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Assignment of Future Property and Preferences

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I. The Basic Problem: Equitable Protection of Assignees *versus* Protection of Creditors from Assignments

From the time of the Tudors to the present day, the courts of law and equity have sometimes supported and extended the policy of insolvency[1] statutes enforcing parity of creditors, and sometimes cut against. A strong case of the former was Lord Mansfield's extension of the rules of fraudulent preference to encompass not just acts prejudicial to a particular creditor or creditors (such as gifts or transfers at undervalue), but any diminution of the post-insolvency trust pool available to all general creditors, including discharge for value of an obligation owed to a particular creditor, which in effect displaced the statutory scheme of *pari passu* distribution.[2] A strong case of the latter, of judicial undercutting of statutory insolvency principles, is found in the protective trust, which developed as a double discretionary trust in nineteenth-century English law, in turn evolving into the asset protection trust in modern American law. Both these devices, notably the

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[1] 'Insolvency' will here be used to denote both corporate insolvency and individual bankruptcy, unless the context indicates otherwise.

[2] *Alderson v Temple* (1768) 4 Burr 2235, 98 ER 165; 1 Black W 660, 96 ER 384. See further R Goode, *Principles of Corporate Insolvency Law*, 4th edn (London, Sweet & Maxwell, 2011) 519–25, 569–97. Thus an attempt to assign all of one's assets to a trustee to hold on trust for all of the creditors could be avoided and treated as itself an act of bankruptcy, not because it delayed or hindered a particular creditor but because it attempted a composition of debts outside the regulated process of the bankruptcy laws: see M Lobban, 'Bankruptcy and Insolvency' in W Cornish et al (eds), *The Oxford History of the Laws of England Vol XII, 1820–1914: Private Law* (Oxford, Oxford University Press, 2010) 779, 780–85.

American model, impose powerful restraints on alienability and attachment not always visible to creditors and so distorting risk allocation in credit markets.[3]

My purpose in this chapter is to investigate one important flashpoint in the judicial control of insolvency policies. I examine how the equitable law of future assignments, designed to enforce paid-for promises and uphold the interests of assignees, is in tension with another 'equitable' policy established by statute, namely the jurisdiction to prevent preferential assignments that tend to defraud creditors by blocking recourse against debtors' assets.

The enforcement of assignments of future property has long been one of the most mysterious parts of Chancery jurisdiction. Such assignments are difficult to explain in rational doctrinal terms, and they also bring disturbing consequences. Future assignments can be used to give a wholly non-possessory security to a favoured creditor, who can leapfrog the general creditors to attach receivables, proceeds, after-acquired property or other future assets as they vest. Courts must balance this freedom of assignment against the statutory policies of 'preference recapture', which nullify attempts to transfer assets that serve to reduce the debtor's estate available in insolvency. The basic policy intuition is that to prefer the interests of certain assignees is to defraud the general creditors of their due: 'persons must be just before they are generous'.[4]

The enforcement of future assignments might be reconciled with statutory insolvency policy on the basis that future property assigned under equity never enters the assignor's beneficial estate, and therefore cannot justly be claimed by creditors under the general assignment in bankruptcy.[5] But this answer may not always persuade. For one, we have the counter-example of the floating charge where the after-acquired property certainly does enter the debtor's estate and can be dealt with by that debtor; yet priority can still be accorded to the assignee

[3] Lord Eldon LC early set limits on the use of trusts and charges calculated expressly to avoid credit obligations in English law: compare *Brandon v Robinson* (1811) 18 Ves Jun 429, 34 ER 379 and *Higinbotham v Holme* (1812) 19 Ves Jun 88, 34 ER 451. The policy of constraining rearrangement of priorities conditioned upon insolvency has been continued into modern English law: see, eg *Re Jeavons, ex parte Mackay* (1873) LR 8 Ch App 643 (CA); *British Eagle International Air Lines Ltd v Cie Nationale Air France* [1975] 1 WLR 758 (HL); *Swiss Bank Corp v Lloyds Bank Ltd* [1982] AC 584 (HL); *Perpetual Trustee Company v BNY Corporate Trustee Services Ltd* [2009] EWCA Civ 1160, [2010] Ch 347; *Butters v BBC Worldwide Ltd* [2009] EWHC 1954 (Ch); criticised for applying the *pari passu* principle outside true insolvency contexts in L C Ho, 'The principle against divestiture and the pari passu fallacy' (2010) 25 *Butterworths Journal of International Banking and Financial Law* 3. The *Quistclose* trust arguably cuts across this entire policy, and is accordingly controversial: see R Stevens, 'Insolvency', in W Swadling (ed), *The Quistclose Trust: Critical Essays* (Oxford, Hart Publishing, 2004) 153. American courts by contrast burst constraints on insolvency-triggered trust arrangements from the later nineteenth century: see J Getzler, 'Transplantation and Mutation in Anglo-American Trust Law' (2009) 10 *Theoretical Inquiries in Law* 355. The wider problem of judgment proofing in America is set out in L LoPucki, 'The Death of Liability' (1996) 106 *Yale Law Journal* 1.

