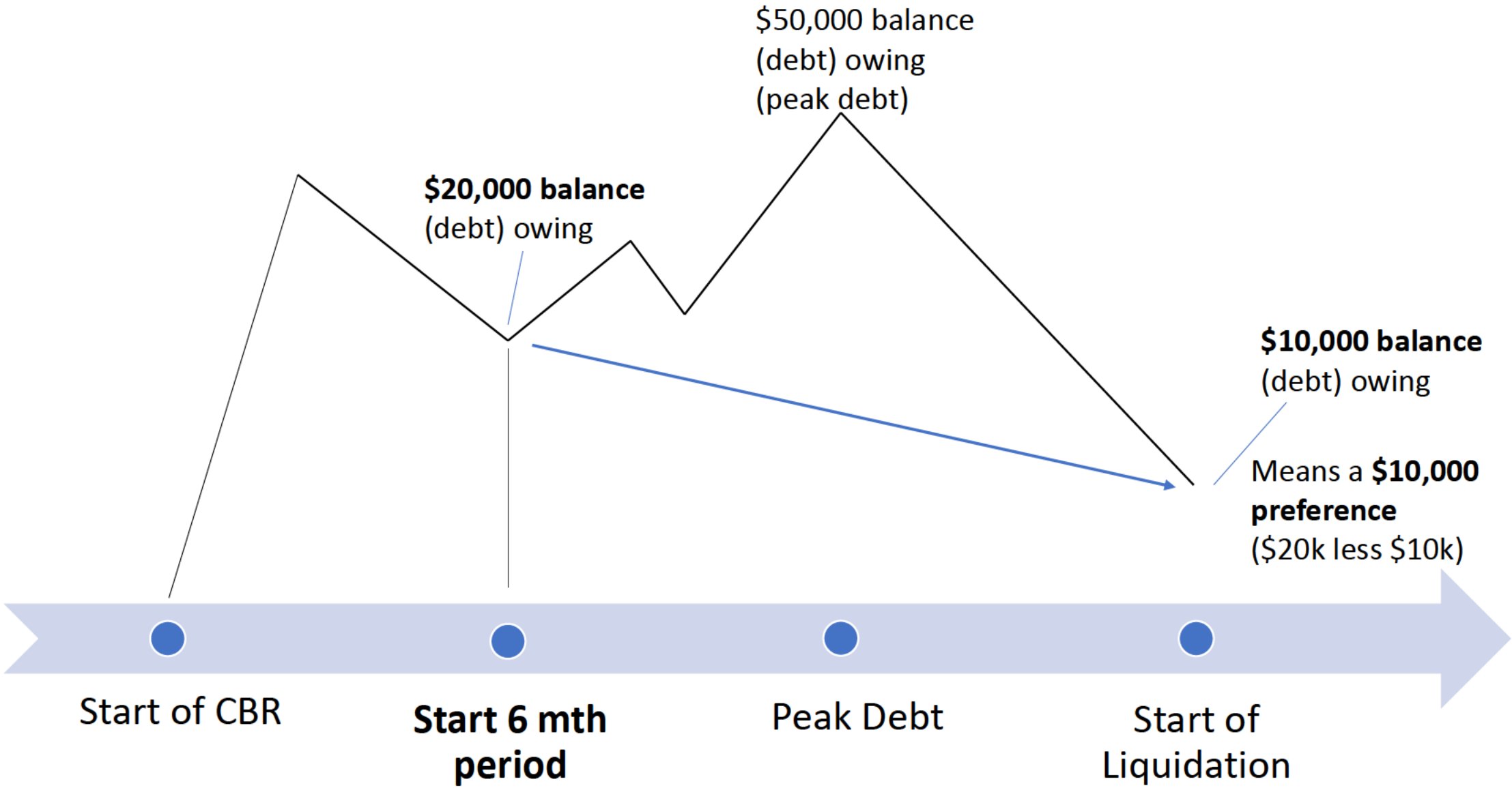
Three scenarios which summarise the position after *Badenoch*

In following three scenarios, it is assumed:

- **Actual insolvency** of company during whole of 6 month period

- **No defences** open to creditor (eg, defence of ‘no reasonable grounds to suspect insolvency’)

A: Continuing Business Relationship ('CBR')



New anomaly: CBR starts *during* 6 month period

per Jagot J at [58]:

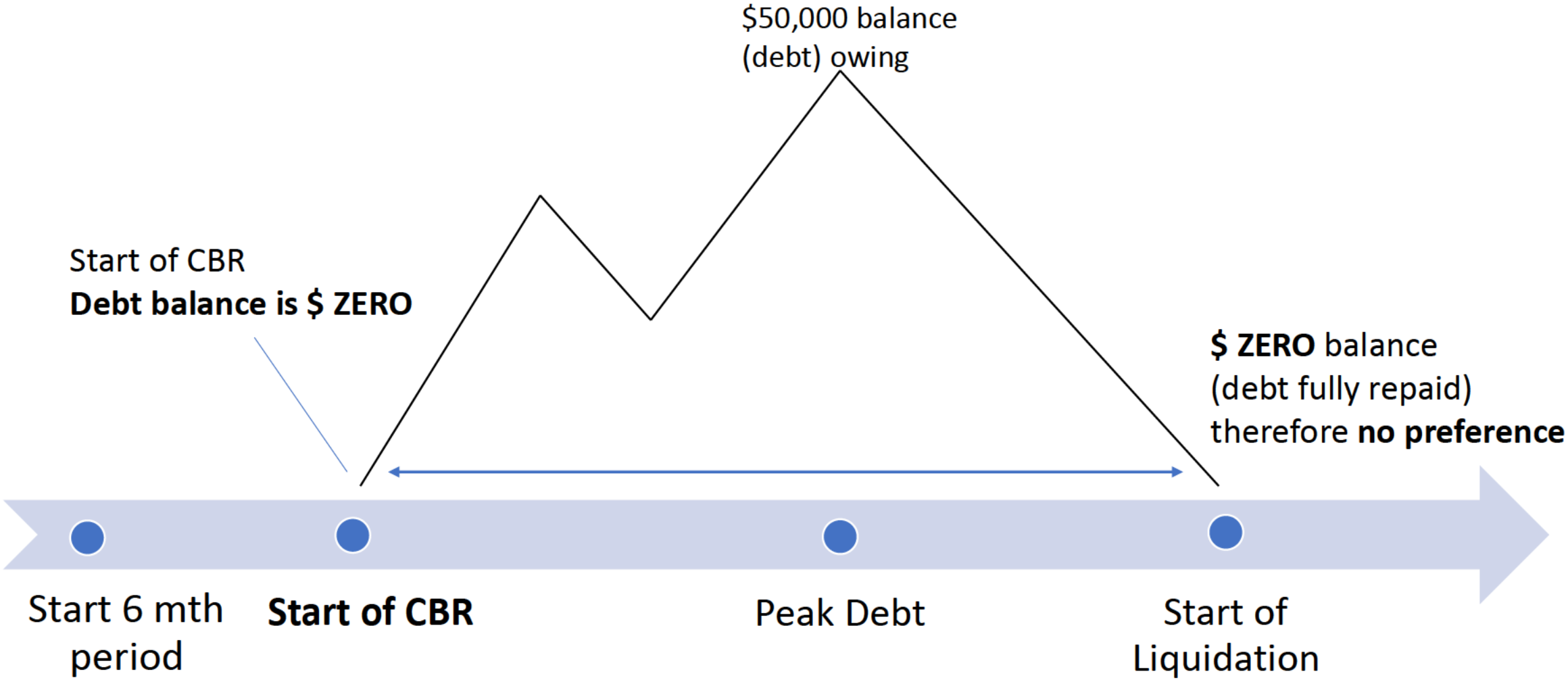
‘No rationale is to be found in the Explanatory Memorandum for the "peak indebtedness rule". The rule also remains unexplained in the decisions which embody it, other than that ***it is obvious that if the relevant "relationship" between debtor and creditor is taken to start at the first transaction between them, there could never be an unfair preference because the account will stand at zero at that time***. It may be inferred that it is for this reason that, in *Rees v Bank of New South Wales*, Barwick CJ conceived of the possible starting points for the relevant "relationship" to be either the date on which the prescribed period ending on the relation-back day commenced or the date selected by the liquidator.’

