VOIDABLE PREFERENCES AND GUARANTOR OFFICERS

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[Pre-liquidation dispositions by a financially troubled company may be used by those in positions of control or influence to reduce their individual exposure on debts for which they have acted as guarantors. This article examines the statutes regulating such transfers, Bankruptcy Act 1966 (Cth) s. 122, and Companies Code s. 453(5), reviewing the judicial interpretations of each. The authors discuss the shortcomings revealed in the current methods employed for regulating transactions which have the effect of preferring company guarantors and suggest possible improvements.]

Introduction

Creditors of a company in financial difficulties often suspect that, prior to its liquidation, its controllers will strip the company of its valuable assets leaving unsecured creditors to share the insufficient remainder on liquidation. This suspicion is well founded in many cases. After all, who is in a better position to know of the company's parlous state and influence its conduct? This inside knowledge can be used to ensure that the debts of the company owed to its controllers or their associates are repaid ahead of other creditors. Or, if there are insufficient funds for repayment, the company's controllers can ensure that they or their associates are granted security for such debts. In either case, this will change the status of the controllers and their associates *viz-à-viz* the other unsecured creditors and allow priority of repayment of the outstanding debts of those individuals willing to exploit their inside knowledge and positions of control.

Because of the unique situation of corporate insiders,[1] they also have other means of denuding their company of assets. They have the ability to arrange for a sale of its assets to themselves at less than their true value. Alternatively, they can sell their own assets to their company for more than their true value.[2]

This article, however, is primarily concerned here with the treatment of company controllers who have given guarantees for their company's debts. In such circumstances, the guarantor, in order to reduce personal exposure, may use his position of control to assure that the debts to which his guarantee applies are repaid in priority to other debts when company insolvency threatens.

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1 The term insider in this context refers not to insiders as regulated by the Securities Industry Code, but rather to the broader concept of any individual, not at arm's length with the company, whose position and knowledge facilitate effective preferential transfers. This term, used in the United States, is discussed in Tuskey, 'The Term Insider Within Section 547(b)(4)(B) of the Bankruptcy Code', (1982) 57 *Notre Dame Lawyer* 726. The Australian Law Reform Commission, General Insolvency Reference, in its 'Briefing Paper on Antecedent Transactions' refers to this type of creditor as a 'related person' creditor.

2 Ss 453(1) and (2) of the Companies Code give a liquidator the right of recovery in such circumstances. There are no equivalent provisions in the Bankruptcy Act 1966.

Recovery of such a transfer from the creditor may not be possible because the creditor, being unaware of the company's financial state, may be able to avail himself of appropriate defences to avoidance of the transfer. Further, the payment of the debt may release the insider guarantor from liability to the creditor under the guarantee so that, even if recovery from the creditor is achieved, the creditor will have no recourse against the guarantor. In either case, lack of a direct recovery against the guarantor enables the guarantor to retain the benefit conferred on him by the preferential transfer either to the detriment of the general creditors (where no recovery of the transfer from the primary creditor occurs) or to the detriment of the primary creditor (where the transfer is avoided but the guarantor is discharged of liability on the guarantee). Alternatively, recovery against the guarantor which does not permit his participation in the appropriate share of the insolvency estate places him in a worse position than if the transfer had not been made. Adequately balancing the interests of all parties in these circumstances is difficult, and a review of the provisions controlling such transactions reveals that the proper allocation of loss in such cases has yet to be effectively achieved.

The regulation of a company's pre-liquidation transactions in these circumstances is governed by two different provisions:

A. Section 451 of the Companies Code[3] applies the voidable preference provisions of s. 122 of the Bankruptcy Act 1966 (Cth)[4] to companies in liquidation. These are general provisions in that they apply to all creditors, having no specific application to insiders or guarantors.

B. Section 453(5) of the Companies Code applies specifically to a particular class of insider. Under s. 453(5) a liquidator has the power to recover the value of a preference, not from the company's creditor, but rather, from its officers.[5] This power can be exercised where the effect of conferring a preference on a creditor is to release an officer of a liability.

[3] S. 451(1) provides: 'A settlement, a conveyance or transfer of property, a charge on property, a payment made, or an obligation incurred, by a company that, if it had been made or incurred by a natural person, would, in the event of his becoming a bankrupt, be void as against the trustee in bankruptcy, is, in the event of the company being wound up, void as against the liquidator.'

[4] S. 122(1) provides: 'A conveyance or transfer of property, a charge on property, a payment made, or an obligation incurred by a person who is unable to pay his debts as they become due from his own money (in this section referred to as "the debtor"), in favour of a creditor, having the effect of giving that creditor a preference, priority or advantage over other creditors, being a conveyance, transfer, charge, payment or obligation executed, made or incurred —

(a) within 6 months before the presentation of a petition on which, or by virtue of the presentation of which, the debtor becomes a bankrupt; or

(b) on or after the day on which the petition on which, or by virtue of presentation of which, the debtor becomes a bankrupt is presented and before the day on which the debtor becomes a bankrupt, is void as against the trustee in bankruptcy.'

[5] Under s. 5(1) 'officer' includes —

(a) a director, secretary, executive officer or employee of the corporation;

(b) a receiver and manager of property of the corporation appointed under a power contained in an instrument;

(c) an official manager or deputy official manager of the corporation;

(d) a liquidator of the corporation appointed in a voluntary winding up of the corporations; and

(e) a trustee or other person administering a compromise or arrangement made between the corporation and another person or other persons,

but does not include —

(f) a receiver who is not also a manager;

(g) a receiver and manager appointed by a court; or

(h) a liquidator appointed by a court.

Whilst the general preference provision in s. 122 of the Bankruptcy Act has no specific application to creditors who are not at arm's length with the company, it has no difficulties in dealing with preferential dealings between such creditors and their company. In a bipartite transaction between an insider creditor and the debtor company, the insider will generally be unable to protect a preference because of his lack of 'good faith'. An insider creditor, in most cases, will either know or have reason to suspect that his company was insolvent at the time the preferential transaction was entered into. 'Good faith' under s. 122(4)(c) is deemed to be absent where a preference is conferred under such circumstances as to lead to the inference that the creditor either knew or had reason to suspect that the debtor was insolvent and the effect of the transaction would be to give him a preference over other creditors.

Problems with s. 122, however, are encountered when other parties are involved in a tripartite transaction. In such cases the effect of the preferential transaction with the creditor may also confer a preference on some person other than the creditor. A typical tripartite transaction is a guaranteed debt. For example, it is quite common for a creditor to insist that, prior to the extension of credit, the debtor obtain a third party to guarantee the repayment of the debt. This is often the case where the debtor is a company. A creditor may require its directors to guarantee their company's obligations. In the event of the debtor company's impending insolvency, the guarantor directors have the incentive to ensure that the guaranteed debt is repaid ahead of other debts with the result that their personal obligations to the creditor under the guarantee are extinguished. For the creditor the repayment of the debt in such circumstances can have four consequences upon the liquidation of the debtor company:

(i) The repaid creditor is unaffected by the debtor's liquidation and retains the sum paid.