[4] *Freeman v Pope* (1870) LR 5 Ch App 538 (CA) 540 (Lord Hatherley LC). See further below, text following note 61, where this quotation is explained.

[5] A rule evolved by the common law courts, taking cognisance of equitable trusts and assignments in interpreting the operation of statutory assignment under the bankruptcy law: *Scott v Surman* (1742) Willes 400, 402; 125 ER 1235, 1236 (Willes CJ).

upon insolvency, attaching to new and circulating assets upon a triggering event.[6] A variant is *post facto* collateralisation of extant debt, where assets that may already have been in the control of the debtor when credit was extended are later subjected to a security in order to guarantee an already-contracted debt, again reducing the assets available to general creditors. But we need not turn to these elaborations of the genus to explore the basic problem, which is the potential of the most simple future assignments to create non-possessory securities disrupting just credit expectations. A survey of English and especially Australian equity, from the days of the early High Court to the present, richly demonstrates the contours of this recurrent problem. The Australian materials turn out to be especially intricate, for overlaying the basic problem of assignment versus preference recapture, we have a spectrum of statutory preference tests emerging from variant federal and state laws governing the related areas of bankruptcy, near-bankruptcy and insolvency. The legislative variances have further impeded the courts in their struggle to find consistent answers to the basic problem.

The insolvency statutes draw deeply from equitable concepts of fraud, and they in turn have been interpreted extensively by judges using equitable ideas.[7] But before we examine how statutory jurisdiction interacts with equitable assignments, we had better establish what those assignments might be.

II. The Operation of Equitable Assignment

A good example of the phenomenon of assignment re-ordering normal priorities is found in *Holroyd v Marshall*,[8] the very decision that established the modern doctrine of assignment of future interests in 1862. In that case a creditor, Holroyd, extended payment to one Taylor, a mill owner, on condition that Taylor should sell his mill inventory to a trustee nominated by Holroyd who would hold it as security and sell it should Taylor be unable to find money to pay off the debt. A further clause of the loan stated that Taylor would assign any further machinery or implements brought into his milling operation so as to add to the security held on trust for sale. Taylor acquired new machinery, and also contracted further unsecured debt, with the new creditors being made aware of Holroyd's security (described in the case sometimes as an 'assignment', sometimes as an 'equitable

[6] See the essays in J Getzler and J Payne (eds), *Company Charges: Spectrum and Beyond* (Oxford, Oxford University Press, 2006).

[7] For a modern survey covering much of preference rules in bankruptcy as well as corporate insolvency, but with a predominantly English focus, see H Bennett and J Armour (eds), *Vulnerable Transactions in Corporate Insolvency* (Oxford, Hart Publishing, 2007). The tangle of Australian statutory instruments before the Corporations Act 2001 (Cth) is dissected in J Edelman, 'The Meaning of Fraud in Insolvency and Bankruptcy: A 400 Year Old Riddle' (2000) 18 *Company and Securities Law Journal* 97.

[8] *Holroyd v Marshall* (1862) 10 HLC 191, 11 ER 999. The best exegesis remains J Keeler, 'Some Reflections on Holroyd v Marshall' (1967–70) 3 *Adelaide Law Review* 360, 468.

charge', most commonly as a 'mortgage', though a modern lawyer would distinguish these concepts).[9] Taylor could not pay his debts; the new creditors then executed judgment, and through Marshall sought to take over the new machinery to recover their judgment debts. Holroyd sued Marshall to assert a prior claim to the after-acquired machinery. Stuart V-C thought that the original assignment was effective to vest Holroyd (through the trustee) with a superior beneficial title, but Lord Campbell LC held that some further assurance was necessary by Taylor to convey an equitable right, and that the judgment creditors should prevail on the common law principle that they had been the first to levy judgment. As counsel for Marshall argued in the further appeal, the general creditors had won the race to the courtroom door, before the assignees had perfected Holroyd's title, so that Holroyd had only a personal equity against Taylor for the assurance of the future property, and this could not bind third parties unless some act of conveyance had occurred on vesting. The fact that the judgment debtors had notice of the prior assignment of future property did not affect the imperfect and merely personal nature of that assignment; on this interpretation the assurance really amounted to a power that had not yet been exercised. The House of Lords reinstated the judgment in Holroyd's favour and, as is well known, Lord Westbury explained the basis of Holroyd's right in terms of the equitable enforcement of a contractual assignment supported by valuable consideration where the contract is 'one of that class of which a Court of Equity would decree the specific performance'.[10] The logic seemed to be that because the contract was capable of specific performance this grounded an instant conveyance of an equitable title once future property had vested in the assignee; no further intervention such as an act of conveyance or assurance was therefore necessary. Lord Chelmsford's judgment did not dwell on the availability of specific performance but rather on the intention of the parties to effect the assurance, and it was this analysis that was expanded and supported in Lord Macnaghten's leading judgment in *Tailby v Official Receiver* in 1888.[11] In that House of Lords case an assignment of existing and future book debts was upheld on the basis that the contract for value had sufficiently identified the subject matter of the assurance and that the parties' intention to effect a transfer immediately on vesting of the future debts was clearly expressed. Lord Macnaghten made clear that the basis of the doctrine was 'the principle that equity considers that done which ought to be done'; the availability of specific performance of the terms of the contract was only a subset or adjunct of that broader principle, and not a