New anomaly: CBR starts *during* 6 month period

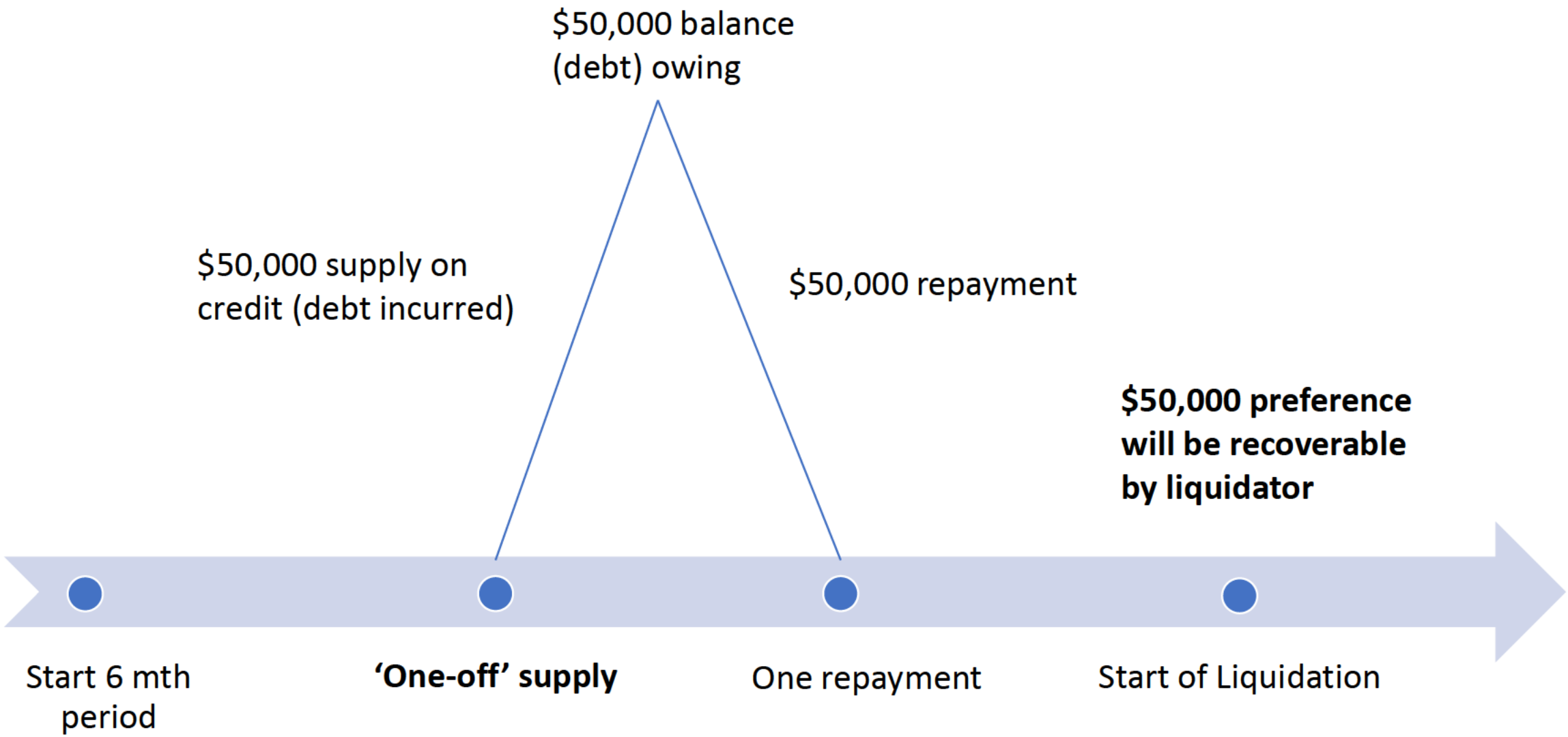
per Jagot J at [77]:

‘Once it is accepted that the first transaction in the continuing business relationship cannot be the first transaction between the creditor and debtor if that occurred before the prescribed period, but must be a later transaction, then (***leaving aside a case in which the continuing business relationship itself starts during the prescribed period and after the date of insolvency***) there was (and is) a policy choice available between two starting points.’