(ii) The repayment has all the characteristics of a voidable preference but takes place outside the time period prescribed under s. 122 of the Bankruptcy Act. Again, the creditor is unaffected by the winding up.

(iii) The repayment satisfies the requirements of a preferential transfer under s. 122(1) but the creditor is able to invoke the protection of s. 122(2)(a) to prevent its recapture by the debtor's liquidator.

(iv) The repayment is a voidable preference which can be recovered from the creditor by the liquidator.

The issue canvassed here is whether a liquidator can recover any amount from the debtor's guarantors given the fact that the repayment of the debt by their company effects a discharge of their liability to the creditor. Section 453(5) of the Companies Code[6] deals specifically with such instances of preferential behaviour. Prior to its introduction only s. 122 of the Bankruptcy Act could possibly deal with preferences conferred on a creditor which had the additional effect of releasing an insider from liability as guarantor to the creditor. As discussed below, however, s. 122 consistently proved to be ineffective in such

[6] This provision, which has no counterpart in the Uniform Companies Act, came into effect with the commencement of the Companies Code on 1 July 1982.

circumstances, necessitating the enactment of s. 453(5) to regulate such behaviour by company officers.

Application of s. 122 to guarantors[7]

An essential pre-condition for the application of s. 122 to guarantors is the requirement that a guarantor be classified as a creditor of the debtor company for purposes of s. 122. As Dixon J. noted in *Robertson v. Grigg*,[8]

> The relationship of debtor and creditor was for long the very foundation of the provisions of the bankruptcy law affecting preference, and, although exceptions have been introduced, the old rule otherwise remains and nothing can amount to a preference unless the person preferred is a creditor.[9]

There appears to be no doubt that a guarantor can be regarded as at least a contingent creditor of the principal debtor. It is presumed that, where a person enters into a guarantee at the valid request of the principal debtor, there is an implied term that the principal debtor will indemnify the guarantor in respect of any liability to the creditor under the guarantee.[10] This right of indemnity constitutes the guarantor a contingent creditor of the principal debtor whilst the principal debt is wholly or partially unsatisfied.[11] The contingency is removed once the guarantor satisfies the principal debt. The guarantor is then subrogated to the rights of the creditor in enforcing the debt of the principal debtor.[12] There is some conflict in the authorities whether the expression 'creditor' in s. 122 includes a contingent creditor.[13] The better view is that it does. If this were not the case it would mean that a creditor who makes an unsecured loan to a debtor repayable at some future time could prior to the date for repayment obtain a secured interest in the debtor's property and this would not be a preference for purposes of that section.

The next requirement of s. 122 is for the liquidator to establish that the impugned transaction comes within one of the classifications recognized. These are, 'a conveyance or transfer of property', 'a charge on property', 'a payment

7 S. 95(1) of the Bankruptcy Act 1924-1960 (Cth), the predecessor of the present s. 122 avoided a dealing which had the effect of giving a creditor or *any surety or guarantor* for the debt due a preference. The reference to sureties and guarantors was deliberately omitted because it was felt that despite the reference s. 95 did not permit recovery of any amount from such sureties or guarantors. See Clyne, T., 'An Outline of Some Recommendations for the Amendment of the Bankruptcy Act' (1964) 1 *Federal Law Review* 24, 40. The justifications for this omission are further discussed at footnotes 36 through 38, *infra* and in the accompanying text.

8 (1932) 47 C.L.R. 257.

9 *Ibid.* 271.

10 *Johnson v. Royal Mail Steam Packet Co.* (1867) L.R. 3 C.P. 38, 43; *Re A Debtor* [1937] Ch. 156; *Anson v. Anson* [1953] 1 Q.B. 636; *Israel v. Foreshore Properties Pty Ltd* (1980) 54 A.L.J.R. 421, 424; O'Donovan & Phillips, *The Modern Contract of Guarantee* (1985) 446.

11 *Re J. F. Aylmer (Manildra) Pty Ltd* (1968) 12 F.L.R. 337, 342; *Re Timbatec Pty Ltd* [1974] 1 N.S.W.L.R. 613, 617.

12 *Duncan Fox & Co. v. North & South Wales Bank* (1880) 6 App. Cas. 1; *Traders Finance Corp. Ltd v. Marks* [1932] N.Z.L.R. 1176; *Craythorne v. Swinburne* (1807) 14 Ves. 160; 33 E.R. 482, 483; O'Donovan & Phillips, *op. cit.* 502.

13 *Re J. F. Aylmer (Manildra) Pty Ltd* (1968) 12 F.L.R. 337, 342; affirmed *sub. nom. Burgess v. Spooner* (1968) 89 W.N. (Pt. 1) (N.S.W.) 79, 83; *Re Timbatec Pty Ltd* [1974] 1 N.S.W.L.R. 613, 617; *Re Expo International Pty Ltd* (1982) 1 A.C.L.C. 577; and *Re Jaques McAskell Advertising Freeth Division Pty Ltd* [1984] 1 N.S.W.L.R. 249, all support the proposition that s. 122 encompasses contingent creditors. *Calzaturificio Zenith Pty Ltd v. N.S.W. Leather & Trading Co. Pty Ltd* [1970] V.R. 605 and *Re Australian Co-Operative Development Society Ltd* [1977] Qd.R. 66, assert the contrary view.

made or an obligation incurred'.[14] Further, the relevant transaction must have been entered into by the company. If s. 122 is to have any impact on a guarantor, the avoidance of the relevant transaction by the liquidator should restore the company and guarantor to their positions before the company entered into the relevant transaction. Alternatively, s. 122 should allow the liquidator to recover the amount of the repayment from the guarantor.

One possibility is that the execution of the contract of guarantee by the guarantor is an 'obligation incurred' by the company for purposes of s. 122.[15] As discussed above, it is by virtue of this transaction that the guarantor is regarded as a creditor of the company. Section 122, however, requires that the impugned transaction, the execution of the guarantee, to have been entered into within the prescribed time frame. This severely limits the liquidator's avoidance powers. Guarantees are usually executed contemporaneously with the extension of credit to the company by the creditor. Consequently, if execution of the guarantee is the relevant transaction, s. 122 can only apply to guarantees in respect of debts incurred within the relevant time frame.

Even if a guarantee is entered into within the required period, there are further obstacles to the liquidator's powers of avoidance. Section 122 only operates against a person who was already a creditor of the debtor at the time of entry into the relevant transaction. It will not apply if the person acquired such character as a consequence of the transaction.[16] If the execution of the guarantee is regarded as the relevant transaction for the purposes of s. 122, then clearly, in the ordinary case, a guarantor will have no pre-existing creditor relationship with the principal debtor company. Even if this is the case this does not mean that s. 122 necessarily applies.