[9] See P Turner, 'Company Charges: Inflexible Interplay of Law and Equity?' (2006) 22 *Journal of Contract Law* 16; for a fuller treatment of securities in land and non-real assets see B McFarlane, *The Structure of Property Law* (Oxford, Hart Publishing, 2008) 582–642, 785–835. In the case of *Associated Alloys v ACN 001 452 106 Pty Ltd* [2000] HCA 25, (2000) 202 CLR 588 it was essential to distinguish a charge over proceeds from a trust assigning proceeds as the former device would be void without registration; the plurality judges (at [6]) made the point that equitable powers over an asset arising under a charge are circumscribed by the essential nature of the institution as a security, whilst an assignment operating as a trust is not so confined.

[10] *Holroyd* (n 8) 209, 1006.

[11] *Tailby v Official Receiver* (1888) LR 13 App Cas 523.

special condition for equitable enforcement of an assurance as Lord Westbury's *Holroyd* judgment might have implied.[12]

This wider approach to equitable enforcement of rights derived from contract has been emphasised by the modern High Court of Australia, for example in *Chan v Cresdon Pty Ltd*,[13] where the majority stated:

> [T]he references in the earlier cases to specific performance should be understood in the sense of Sir Frederick Jordan's explanation adopted by Deane and Dawson JJ in *Stern v McArthur*:[14]
>
> 'Specific performance in this sense means not merely specific performance in the primary sense of the enforcing of an executory contract by compelling the execution of an assurance to complete it, but also the protection by injunction or otherwise *of rights acquired under a contract which defines the rights of the parties*': ... Chapters on Equity in New South Wales, Select Legal Papers, 6th ed (1947), p 52, n(e).[15]

Meagher JA writing both *ex curia*[16] and *in banco*[17] has stringently criticised the High Court's acceptance of 'Sir Frederick Jordan's footnote' on the basis that it is too wide in its understanding of how equitable interests beyond the contract and binding third parties can be generated by a bargain to convey; there may be contingencies or conditions for the hardening of the equitable right, such as third party consents, or formality requirements, or identification and gathering of assets, or complete execution of the consideration, that must be met before a full interest persisting against third parties can vest, and it is impossible to see how the strong equitable protection of agreements to convey suggested by Jordan CJ's note would operate in such contingent transfers. There is also a question whether Jordan CJ was stating at large how equity enforces assurances for value, whether present or future interests, or was confusing the language of future assignments capable of specific performance found in *Holroyd* and applying it too widely. Meagher JA noted[18] that equity may in many instances recognise a personal chose amounting to a power to require steps to be taken to perfect a transfer, without giving a proprietary claim, or even a full right to specific performance, tracking the analysis of interests under an unadministered estate found in *Commissioner of Stamp Duties v Livingston*.[19] Such an interpretation, applied to contractual examples such as estate contracts and assignments of future interests, would allow

[12] Ibid 545–51.

[13] *Chan v Cresdon Pty Ltd* (1989) 168 CLR 242 (HCA).

[14] *Stern v McArthur* (1988) 165 CLR 489 (HCA) 522.

[15] *Chan* (n 13) 253 (Mason CJ, Brennan, Deane and McHugh JJ) (emphasis added). The High Court also adopted the theory of Jordan CJ in two earlier cases: *Hewett v Court* (1983) 149 CLR 639 (HCA) and *Legione v Hately* (1983) 152 CLR 406 (HCA).

[16] R Meagher, 'Sir Frederick Jordan's Footnote' (1999) 15 *Journal of Contract Law* 1. See also R Meagher, D Heydon and M Leeming, *Meagher, Gummow & Lehane's Equity: Doctrine and Remedies*, 4th edn (Chatswood, Butterworths LexisNexis, 2002) paras [7–150]–[7–195].

[17] *Chief Commissioner of Stamp Duties v ISPT Pty Ltd* (1998) 45 NSWLR 639 (NSWCA) 654–55 (Meagher JA).

[18] Meagher, 'Sir Frederick Jordan's Footnote' (n 16).

[19] *Commissioner of Stamp Duties v Livingston* [1965] AC 694 (PC).

a more discriminating approach to the timing and priority of such interests and their defeasibility, should the underlying contract founder; the specific performance base by contrast suggests all-or-nothing enforcement of the contract on its terms. The power concept of an incomplete interest under an executory conveyance also helps explain equitable forfeiture for breach of contractual condition: dealing with such an instance in *Tanwar Enterprises Pty Ltd v Cauchi* the High Court in 2003 ventured a hesitant *obiter dictum* siding with Meagher JA against Jordan CJ's analysis:

> In the New South Wales Court of Appeal, doubt since has been cast upon the support for any such general principle by the authorities cited by Sir Frederick Jordan, beginning with *Tailby v Official Receiver*. It is sufficient for present purposes to observe that, where the issue, as in Tanwar's appeal, concerns alleged unconscientious reliance by vendors upon their contractual right to terminate, it does not assist to found the equity of the purchaser upon the protection of rights to injunctive relief acquired under a contract the termination of which has taken place. Whilst the contracts here were on foot, breach thereof by the vendors would have been restrained. But there was no relevant breach of contract by the vendors, and the contracts were terminated in exercise of a contractual right to do so.[20]