B: Continuing Business Relationship ('CBR')



C: ‘One-off’ supplier and repayment

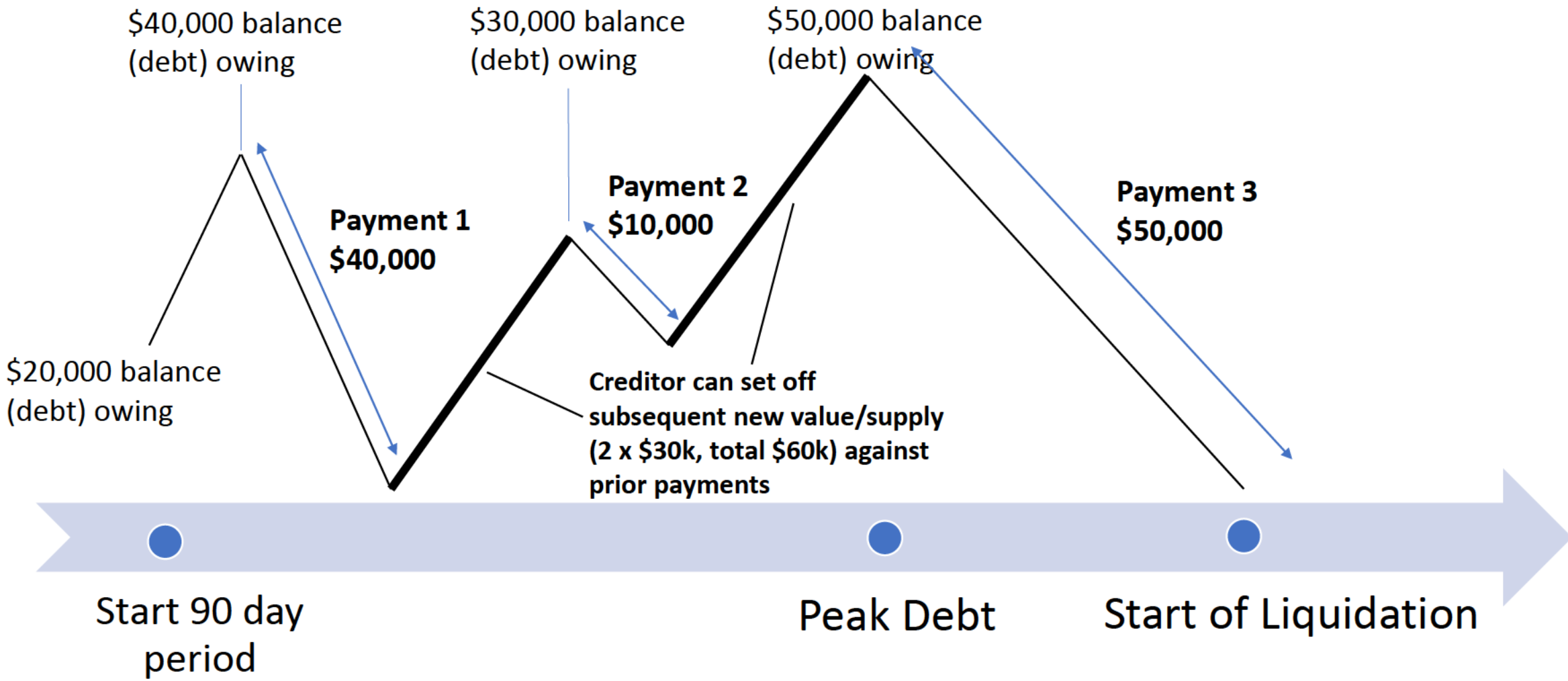


Anomaly: CBR creditor versus ‘one-off’ supplier

- Why is Creditor B *not* liable to disgorge (repay) a preference but Creditor C *is* liable to repay a preference?

- ‘One-off’ suppliers (or suppliers with no CBR making multiple, independent supplies) have their own ‘peak debt’ (of sorts), which *is* applied to determine their liability to repay ‘unfair’ preferences.

US approach: ‘subsequent new value’ defence



Wider Policy Issues on Unfair Preferences

- Two High Court decisions (8 Feb 2023) have addressed two uncertainties (peak indebtedness rule and set-off)
- But does current law achieve goals of insolvency law?
- Revisit underlying policy rationale for unfair preference recoveries - Is there a better way?
- Law Reform Options - Different models (varying degrees of strictness)
  - US Bankruptcy Code (s 547(c)(4) Bankruptcy Code contains “subsequent new value defence”
  - Concessional (threshold) scheme (2022 Government Proposal)
    - Moral Hazard
  - Automatic avoidance schemes in relation to preferences
    - Strict approach (based on notions of fairness, efficiency and effectiveness).
    - Andrew Keay, 'Liquidators' Avoidance of Preferences: Issues of Concern and a Proposal for Radical Reform' (1996) 18(2) *Adelaide Law Review* 159