This point is illustrated in *Expo International Pty Ltd v. Torma*.[17] In that case the company paid Torma, one of its promoters and an original director, the sum of $15,000. This amount represented the balance owing on the sale of his shares in the company to Renz, the other director of the company. At the time of the payment Torma was a creditor of the company in respect of a $12,000 loan. He had also guaranteed repayment of the company's loans from other creditors. The liquidator sought to recover the payment of $15,000 under s. 122. The main point at issue was whether Torma was a creditor of the company for purposes of s. 122. The liquidator submitted that he was, arguing that Torma was a creditor in two capacities; one as a lender of $12,000 and the other as a guarantor of Expo's debts. Whilst the court conceded that Torma was a creditor of the company in both respects, this was not sufficient for purposes of s. 122. Hope J. remarked:

14 In most respects, the transactions included within s. 451(1) of the Companies Code, see n. 3, *supra*, correspond to those included in s. 122 of the Bankruptcy Act. The inclusion of the additional term 'settlement' in s. 451(1) applies to companies in liquidation limitations on voidable settlements similar to those imposed upon individuals by the provisions of s. 120 of the Bankruptcy Act.

15 This possibility was raised by the liquidator in *Re Jaques McAskell Advertising Freeth Division Pty Ltd* [1984] 1 N.S.W.L.R. 249.

16 *Re Paine* [1897] 1 Q.B. 122; *Re Blackpool Motor Car Co. Ltd* [1901] 1 Ch. 77; *Re Jacques McAskell Advertising Freeth Division Pty Ltd* [1984] 1 N.S.W.L.R. 249.

17 (1982) 1 A.C.L.C. 577; affirmed (1985) 3 A.C.L.C. 748.

> In my opinion, a person to whom a payment has been made by a company within six months of its winding up does not obtain a preference merely by reason of the fact that he happens to be a creditor of the company. In order for the payment to be a preference, it must be made to the payee in his capacity as a creditor of the company and not otherwise.[18]

There was no preference to Torma in this case. The payment was not made to him in his capacity as guarantor nor was it made in his capacity as creditor of the $12,000. It was made to discharge the liability of Renz not any liability of the company.[19]

Finally, under s. 122, the effect of the transaction, the execution of the guarantee, must be to confer on the creditor guarantor a preference over other creditors in the sense of changing the position of the guarantor to his advantage.[20] Again, in the ordinary case, execution of a guarantee does not better secure or otherwise advantageously effect the guarantor in respect of some pre-existing debt.

From the foregoing it is apparent that execution of a guarantee does not satisfy the requirements of s. 122(1). Another possibility is that the relevant transaction for purposes of that provision arises when the guarantor is discharged from his obligations to the creditor. For example, unless there is some provision in the contract of guarantee to the contrary, the obligations of the guarantor to the creditor are discharged if the debtor company fully performs its obligations under its contract with the creditor. Ordinarily, this will occur if the debtor company pays the creditor the full amount of the debt and this payment is a 'good and satisfactory payment'.[21] A guarantor will also be discharged from his obligations under the guarantee if the creditor voluntarily releases him. This is unlikely to occur in practice. A previously unsecured creditor may, however, agree to discharge the guarantor if the debtor company provides the creditor with some security for the debt.

The preferential effect of a discharge of a guarantee by payment of the debt by a debtor company was considered in *Re Timbatec Pty Ltd.*[22] In that case one of the transactions challenged by the liquidator under s. 122 was the repayment of a debt by the company which had the effect of discharging one of its directors from his liability under a guarantee to the creditor. The liquidator made no attempt to attack the payment by the company to the creditor, rather he sought to invalidate the guarantor's discharge. He submitted that the extinguishment of liability gave the director a preference over the company's other creditors. Bowen C.J. rejected this submission. He asserted that it was not possible to invalidate this transaction under s. 122. It was not an independent transaction in itself but was rather an effect or consequence of the payment to the creditor. Accordingly, it was not

18 (1985) 3 A.C.L.C. 748, 751. See also *Robertson v. Grigg* (1932) 47 C.L.R. 257, 271 and *Burns v. Stapleton* (1959) 102 C.L.R. 97, 105.

19 The payment by the company to Torma may well have been void under s. 67 of the Companies Act 1961 (N.S.W.) in that it financed the purchase of its own shares. S. 129 of the Companies Code is the equivalent current provision; however, since 1983, s. 130 of the Companies Code has given such transactions limited validity in appropriate circumstances. Had the transaction been void or invalidated, then clearly Torma's status as creditor would have been affected. Since the case was decided, however, s. 122(4A) of the Bankruptcy Act 1966 came into operation. The effect of that provision is to confirm a person's status as creditor for purposes of s. 122 notwithstanding that the contract giving rise to that status is void or unenforceable.

20 *Robertson v. Grigg* (1932) 47 C.L.R. 257, 271; *Burns v. Stapleton* (1959) 102 C.L.R. 97, 105.

21 *Pritchard v. Hitchcock* (1843) 6 M. & G. 151; 134 E.R. 844, 851.

22 [1974] 1 N.S.W.L.R. 613.

possible to invalidate the guarantor's discharge without also avoiding the payment to the creditor. Bowen C.J. stated:

> In my opinion it is not possible under s. 122 in circumstances such as the present, simply to invalidate the effect or consequence of the payment to the principal creditor, without avoiding the payment to him, and then to make an order that the surety who has been preferred should pay the liquidator the amount which has in fact not been paid to him, but has been paid to the principal creditor.[23]

Even if both the payment to the creditor and the resultant discharge of the guarantor are challenged under s. 122, there remain impediments to the liquidator's power of avoidance. Whilst the payment may satisfy the initial characterization as a preference under s. 122(1), the creditor may be able to avail himself of the defence in s. 122(2)(a)[24] which may not apply to the guarantor. In such situations the requirement of dual challenge against both the payment and discharge is not satisfied, leaving the transfer irrecoverable from the guarantor despite the absence of any appropriate defence available to him.

Bowen C.J. also averted to further difficulties in resolving the rights of all parties to a guarantee transaction when a payment to the primary creditor is set aside as preferential. This problem is clearly illustrated in the case of *Commercial Bank of Australia Ltd v. Carruthers*,[25] wherein a transfer from a debtor to his primary creditor, also resulting in the discharge of the guarantor's liability upon the debt, was set aside as a preferential transfer. In that case, a deposit by the debtor, Mr Walsh, into his account with the Commercial Bank of Australia eliminated his overdraft and enabled his guarantor, Mr Carruthers, to be discharged from secondary liability on the overdraft. Although the transfer by Mr Walsh to the bank was avoided as a preferential transfer, this did not, according to Manning J., necessarily revive the obligation of the guarantor upon the debt.[26] Consequently, aside from contractual arrangements reviving the guarantor's liability upon the recovery of a preferential transfer from the original creditor, the guarantor's liability to the creditor remains discharged and the primary creditor's only recourse upon surrender of such preference is to dividends from the bankrupt's estate.[27]

23 *Ibid.* 616.