If this negates the Jordan analysis, what can be put in its place? One path to help conceptualise the doctrine (or doctrines) of *Holroyd* and *Tailby* is to contrast assignments of future interests for value with equitable enforcement of gifts. Equity will not perfect an imperfect gift unless steps have been taken tantamount to a positive commitment to make the assurance absent some further negative intervention (so that everything *necessary*—read *sufficient*—to be done by the donor has been done, even if a *locus poenitentiae* remains). Where the assurance of a future or unascertained asset is supported by a valuable consideration that has been fully executed, however, that commitment to convey is embodied in the paid-for bargain *per se*, not in any executed steps to convey the property, which of course is impossible prior to vesting or identification. Because one side has given full value, for example by payment over of loan monies, equity will therefore bestow on that value-giver a power to ensure the other side reciprocates, and does not exploit the futurity of the promised benefit to renege on the promise.[21] Here equity sees a kind of irrevocable floating trust or trust power over the assets of the assignor as they presently stand being constituted via the agreement,[22] with

[20] *Tanwar Enterprises Pty Ltd v Cauchi* [2003] HCA 57, (2003) 217 CLR 315 [57] (footnotes omitted).

[21] S Gardner, *An Introduction to the Law of Trusts,* 3rd edn (Oxford, Oxford University Press, 2011) 325–27.

[22] *Gomez v Graham* (1743) 9 Mod 287, 88 ER 457; *Stuart v Tucker* (1777) 2 Black W 1137, 96 ER 671; discussed in M Leeming, 'What is a Trust?' (2008) 31 *Australian Bar Review* 211, 218–19. This analysis is afforced by the possibility that trusts can effect a transfer of the enjoyment of contractual benefits subject to anti-assignment clauses, underlining the fact that entrustment is not equivalent to assignment: see *Barbados Trust Company Ltd v Bank of Zambia* [2007] EWCA Civ 148, [2007] 1 Lloyd's Rep 495; *Don King Productions Inc v Warren* [2000] Ch 291 (CA); A Trukhtanov, 'Trust of a Non-Assignable Contractual Benefit' (2007) 70 *MLR* 848; P Turner, 'Trusts of Debts of Restricted Assignability' [2008] *CLJ* 23.

the equity waiting to descend on the specified property once it vests in the estate or is identified from within the estate. In a wonderful phrase, Pollock CB labelled such an interest 'a prophetic conveyance'.[23] It is a more powerful equity than that frailer type evoked by a right to insist on specific performance, which is engaged on different grounds and does not depend on executed consideration.[24]

III. Future Assignments and the Problem of Non-Possessory Security

There are many other areas in our law beyond the *Holroyd v Marshall* equity where non-possessory interests may be created by agreement on terms that can disturb third-party credit risk and displace priorities. At common law, reproduced in the sale of goods legislation, documentary sale of chattels allowed title to shift ahead of factual possession;[25] the factual control of the vendor could then mislead rival creditors assessing the vendor's credit risk, amounting to a representation of reputed ownership.[26] In equity the *Lysaght v Edwards*[27] or *Walsh v Lonsdale*[28] doctrine or doctrines shifting a beneficial interest on perfection of an estate contract can have a similar effect; here the specific performance base of the right makes good sense as land interests are each unique.[29] Perhaps the strongest example is floating charge security over corporate assets. These securities were

[23] *Belding v Reed* (1865) 3 H & C 955, 961; 159 ER 812, 814.

[24] *Federal Commissioner of Taxation v Everett* (1980) 143 CLR 440 (HCA) 450–51. For a like argument basing the 'estate contract' trust on fully executed consideration see N Hopkins, 'Acquiring Property Rights from Uncompleted Sales of Land' (1998) 61 *MLR* 486. The case of non-bargain assignments is rather different: see *Norman v Federal Commissioner of Taxation* (1963) 109 CLR 9 (HCA); *Shepherd v Federal Commissioner of Taxation* (1965) 113 CLR 385 (HCA); *Olsson v Dyson* (1969) 120 CLR 365 (HCA).

[25] See, eg *Dennant v Skinner* [1948] 2 KB 164 (KBD); *Sirius Shipping Corporation v The Ship Sunrise* [2006] NSWSC 398; Sale of Goods Act 1979, s 18 r 1 (Eng).

[26] It is no surprise that in the later nineteenth century commercial judges and legislatures aiming to promote a more complex sales law worked together to largely uproot the reputed ownership doctrine: see especially *Re Stockton Iron Furnace Company* (1879) 10 Ch D 335 and *Re Crumlin Viaduct Works Company* (1879) 11 Ch D 755, both decisions of Jessel MR; and *Gorringe v Irwell India Rubber and Gutta Percha Works* (1885) 34 Ch D 128 (CA); see further J Getzler, 'The Role of Security over Future and Circulating Capital: Evidence from the British Economy circa 1850–1920', in Getzler and Payne, *Company Charges* (n 6) 227–51.

[27] *Lysaght v Edwards* (1876) 2 Ch D 499 (ChD).

[28] *Walsh v Lonsdale* (1882) 21 Ch D 9 (CA).

[29] The nature of such interests in land as something less than a full beneficial estate under a trust is discussed in *Chang v Registrar of Titles* (1976) 137 CLR 177 (HCA) 184 (Mason J); *Chan* (n 13) 250–58 (Mason CJ, Brennan, Deane and McHugh JJ); *Tanwar* (n 20); *Jerome v Kelly (Inspector of Taxes)* [2004] UKHL 25, [2004] 1 WLR 1409 [31] (Lord Walker); S Gardner, 'Equity, Estate Contracts and the Judicature Acts: *Walsh v Lonsdale* Revisited' (1987) 7 *OJLS* 60; N Hopkins, 'Acquiring Property Rights' (n 24). Chambers argues that the equity arises from the uniqueness of the property rather than equitable doctrine of consideration. Swadling in contrast has argued that even in a land context specific performance should not have third party implications and constructive trust language should be expelled; and he explicitly rejects the alternative paid consideration theory: see R Chambers, 'The Importance of

recognised in the late nineteenth century, and were promoted with alacrity by Sir George Jessel MR. Such devices swiftly became a dominating presence in corporate finance, attractive because of the strong receivership powers afforded to banks and other lenders. In form they were a hybridisation of future assignments, overlapping charges and powers of the possessor-debtor to deal in the present assets, and it quickly became clear that these devices exacerbated the problem of hidden securities disrupting credit assessment and risk in trade, leading over time to legislative redistribution of assets otherwise subject to security, in order to pay preferred debts and meet some of the unsecured debts and liquidation costs.[30]

Equity's permissiveness in allowing secret conveyances and securities had long troubled the common lawyers,[31] but the exuberant development of hidden securities and assignments by the equity courts of the late nineteenth century provoked outrage in the trading communities, and even opposition amongst some of the senior judges,[32] leading to Parliament introducing a raft of registration requirements, touching *inter alia* assignments of book debts, bills of sale and company charges, and adding to existing formality and notice requirements imposed by Parliament since the original Statute of Frauds.[33] But the legislative overlay did not dispel the sense of policy disquiet in the courts as they were called upon to enforce ever more elaborate non-possessory securities. The dilemma can be modelled as a three-way choice of strategies for the control of secured credit, as John Armour has recently suggested.[34] Should lawmakers restrict the types of instrument that can be deployed, curbing freedom of contract? Or apply a remedial regime of selective enforcement, as where equity courts will allow a bona fide purchaser for value without notice to defeat prior securities? Or should legislatures enforce formal notice and registration requirements, which combine the policies of channelling security interests into a manageable *numerus clausus* and ensuring that contracting parties have knowledge of rival claims when assessing credit risk? The current destabilised world of securitisations and derivatives presents these

Specific Performance', and W Swadling, 'The Vendor-Purchaser Constructive Trust' both in S Degeling and J Edelman (eds), *Equity in Commercial Law* (Sydney, LawBook Co, 2005) 431, 463.

[30] See J Armour, 'Should We Redistribute in Insolvency?' in Getzler and Payne (n 6) 189–225, and other essays in that collection.

[31] See, eg 'Thomas Audley's Reading on Uses (1526)' in JH Baker, *Baker and Milsom's Sources of English Legal History: Private Law to 1750*, 2nd edn (Oxford, Oxford University Press, 2010) 118–19.

[32] Notably Lord Herschell in *Saloman v Saloman & Co Ltd* [1897] AC 22, 41–47 (HL), as to which see P Johnson, *Making the Market: Victorian Origins of Corporate Capitalism* (Cambridge, Cambridge University Press, 2010) 153–59.

[33] For the Statute of Frauds as a surrogate or evasion of a registration system, see P Hamburger, 'The Conveyancing Purposes of the Statute of Frauds' (1983) 27 *American Journal of Legal History* 354. For the politics of land registration see A Offer, *Property and Politics 1870–1914: Landownership, Law, Ideology and Urban Development in England* (Cambridge, Cambridge University Press, 1981); cf S Anderson's critique of Offer's rent-seeking thesis in *Lawyers and the Making of English Land Law, 1832–1940* (Oxford, Oxford University Press, 1992). Offer replies to Anderson in 'Lawyers and Land Law Revisited' (1994) 14 *OJLS* 269.

[34] See J Armour, 'The Law and Economics Debate About Secured Lending: Lessons for European Lawmaking?' (2008) 5 *European Company and Financial Law Review* 3.

dilemmas most sharply, but we can also see the same policy tensions at work in the seedbed English cases of the late nineteenth century.