24 S. 122 does not affect 'the rights of a purchaser, payee or encumbrancer in good faith and for valuable consideration and in the ordinary course of business'.

25 (1964) 82 W.N. Pt. 1 (N.S.W.) 76.

26 This very result was anticipated in the *Report of the Committee Appointed by the Attorney-General of the Commonwealth to Review the Bankruptcy Law of the Commonwealth* (1962). The Committee reports, at paragraphs 177-78: '. . . It has been urged on behalf of certain banks that where a payment by a debtor to a creditor is avoided by section 95 as a preference and a person was a surety or guarantor for the debt, the creditor should, on repayment to the trustee of the amount received by him, have the same remedies against the surety or guarantor, and against any property mortgaged or charged by the surety or guarantor as security, as he would have had if the debtor had not made the payment to the creditor. The Committee has given careful attention to this suggestion, which at first sight appears to be a reasonable provision aimed at achieving substantial justice for all parties concerned. However, the Committee has come to the conclusion that such a provision should not be included in the legislation.

In coming to this conclusion, the Committee has had regard to the difficulties that would arise in restoring all the parties to their former positions many months after the payment concerned had been made. To take one example, a surety may have entered into such other commitments on the faith of his apparent release from liability as would make it inequitable to restore the creditor's rights against him. The Committee has also taken into account that it is open to a creditor who takes a surety or guarantee to make it a condition of giving credit that the surety or guarantor shall remain liable if payment by the principal debtor is set aside as a preference.'

27 (1964) 82 W.N. Pt. 1 (N.S.W.) 76, 82.

In *Re Timbatec Pty Ltd*, Bowen C.J. relied upon the decision in *Commercial Bank of Australia Ltd v. Carruthers* when he observed:

> Different considerations would arise if the attack were made on the payment to the principal creditor, or upon any preference that both of them may have received. In the former case, even then, if the payment to the principal creditor were held to be void, it would not necessarily restore the liability of the guarantor, which had been extinguished by the payment, unless the terms of the guarantee were specifically drafted to provide for this contingency.[28]

Despite Bowen C.J.'s acceptance of the decision in *Commercial Bank of Australia Ltd v. Carruthers*, O'Donovan and Phillips[29] argue that the decision in the case is unfair to creditors and contrary to U.K. authorities.[30] In fact, Manning J. clearly considered the English authorities inappropriate despite their unequivocal indication that in similar circumstances under the United Kingdom provision,

> An acceptance of money from the debtor, which the creditor thought at the time he accepted it was a good and valid payment, cannot therefore discharge the surety.[31]

Manning J. concluded that the English position would not discharge the surety because the payment was made with fraudulent intent, a requirement not found under the Australian statute, and because the Australian statute only made such transfer 'void as against the trustee in bankruptcy'. In view of these differences, Manning J. did not find that the English authorities correctly stated the law with regard to the Australian statute.[32] Nevertheless, O'Donovan and Phillips suggest that the expression 'void against the trustee in bankruptcy' in s. 122(1) is not necessarily inconsistent with the view that the repayment to the trustee has the effect of restoring all the parties, including guarantors, to the positions existing before the payment was made. If this is correct it would mean that the creditor, upon having to return the unvalidated payment to the liquidator under s. 122, can then in turn recover from the guarantor.

Even if an appellate court adopts the English approach in Australia there remains the question of the guarantor's entitlement in the winding up when the liquidator proceeds against him and either elects not to invalidate the payment to the creditor or invalidation is not possible because the payment is protected by the operation of s. 122(2)(a). As noted earlier, payment of the debt by a guarantor gives the guarantor a right of indemnity against the debtor. This entitles the guarantor to prove for that payment in the debtor's liquidation. If the liquidator does not avoid the payment to the creditor, then recapture from the guarantor results in the guarantor losing his rights to prove in the debtor's liquidation. This

28 *Re Timbatec Pty Ltd* [1974] 1 N.S.W.L.R. 613, 616.

29 *Op. cit.* 201.

30 According to Blackburn J. in *Petty v. Cooke* (1871) L.R. 6 Q.B. 790 at 795, a guarantor is not discharged by a preferential payment because the creditor has done nothing knowingly to injure the guarantor's rights by 'taking money he could not refuse'. The court in *C.B.A. Ltd v. Carruthers* distinguished the English cases on the basis that the U.K. preference provision avoids payments made with 'a view' of preferring the creditor. O'Donovan and Phillips correctly assert that this is an irrelevant distinction in this context.

31 *Petty v. Cooke* (1871) L.R. 6 Q.B. 790, 795 (*per* Lush J.). *Rowlatt on Principal and Surety* (4th. ed. 1982) 94 also stated the position under the United Kingdom statute, and was referred to by Manning J.: 'If a payment received by the creditor from the principal is afterwards, upon the bankruptcy of the principal, adjudged a fraudulent preference, and has to be restored to the estate by the creditor, the surety is liable for the amount where the creditor was not a party to the fraudulent preference. There has been no valid payment, and the creditor has not done anything to discharge the surety upon equitable grounds.'

32 (1964) 82 W.N. Pt. 1 (N.S.W.) 76, 80-81.

harsh consequence was regarded as significant by Bowen C.J. in *Re Timbatec Pty Ltd* when he rejected the liquidator's right to apply s. 122 to the guarantor:

> Practical difficulties arise if the effect or consequence of the release of the surety is avoided in some fashion and an order is made for him to pay to the liquidator the sum . . . which had been paid to the principal creditor. The difficulty . . . would be to determine what dividend, if any, [the guarantor] would be entitled to receive as a so-called creditor in the liquidation. It seems that he would be entitled to receive nothing. The reason for this would be that, the principal creditor having been paid in full, and no steps having been taken by the liquidator to set aside this particular payment, there would be no amount for which [the guarantor] could prove. He would presumably receive no dividend in respect of the amount which he had been called upon to pay into the common pool.[33]

Bowen C.J., however, noted that there was one situation where s. 122 could apply to the discharge of a guarantee. The discharge may be an inseparable part of a wider transaction which gives the guarantor a preference over other creditors.[34] This was the situation which arose in *Re J. F. Aylmer (Manildra) Pty Ltd.*[35] In that case the company obtained an overdraft facility from its bank. Its members guaranteed this debt. Their obligations under the guarantee were secured. The members were obliged to lodge fixed interest bearing deposits with the bank to which it had recourse in the event of default by their company. Subsequently, the company, whilst insolvent, entered into an arrangement with its members whereby in consideration for the issue of debenture to them the members applied their funds on fixed deposit toward repayment of the company's overdraft. This had the effect of releasing them from further obligation to the bank. When the company was placed in voluntary liquidation, its liquidator challenged the secured status the debentures conferred on the members. Street J. upheld this claim. He held that the issue of debentures, the release of the members and repayment of the overdraft were inseparable parts of a wider transaction. This wider transaction had the effect of altering the members' status *viz-à-viz* their company from contingent unsecured creditors under the guarantee to secured creditors in respect of the debentures. The practical difficulties which so concerned Bowen C.J. in *Re Timbatec Pty Ltd* did not arise in this case. The members' ability to prove in their company's liquidation presumably remained, only their priority as secured creditors was invalidated.

Section 453(5) of the Companies Code

As discussed above, payment of a debt by a debtor company discharges the obligations of its guarantor to the creditor. Whilst s. 122 may in appropriate circumstances invalidate the payment to the creditor, it does not operate to subject the guarantor to a direct liability to the liquidator of the debtor, nor, apparently, was it ever intended to allow such recovery. Even though the predecessor to s. 122, s. 95(1) of the Bankruptcy Act 1924-1960 (Cth) avoided dealings which had the effect of giving a preference to a creditor, or any surety or guarantor for the debt, it is clear that inclusion of the reference to guarantors and sureties was inappropriately taken from the statute of the United Kingdom, where such was necessary to enable recovery from even the primary creditor

33 [1974] 1 N.S.W.L.R. 613, 616-7.
34 *Ibid.* 617.
35 (1969) 12 F.L.R. 337.

where the debtor made a transfer only intended to prefer the guarantor.[36] It is unlikely that retention of such language would have subjected a guarantor to direct liability for a transfer effecting a discharge of the guarantee any more effectively in Australia than it did under the United Kingdom statute.[37] Recognition that the Australian preference provision, defining preference by regard to preferential effect rather than the debtor's intention, would allow recovery against the primary creditor without regard to the preferential effect upon sureties and guarantors, led to the deletion of those terms in 1966.[38]

Although direct recovery against sureties and guarantors under the general preference provision applicable to individual debtors is not currently possible under the Bankruptcy Act, company officers who have been discharged of liability on their guarantees of a company debt may, however, still be liable upon liquidation of their company under s. 453(5). This section allows the liquidator of a company to recover from an officer the value of property disposed of by a company where such disposition:

(i) occurs within 6 months before the commencement of the winding up of the company;

(ii) confers a preference upon a creditor of the company; and

(iii) has the effect of discharging that officer of the company from a liability.

Where the liquidator has already recovered from the creditor part of the value of the relevant property or part of the actual property, the right of recovery against the officer is limited to the unrecovered portion.[39]

Although the reasons for the enactment of s. 453(5) are unarticulated in the

36 Originally, a transfer by a debtor to a creditor with the intention to prefer a guarantor was not a preferential transfer under the United Kingdom statute either because there was no intention to prefer the recipient creditor, *Re Mills; ex parte Official Receiver* (1888) 58 L.T. 871, or because the person intended to be preferred, the surety or guarantor, was not a creditor, *In re Warren; ex parte The Trustee* [1900] 2 Q.B. 138. The preferential transfer section, The Bankruptcy Act, 1914, 4 & 5 Geo. 5, 49, s. 44(1) was amended in 1913 so as to require a transfer to be 'with a view of giving such [a] creditor, or any surety or guarantor for the debt due such [a] creditor, a preference over the other creditors . . .'

37 Despite the opinion expressed by Eve J. in *In re G. Stanley & Co. Ltd*, [1925] Ch. 148, that the 1913 amendment to the United Kingdom statute intended to allow direct recovery from guarantors or sureties in the situation where the debtor's intention was to prefer them rather than the primary creditor, the general weight of opinion was that the alteration only allowed recovery against the creditor in such situations. See for example the judgment of Farwell J. in *Re Conley* [1937] 4 All E.R. 438; the decision of the Court of Appeal (Sir Wilfred Green, M.R., Clauson L.J., and Luxmoore J.) in the same case, [1938] 2 All E.R. 127, and the decision of Clauson J. in *Re Lyons; ex parte Barclays Bank Ltd v. Trustee* (1934) 152 L.T. 201.

38 The *Report of the Committee Appointed by the Attorney-General of the Commonwealth to Review the Bankruptcy Law of the Commonwealth* (1962) at para. 180, states: '. . . the English section differs materially from its Australian counterpart in that it makes the *intention* of the debtor to give a preference, and not the *fact* of preference, the crucial matter. If the reference to a surety or guarantor were not included in the English section, and it were shown that the debtor's intention was to prefer not the creditor but a surety or guarantor for the relevant debt, the payment could not be set aside as a preference. Since, under the Commonwealth section, the intention of the debtor is immaterial, it does not appear to be possible for a payment to give a preference to a surety or guarantor without at the same time giving a preference to the principal creditor.'

39 S. 453(5) provides:

Where —

(a) a disposition of property is made by a company within a period of 6 months before the commencement of the winding up of the company;

(b) the disposition of property confers a preference upon a creditor of the company; and

(c) the disposition of property has the effect of discharging an officer of the company from a liability (whether under a guarantee or otherwise and whether contingent or otherwise),

the liquidator —

legislative history of the Companies Code, the application of direct liability of guarantors only in relation to company officers makes it likely that s. 453(5) was intended as much to prohibit company officers, as fiduciaries, from benefiting themselves by virtue of their position as to prevent circumvention of insolvency regulation. This sub-section in some respects is not as effective as it might be and in other respects treats officers unfairly. As is indicated in the analysis below of the decision in *Re K.D.S. Construction Services Pty Ltd*,[40] s. 453(5) may also be avoided easily.

It is apparent that s. 453(5) only applies if there is a 'disposition of property' made by the debtor company. This is in contrast to s. 451(1) of the Companies Code and s. 122(1) of the Bankruptcy Act which focus on a wider range of transactions.[41] In this respect, s. 453(5) adopts similar terminology to s. 368(1) of the Companies Code which invalidates any 'disposition of property' made after the commencement of winding up.[42] It seems clear that a payment by a debtor company to a creditor is a 'disposition of property' in this context.[43] Section 368, for example, specifically excludes from its operation certain payments of money as 'exempt dispositions' by virtue of s. 368(1A), indicating that such payments would be included as dispositions under s. 368(1) otherwise.

It is doubtful, however, whether the expression 'disposition of property' in s. 453(5) extends to the granting of a secured interest in the company's property.[44] This means that s. 453(5) would not allow recovery from an officer where his company gives a previously unsecured creditor a mortgage or charge over its property in consideration of which the creditor discharges the officer from a liability under a guarantee. Whilst this situation is uncommon in practice, the limitation on the operation of s. 453(5) is unwarranted. There is no reason why s. 453(5) should restrict itself to dealings between the company and its creditor which amount to a 'disposition of property' and not apply in respect of any transactions which are capable of being classified as a preference.[45]

(d) in a case to which paragraph (e) does not apply — may recover from that officer an amount equal to the value of the relevant property, as the case may be; or

(e) where the liquidator has recovered from the creditor in respect of the disposition of the relevant property —

(i) an amount equal to part of the value of the relevant property; or

(ii) part of the relevant property,

may recover from that officer an amount equal to the amount by which the value of the relevant property exceeds the sum of any amounts recovered as mentioned in sub-paragraph (i) and the amount of the value of any property recovered as mentioned in sub-paragraph (ii).