Just one case, being a *locus classicus* of the post-*Holroyd* law of equitable assignment, will illustrate some of that basic tension between facilitating security transactions and protecting creditor interests. In *Re Lind* a contingent heir executed two mortgages over his expectancy.[35] He then went bankrupt, and in due course received his discharge, ending all extant contractual rights and duties proved in the bankruptcy. The mortgagees had not proved their claims in the bankrupt estate. Post-discharge the heir once more assigned his expectancy for value to a fresh creditor, and when the expectancy was realised executed a further assignment purporting to transfer the present interest to that same later creditor. The prior mortgagees then claimed the estate, and won in the Court of Appeal. Phillimore LJ stated the operative law in terms rejecting the specific performance model of Lord Westbury in *Holroyd v Marshall*, and preferring the trust or equitable charge model of Lord Chelmsford in that case:

> If the assurance rest in contract and if by consequence the only way in which equity fastens upon the property be by the operation of the doctrine of specific performance, then the liability under the contract would be, as it seems to me, discharged by bankruptcy….
>
> In order that the assignment may survive and have its effect it must give to the assignee something more than a mere right in contract, something in the nature of an estate or interest … notwithstanding … allusions to the doctrine of specific performance of contracts, it is I think well and long settled that the right of the assignee is a higher right than the right to have specific performance of a contract, that the assignment creates an equitable charge which arises immediately upon the property coming into existence. Either then no further act of assurance from the assignor is required, or if there be something necessary to be done by him to pass the legal estate or complete the title, he has to do it not by reason of a covenant for further assurance the persistence of which through bankruptcy it is unnecessary to discuss, but because it is due from him as trustee for his assignee.[36]

All of this supported the approach of Lord Macnaghten in *Tailby*; equity created a 'higher right' to the security emerging from the contract but not identical to it. But Phillimore LJ also noted that in *Collyer v Isaacs* in 1881 a strong Court of Appeal led by Jessel MR had held that a discharge from bankruptcy gave the debtor a fresh start including discharge of covenants to assign future property;[37] and overall Phillimore LJ seemed to prefer Jessel's logic in *Collyer* but felt bound by the House of Lords

[35] *Re Lind* [1915] 2 Ch 345 (CA).

[36] Ibid 365–66 (Phillimore LJ).

[37] *Collyer v Isaacs* (1881) 19 Ch D 342 (CA). See also *Ex parte Nicholls* (1883) 22 Ch D 782 (CA) 786–87 (Jessel MR), stating that an assignment of future profits as a chose in action has those profits as they accrue vest in the trustee or assignee in bankruptcy, and do not go to the original assignee of the chose; this stream of authority is explored in M Smith, *The Law of Assignment: The Creation and Transfer of Choses in Action* (Oxford, Oxford University Press, 2007) 400–04, but without making reference to the alternative and dominant stream headed by *Tailby* and *Lind*.

decision in *Tailby*. Indeed Phillimore LJ seemed to affirm the *Tailby* doctrine through clenched teeth, concluding his judgment with these reflections:

> I do not understand an assignment which at the time only operates as a contract, but when the property comes into possession operates without more as an actual assurance; and even if this were intelligible I do not understand why in its chrysalis state it is not subject to the laws of a chrysalis, why, being still only a contract, it is not discharged by a discharge of contracts. And I may add that I think it would be better as matter of public policy that all assignments of bare futurities were made impossible. But the law is settled in the other sense by the highest authority…[38]

The rival doctrine of *Collyer v Isaacs* had already been sidestepped in nineteenth century cases where a covenant to assign future property in a family will or settlement had been followed by the bankruptcy of the settlor.[39] *Re Lind* was important because the same doctrine was extended into general credit relations in the commercial economy, and in effect overruled or displaced *Collyer* entirely.[40] It establishes that a future assignment survives and remains operative after the discharge of the founding contract, and so is apt to establish priority over the future property when it vests by attaching an equitable interest independent of the agreement constituting the interest and taking effect outside the promisor's estate. But the nature of the equitable interest that effects this magic still escapes rational explanation, with commentators resorting to opaque metaphors such as 'inchoate interests' and 'empty funds'.[41] It seems to work in practice but not in theory; and Phillimore LJ in *Re Lind* was not the only judge to doubt that it worked well at all.[42]

IV. Preference Recapture and 'Intention to Defraud'

The law of assignments was developed against the backdrop of older laws governing avoidance of fraudulent preferences, or 'preference recapture' in the phrase of

[38] *Lind* (n 35) 368 (Phillimore LJ).

[39] Notably in *Robinson v Ommanney* (1882) 21 Ch D 780 (Kay J), following the older case of *Lyde v Mynn* (1833) 1 Myl & K 683, 39 ER 839 (Lord Brougham LC).

[40] *Lind* (n 35) 375 (Bankes LJ).

[41] See, eg L Gullifer and J Payne, *Corporate Finance Law: Principles and Policy* (Oxford, Hart Publishing, 2011) 237–39. The applicability of the fund concept to assignment of intangibles including future rights is defended in R Goode, 'Are Intangible Assets Fungible?' [2003] *Lloyd's Maritime and Commercial Law Quarterly* 379; R Nolan, 'Property in a Fund' (2004) 120 *LQR* 108. For doubts concerning fund analysis see D Sheehan, 'Property in a Fund, Tracing and Unjust Enrichment' (2010) 4 *Journal of Equity* 225

[42] For example in *Re Wait* [1927] 1 Ch 606 (CA), in the context of a contract to sell goods only partly ascertained, Atkin LJ (at 634) found that criticism of the specific performance theory of equitable assignment set out in *Holroyd* 'seems well founded and weakens its authority'; and further doubted (at 638) the alternative consideration theory: 'Similarly, I fail to see how the payment of the price can convert that which was not an equitable assignment before the payment, into an equitable assignment after the payment'. In *Re Goldcorp Exchange Ltd (in receivership)* [1995] 1 AC 74 (PC) 90 the Privy Council referred to 'the reasoning contained in the judgment of Atkin LJ [in R*e Wait*], which their Lordships venture to find irresistible'.

some modern courts.[43] The jurisdiction to avoid fraudulent preferences forms a key part of the modern system of bankruptcy and insolvency law.[44] It may be seen as a sister doctrine to the basic equitable jurisdiction to avoid contracts for fraud, as where a person dishonestly misrepresents some material fact in order to win an asset which is then sold on to another innocent party.[45] The difference is that the fraudulent preference relates to the pool of assets that would be available to a creditor or creditors on a distribution, not particular assets. Preference recapture has generated a complex and contradictory body of doctrine, which is not surprising when we see how the jurisdiction was constructed over five centuries or more, from a bewildering array of sources. The unwieldy historical rules and procedures are contained in a variety of statutory instruments and a sprawling case law, which is particularly bewildering in federalised Australia;[46] yet America's uniform commercial and bankruptcy laws and the operation of the federal insolvency jurisdiction suggests that cross-federal codification is not a panacea.

The origins of the preference laws lie in some rather simple and elegant texts of classical Roman law. The *actio Pauliana* nullified voluntary transactions or transactions at undervalue to family or friends which defrauded creditors of recourse against the debtor's assets.[47] Later Civilian law developed the reputed ownership doctrine making assets available to creditors where the true owner had represented that a debtor through possession had those assets under his control or within his patrimony and had so helped him to gain extensions or expansions of credit; this was a kind of estoppel preventing the owner from denying the title of the possessor due to the debtor's justified reliance. The two strategies of avoiding preferences and enforcing reputed ownerships could coincide, as where a person sold an asset secretly to a preferred creditor or associate whilst keeping the possession in order to maintain or advance credit relationships with others. Here both doctrines operated in tandem to return or vest the *dominium* of the asset in the debtor's estate so as to be available to the general creditors who could reasonably presume access.

[43] Eg *Ferrier and Knight (As Liquidators of Compass Airlines Pty Limited (In Liq)) v Civil Aviation Authority* (1994) 55 FCR 28 (FCA) 42–63 ('*Compass Airlines*'), reversed on the facts by majority in *Airservices Australia v Ferrier* (1996) 185 CLR 483 (HCA).

[44] See further D Baird, 'Fraudulent Conveyance', in *The New Palgrave Dictionary of Law and Economics* (London, Macmillan, 1998) II, 192; D Baird and T Jackson, 'Fraudulent Conveyance Law and its Proper Domain' (1985) 38 *Vanderbilt Law Review* 829; H Bennett and J Armour (eds), *Vulnerable Transactions in Corporate Insolvency* (n 7) especially chs 3–4, 7–8.

[45] *Small v Attwood* (1831) Younge 407, 159 ER 1051 is an example of how ordinary equitable fraud can resemble fraudulent preference.

[46] See the impressive Australian Law Reform Commission paper: *General insolvency inquiry* (ALRC 45, 1988), available at http://www.austlii.edu.au/au/other/alrc/publications/reports/45/ accessed 17 June 2011.

[47] D.42.8.1.–25, D.22.1.38.4; the surrounding sources are summarised in M Radin, 'Fraudulent Conveyances at Roman Law' (1931) 18 *Virginia Law Review* 109. The name '*actio Pauliana*' is post-classical, possibly a glossatorian interpolation; for an outline of the content of the *actio* see W Buckland, *A Textbook of Roman Law from Augustus to Justinian*, 3rd edn, revised P Stein (Cambridge, Cambridge University Press, 1966) 596.

The twin doctrines of voidable preferences and reputed ownerships circulated in the early court of Chancery and the commissions of bankruptcy as species of fraud and estoppel, with Scottish law as a possible bridge moving ideas between the Continental and English law. The reputed ownership doctrine was set out by the statute 21 Jac 1, c 19 (1623–24), probably codifying existing curial practice. A version of the preference doctrine was legislated as early as 1376 and 1379,[48] but its modern incarnation is found in the 1571 Statute of Elizabeth, the famous 13 Eliz 1, c 5, extended by 27 Eliz 1, c 4 in 1585, then reiterated in James's first bankruptcy statute of 1601, 1 Jac 1, c 15, and repeated and adapted in many statutes to follow over the next four centuries.[49] Each statute used slightly different language to define the triggering conduct for preference avoidance, as many judges have noted to their dismay in the reams of litigation that followed. The 1585 statute seemed to go well beyond its 1571 predecessor, stating that any attempt to reduce an estate in order to hide assets from creditors could be avoided, even for example where the assignment preceded the contracting of the debt. This left a question of measuring the requisite level of intention necessary to characterise a preference as fraudulent. The original 1571 Statute of Elizabeth allows any conveyance of property made for 'the purpose of delaying, hindering or defrauding creditors' to be avoided by any person thereby prejudiced, subject to a defence of bona fide purchase for value that could be raised by the assignee. As Parliaments have reiterated the words 'for the purpose of' with variants such as 'with intent', 'with a view to', 'with real intent', 'the main purpose', or, with maximal baroque expansiveness, 'to the intent or whereby his creditors shall or may be defeated or delayed', courts have struggled through numerous cases to define the necessary mental element on the debtor's part in making such an undue preference, drawing on parallel equitable doctrines of fraud in a search for principle. A jurisprudence developed exempting involuntary payments on the part of the debtor from the sweep of preference controls, together with a defence of bona fide purchase on the part of the favoured creditor. As a corollary, payments in the 'ordinary course of business' or in the ordinary maintenance of family were not 'voluntary' preferences and did not compromise the good faith of the assignee; and in reverse extraordinary transactions by a near-insolvent trader or company would fix the transferee with notice and impugn the transaction. Legislation in jurisdictions including the USA and Australia later hardened the uncodified position and made it a stipulation that a transaction for value in the run up to insolvency must be in the 'ordinary