40 (1986) 4 A.C.L.C. 250.

41 See n. 14 *supra* and accompanying text.

42 See also s. 121 of the Bankruptcy Act which invalidates fraudulent dispositions of property.

43 For example, a deposit of funds into a debtor's bank account, which would give rise to a chose in action, is a 'disposition of property'. See *Matthews v. Geraghty* (1986) 4 A.C.L.C. 727, 730 (*per* Bollen J.).

44 According to Helsham C.J. in Eq. in *Re Margart Pty Ltd* (1984) 2 A.C.L.C. 709, 712, a disposition of property normally connotes 'a change in the beneficial ownership of an asset by transfer or other type of dealing'. See also *Re Mal Bower's Macquarie Electrical Centre Pty Ltd* [1974] 1 N.S.W.L.R. 254. Note also that in addition to 'disposition of property', s. 122 of the Bankruptcy Act and s. 451 of the Companies Code specifically refer to 'a charge on property', a term absent in s. 453(5).

45 However, it seems authority for the proposition that the granting of a debenture is a disposition of property under the British equivalent of Companies Code s. 368 can be found in the English cases of *In re Park Ward & Co. Ltd* [1926] Ch. 828 and *Re Steane's (Bournemouth), Ltd* [1950] 1 All E.R. 21.

As is the case with s. 122 of the Bankruptcy Act, s. 453 does not apply to all dispositions which have the stated effect. It operates where the disposition to the creditor is made 'within the period of 6 months before the commencement of the winding up of the company'. Overseas experience indicates that there may be good reason for extending the preference period in the case of insiders.[46] Leaving this issue aside, the relevant period for the operation of s. 453(5) should at least be the same as applies to creditors under the general preference provision. This is not, however, the case. In some circumstances, for example where liquidation is preceded by official management, the relevant period under s. 453(5) is shorter.[47]

Under s. 453(5)(b) the disposition of property must confer a 'preference' on a creditor of the company. The requirement that a preference be conferred is somewhat ambiguous. A 'preference' conferred on the creditor for purposes of that paragraph could be either a transaction which comes within the ambit of s. 122(1) but which is protected from recovery by s. 122(2) or a transaction in respect of which recovery from the creditor under s. 122 may be accomplished because he has no defence.[48] Section 453(6) is consistent with the former interpretation. Under that provision, where the liquidator succeeds in recovering from an officer under s. 453(5) and subsequently recovers from the creditor under s. 122, the liquidator must reimburse the officer. While an officer's right to be reimbursed is dependent on the successful invalidation of the disposition *viz-à-viz* the creditor, there is nothing in s. 453(5) to indicate that the liquidator is required to take any action against the creditor at all.

The alternative interpretations of the term 'preference' in s. 453(5) were considered in *Matthews v. Geraghty*,[49] a recent decision of the South Australian Supreme Court (King C.J., Cox and Bollen JJ.). The respondents in the case, the first in Australia to apply s. 453(5), were directors of Carpet Care Pty Ltd, a company which maintained both a current account and a fully drawn advance account with the ANZ Banking Group Ltd. In November 1982, the current account had a negligible credit balance while the fully drawn advance account, upon which the respondents were liable as guarantors, was overdrawn to the extent of $10,577.40. On 11 November 1982, the company deposited approximately $21,000 into its current account, and on 15 November the bank transferred sufficient funds from the company's current account to clear the overdraft

[46] A suggested lengthening of the preference period for 'related person' creditors to two years has been mentioned by the Australian Law Reform Commission, General Insolvency Reference, in its 'Briefing Paper on Antecedent Transactions'. In this regard the Commission has had reference to similar proposals for the United Kingdom as well as enacted legislation in the United States and Canada.

[47] S. 451(2) defines the relevant date for companies which corresponds with the date of presentation of the bankruptcy petition of an individual for purposes of s. 122. In most cases the relevant date will be the commencement of winding up (see ss 365 and 393). However, where liquidation is preceded by official management, the relevant date is the commencement of the official management, which occurs on the date specified in the resolution placing the company under official management: s. 341(1). This earlier date for commencement of the preference period is one of the features designed to make official management an attractive proposition. Indeed, s. 348 gives official managers the same rights as liquidators to invalidate preferences conferred on creditors. It is not clear why official managers are not also able to recover from officers in circumstances where s. 453(5) would otherwise apply.

[48] See s. 122(2)

[49] (1986) 4 A.C.L.C. 727

on the fully drawn advance account, such transfer being effected pursuant to a 'Letter of Set-Off' which the company had previously executed.[50]

When Carpet Care Pty Ltd was placed in liquidation late in November 1982, the liquidator sought recovery of $10,577.40 from the guarantors under s. 453(5), asserting that the original deposit of $21,000 into the company's current account was a disposition of property by the company which conferred a preference upon the bank and had the effect of relieving the directors of their liability under the guarantee. The respondents did not dispute that there was a disposition of property, but they contended that s. 453(5) did not apply. The respondents argued that there was no 'preference' by asserting that the term, when used in s. 453(5), referred to a transaction which could be recovered under s. 122. Both King C.J. and Bollen J. agreed that the company did confer a preference on the bank even though the bank could have availed itself of defences to recovery under s. 122. King C.J. concluded that the term 'preference' in s. 453(5) was merely a disposition of property which gave its recipient an advantage over creditors, explaining in the following terms:

> That the word 'preference' is not used in s. 453(5) in any such compendious sense as that contended for is made clear by the fact that certain of the other elements of s. 122 of the Bankruptcy Act are reproduced in either identical or analogous terms in s. 453(5). The expression 'a disposition of property' is used as the counterpart of the description of the relevant transation used in s. 122(1). The time in which the transaction must have occurred is provided in s. 453(5) in terms which are analogous to, although not identical with, the terms of the provision in s. 122(1) . . . If the word 'preference' were intended to comprehend all the elements included in s. 122(1), there would be no need to reproduce those elements or their analogues in s. 453(5).[51]

The successful operation of s. 453(5) is also dependent on the liquidator establishing that the disposition of property conferring the preference had the effect of discharging an officer of the company from a liability.[52] The term 'officer' is broadly defined in s. 5(1).[53] It is suggested, however, that the s. 5(1) definition is inappropriate for the purposes of s. 453(5). In some respects it is too narrow. For example, s. 453(5) does not apply to former directors of a company nor to the relatives of existing or former directors. If s. 453(5) is to provide an effective disincentive to insiders attempting to manipulate their insolvent company's affairs to their advantage, the provision should cover all persons who are not at arm's length with the company.[54]

Section 453(5) also covers persons who ought not be subject to the liquidator's power of recovery. For example, a receiver and manager potentially is subject to s. 453(5). Under s. 324(1) the receiver is personally liable for certain debts

50 For an analysis of the common law rights of set-off of a bank, see *National Westminster Bank Ltd v. Halesowen Presswork & Assemblies Ltd* [1972] A.C. 785 and Herzberg, A., 'Bankers' Rights of Combination' (1982) 10 *Australian Business Law Review* 79.

51 (1986) 4 A.C.L.C. 730, 733.

52 See s. 453(5)(c).

53 See n. 5 *supra*.

54 By way of contrast, ss 453(1) and (2), which concern the purchase or disposition of any property, business or undertaking by the company within four years of the commencement of winding up, give a liquidator rights of recovery when, in the appropriate circumstances, the company disposes to or purchases from —

(a) promoters of the company, their spouses or their respective relatives;
(b) directors of the company, their spouses or their respective relatives;
(c) related corporations or the directors of such related corporations, their spouses or their respective relatives.

incurred by him in the course of the receivership. If the receiver causes the company to pay those debts and it subsequently is placed in liquidation this might attract s. 453(5)(c). The payment has the effect of discharging the receiver from the liability imposed by s. 324. The receiver could be liable under s. 453(5) to account for the payment if it was made within the relevant period and conferred a preference on the creditor who was paid. Although it could be argued that in such circumstances there is no disposition 'by the company' because the beneficial interest in the property is with the holder of the charge under which the receiver was appointed, uncertainty as to the appropriate application of s. 453(5) to such officers remains.

Section 453(5) further requires the liquidator to link paragraph (b) and (c) of that subsection. In *Matthews v. Geraghty*, this issue was raised by the respondents' denial that there was a causative link between the disposition of property (the deposits by the company to its current account) and the discharge of the company officers required of that section. According to the directors, it was the bank's transfer to the fully drawn advance account, effected without the company's knowledge, rather than the company's deposit into its current account, which operated to discharge the directors of their liability under the guarantee. This submission was not accepted by the Court. Given the directors' knowledge of the bank's rights under the set-off agreement, the two aspects of the transaction, the deposit to the current account and the transfer by the bank to the fully drawn advance account, could not be treated separately. According to Bollen J.:

> The fact that some other action by someone else is a step in the conferring and discharging does not necessarily mean that the disposition did not confer and have the effect of discharging. Here the disposition was made by the company which, through its officers, must have known the terms and effect of the Letter of Set-Off. That disposition played a significant and, indeed, an essential part in the conferring and discharging.[55]

Despite the clarification provided by *Matthews v. Geraghty*, s. 453(5)(c) still provides certain difficulties in application. For example, the section requires that the disposition of property have the effect of discharging the officer from a liability whether under a guarantee or otherwise and whether contingent or otherwise. If the decision in *Commercial Bank of Australia Ltd v. Carruthers*[56] is correct, payment of a guaranteed debt by the company discharges the guarantor from a liability to the creditor. Where, however, the guarantee is drafted so as to ensure that the guarantor is not discharged in the event of invalidation of the disposition to the creditor, s. 453(5) by definition cannot apply.

This gives rise to a curious anomaly. The creditor, being obliged to return the payment to the liquidator, can then turn to the guarantor. When the guarantor satisfies his obligations under the guarantee he is subrogated to the creditor's rights against the debtor company and may prove for the debt on its liquidation.

Contrast this with the guarantor officer's rights where s. 453(5) applies. As noted earlier, the liquidator is under no obligation to challenge the disposition to the creditor before proceeding against the officer.[57] In such cases s. 453(5)(d)

55 (1986) 4 A.C.L.C. 727, 732.

56 (1964) 82 W.N. Pt. 1 (N.S.W.) 76.

57 The liquidator may, for instance, perceive that the disposition to the creditor is protected by s. 122(2).

specifies that the liquidator may recover from the officer an amount equal to the value of the property disposed of by the company. In other words, the liquidator may recover from the officer the payment made by his company to the creditor. No provision is then made for the officer to prove for this amount in the company's liquidation. The loss is borne by the guarantor to the advantage of the other unsecured creditors. This is unfair to the guarantor officer in that he is treated more harshly in respect of this type of preferential transaction than is the case of preferences invalidated under s. 122 which merely restores the parties to their pre-preference positions.[58]

Likewise, where the liquidator takes s. 122 proceedings against the creditor but succeeds only in recovering part of the payment, s. 453(5)(e) permits him to recover the balance from the officer. Again, the officer is unable to prove for this amount in the company's liquidation.

The anomaly which s. 453(5) presents in this regard was acknowledged by King C.J. in *Matthews v. Geraghty*. In that case he remarked:

> If the bank had not been paid and the respondents had discharged their obligations under the guarantee, they would have been subrogated to the rıght of the bank to prove in the liquidation. The liquidator has chosen to sue the respondents rather than to proceed against the bank to recover the amount of the preferential payment. There may be sound reasons for that course but its consequence is that the respondents are placed in a less favourable position than if they were called upon to discharge their obligations under the guarantee.[59]

The ultimate allocation of loss between guarantor officer and creditor is governed by s. 453(6). If the liquidator recovers the payment from the officer and subsequently invalidates the disposition to the creditor, s. 453(6) entitles the officer to recover the amount he previously paid to the liquidator. The loss is borne by the creditor to the advantage of the guarantor officer. This legislative allocation of losses is curious given the fact that by entering into the guarantee it was contemplated by the parties that the ultimate responsibility for the payment of the company's debt woud lie with the guarantor, not the creditor. By way of contrast, both the United Kingdom and the United States make provision for allocation of this responsibility to the guarantor when a preference is recovered. In the United Kingdom this is accomplished through inclusion of the guarantor as a third party contributory in the recovery action against the creditor.[60] In the United States, the right of direct recovery against the guarantor facilitates the proper distribution of loss through flexible formulation of the recovery orders by the courts in their exercise of this equitable jurisdiction.[61]

Section 453(5) imposes a strict liability on the officer where it applies. Where the liquidator can establish the facts required by ss 453(5)(a), (b) and (c) he can recover from the officer. On the other hand, where the company confers a preference on an officer to which s. 122 applies, the officer has the ability to protect the preference if he can make out the s. 122(2) defences. There appears to be no reason in principle why one type of preference should be treated differently

58 See s. 122(5).
59 (1986) 4 A.C.L.C. 727, 735.
60 Companies Act 1985 (U.K.) s. 616(3), which applies to recoveries under the United Kingdom equivalent of s. 451, s. 615 of the Companies Act 1985 (U.K.).
61 See, *e.g.*, *Swarts v. Siegel* 117 F. 13 (8th Cir. 1902) and *South Falls Corporation v. Rochelle* 329 F.2d. 611 (5th Cir. 1964).

than another. An indirect preference which discharges an officer of a liability is not inherently worse than a direct preference conferred on an officer. Perhaps in recognition of this point, the Australian Law Reform Commission has tentatively proposed that any provision which would allow direct recovery by the insolvency administrator against 'related person' guarantors should apply the same 'time limits, presumptions and protective provisions' as applicable to other creditors.[62]

An analysis of the recently reported decision of the Supreme Court of Queensland in *Re K.D.S. Construction Services Pty Ltd*[63] indicates the ease with which s. 453(5) can be avoided. Section 453(5) was not at issue in that case as the relevant transactions occurred prior to the commencement of the Companies Code which brought that provision into operation. It had no counterpart under the Uniform Companies Acts.

The facts of the case are quite straightforward. The company had an overdrawn account with the National Bank of Australia. In September 1981 it deposited two cheques for $102,000 into its account which were more than sufficient to clear its overdraft and put it in credit. Subsequently, Appleton, one of the directors, drew a cheque in favour of himself and his wife for $40,000 from the company's account. The proceeds were placed in the Bank's suspense account. After the company was placed into liquidation the amount in the suspense account was applied towards satisfying Mr and Mrs Appleton's obligations to the Bank under guarantees.

The liquidator sought a declaration that the deposit of $102,000 into the overdrawn account conferred a preference on the Bank under s. 122. This applied by virtue of s. 293(1) of the Companies Act 1961-1981 (Qld).[64] The liquidator also applied to set aside as a preference the payment of the $40,000 to the Bank.

Kelly A.C.J. had no hesitation in deciding that the deposit of $102,000 conferred a preference on the Bank under s. 122(1); the 'payment' being made when the cheque was deposited not when it eventually cleared. However, the Bank was able to satisfy the Court that it was, in respect of that deposit, entitled to the protection of s. 122(2)(a).

More significantly for present purposes, Kelly A.C.J. also decided that the $40,000 paid to the Bank was also safe from the operation of s. 122. Indeed, he held that section had no operation at all in the circumstances. The $40,000 cheque once drawn and deposited into the suspense account belonged to Mr and Mrs Appleton not the company. Hence there was no 'payment' by the company to the creditor bank as required by s. 122(1). We suggest that even if s. 453(5) operated it could not apply in the circumstances. The simple expedient of an officer depositing the company's funds into his own account and then personally repaying the guaranteed debt breaks the required nexus between s. 453(5)(a) and (b); the disposition of the company's property and the conferment of a preference on the creditor.

62 Australian Law Reform Commission, General Insolvency Reference, 'Briefing Paper on Antecedent Transactions', 22.

63 (1986) 4 A.C.L.C. 250.

64 S. 451(1) of the Companies Code is the equivalent provision.

Despite this glaring defect, in appropriate circumstances there may be alternate means of recovering the payment to a director. The liquidator may be able to treat the payment as a preference conferred on the director under s. 122 rather than the creditor. In other circumstances the liquidator may be able to recover from the director on the basis of breach of fiduciary duty.

Section 453(5) has a wider application than discharge of a guarantor's liability. The provision contemplates that a disposition of property by a company may have the effect of discharging other liabilities of an officer.[65] Section 453(5)(c) does not expressly specify which other liabilities. In that the paragraph refers to the discharge of an officer's liability under a guarantee then *ejusdem generis* it would also contemplate discharge of a liability under an indemnity and indeed any situation where an officer is surety.

Clearly, in the context of guarantees, the section is attracted when the disposition of property by the company discharges the liability of the officer to the particular creditor in receipt of the disposition. Must this always be the case? If it is then, presumably s. 453(5) also has application where the company and an officer are co-sureties for a debt. Whilst repayment of a debt by one surety has the effect of discharging the co-surety's liability to the creditor, it does not release the co-surety from the right of contribution. Co-suretyship arises whenever the company and its officers share joint and several liability for a debt. The effect of repayment by the company will be to discharge the officer's liability to the creditor. For example, where the company draws a bill of exchange it is liable to the payee and any subsequent indorsers.[66] It is not uncommon where a bill has been drawn by a company to have it indorsed by its directors. Director/indorsers and the drawer are jointly and severally liable to the holder of the bill or subsequent indorsers in the event of its dishonour.[67] Accordingly, payment of the bill by the company discharges the officer of a liability and s. 453(5)(c) is satisfied.

It is interesting to speculate on the relationship between s. 453(5) and s. 556(1), which in certain circumstances renders company directors and managers jointly and severally liable with the company for debts incurred by it. This is the case where a company incurs a debt and there are reasonable grounds to expect that it will not be able to pay all its debts as and when they become due.

Assume that the company incurs a debt to a creditor in circumstances where s. 556(1) would apply. Further, assume that the repayment of the debt is guaranteed by the company's directors and that this debt is repaid in circumstances which would confer a preference on the creditor. It is arguable that the effect of the repayment of the debt is to discharge the directors from their liability under s. 556(1) and hence the operation of s. 453(5) is attracted.

Conclusion

The enactment of a specific provision applicable to guarantors benefited by a preferential transfer is clearly desirable given the interpretational difficulties

65 This is expressly provided for by s. 453(5)(c).
66 S. 60(1)(a) of the Bills of Exchange Act 1909 (Cth).
67 S. 60(2)(a) of the Bills of Exchange Act.

attendant on applying the general preference provision of s. 122 to guarantors. The only current provision which specifically addresses the preferential effect of the discharge of a guarantor, s. 453(5), pertains only to guarantors of corporate debt who are company officers. As indicated, there are numerous problems associated with s. 453(5) as presently drafted. Nevertheless, it is hoped that these deficiencies will be remedied by the Australian Law Reform Commission when it completes its reference on insolvency law. Should the regulatory scheme of s. 453(5) be accepted as both appropriate and effective, a comparable provision in the Bankruptcy Act allowing direct recovery against guarantors who arrange the preferential discharge of the guaranteed debt through their close connection with a non-corporate insolvent may also be warranted.

There are, however, other issues which are equally as important as the apparent limitations and deficiencies of s. 453(5). First, there is the policy question of whether the ultimate loss on corporate insolvency should be borne primarily by the officers or creditors. This presumably will be considered eventually by the Companies and Securities Law Review Committee as it received a long term reference from the Ministerial Council on the circumstances in which the courts should be specifically empowered to look behind the 'corporate veil'.

Second is the question of whether all parties related to an insolvent, whether it be a corporate or individual debtor, should be subjected to greater scrutiny in insolvency proceedings than is applied to arms-length creditors. The Australian Law Reform Commission is currently considering such a proposal based upon the experience in the United States and Canada.

The difficulties of regulating preferential transfers discharging corporate officers of their liability on guarantees of corporate debt are complex in themselves. The implications of the possible solutions extend beyond application to those specific transactions alone. It is hoped that the consideration of the shortcomings in the current legislative enactments discussed above may provide a useful insight into the proper responses.