[48] 50 Edw 3, c 6; 2 Ric 2, st 2 c 3.

[49] For exhaustive history of the older law see W Roberts, *A Treatise on the Construction of the Statutes 13 Eliz c.5. and 27 Eliz. c.4. relating to Voluntary and Fraudulent Conveyances, and on the nature and force of different considerations to support deeds and other legal instruments, on the Courts of Law and Equity* (London, Butterworth, 1800); S Worthington, *May on Fraudulent Conveyances*, 2nd edn (London, Stevens and Haynes, 1887). A fresh view of eighteenth century developments is found in E Kadens, 'The Last Bankrupt Hanged: Balancing Incentives in the Development of Bankruptcy Law' (2010) 59 *Duke Law Journal* 1229, and of nineteenth century developments in Lobban, 'Bankruptcy and Insolvency', (n 2).

course of business', thus converting a form of evidence tending to negate intention to voluntarily prefer into a substitute test.[50]

The judges in interpreting and applying these statutes seemed to regard them as re-enactments of a much older inherent curial jurisdiction to regulate insolvencies; but the statutes could in turn provoke new departures. In the 1749 case of *Ryall v Rolle* it was held that the reputed ownership doctrine could apply beyond corporeal choses in possession and embraced fractional and incorporeal interests left in a debtor's control,[51] and moreover that the bona fides of a purchaser who had left a vendor in possession after the sale did not bar the claim. Another important curial augmentation, mentioned earlier, came with Lord Mansfield from the late 1760s, who developed the doctrine that conveyances that had the purpose of disturbing the ordained statutory scheme of *pari passu* distribution could be avoided as an undue preference, even if the transaction was supported by consideration and even if made precedent to an act of bankruptcy. Whether this extension of preference recapture used the same concepts of *mens rea* as in a direct statutory fraudulent preference was contested; some judges used a presumptive fraud analysis, others a strict liability approach based on the effect of the transaction. Lord Mansfield's concept of presumptive fraud based on the equity of the statute was then reflexively codified in legislation separate from the original Elizabethan legislative root-stock.[52] The requisite mind state triggering avoidance under this statutory jurisdiction was especially contested; for many judges the *actus reus* was enough to presume a *mens rea*, but the search for a *mens rea* element seemed to intensify and converge with the older dishonesty requirements, when the making of such a voidable preference came to be classified itself as an independent act of bankruptcy triggering statutory assignment to an official trustee in bankruptcy.[53]

[50] *Taylor v White* (1964) 110 CLR 129 (HCA); *Harkness v Partnership Pacific Ltd* (1997) 41 NSWLR 204 (NSWCA). For comparison of the statutory 'ordinary course' tests see G McCormack, 'Swelling Corporate Assets: Changing what is on the menu' (2006) 6 *Journal of Corporate Law Studies* 39; A Keay, 'The Avoidance of Pre-Liquidation Transactions: An Anglo-Australian Comparison' [1998] *Journal of Business Law* 515.

[51] *Ryall v Rolle (Rowles)* (1749) 1 Atk 165, 26 ER 107; Ves Sen 165, 28 ER 490 (Lord Hardwicke LC); see J Getzler and M Macnair, 'The Firm as an Entity before the Companies Acts', in P Brand, K Costello and WN Osborough (eds), *Adventures of the Law* (Dublin, Four Courts Press, 2005) 267, 275–76; also available at http://ssrn.com/abstract=941231 accessed 17 June 2011.

[52] The passage of the English bankruptcy laws was tortuous, as Lobban (n 2), has shown. For our purposes the key legislation begins with the English Bankruptcy Act 1824 ss 3, 8, 108, 122, and culminates in the Bankruptcy Act 1861 s 70 and the Bankruptcy Act 1883 ss 4(1), 29, 47–49 (reproduced and enlarged in New South Wales by the Bankruptcy Act 1861 (NSW) ss 1–2 and the Bankruptcy Act 1887 (NSW) ss 4, 51, 54–56).

[53] The history of distributions and preferences counting as acts of bankruptcy under nineteenth century statutes was traced in *Williams v Official Assignee of the Estate of William Dunn* (1908) 6 CLR 425 (HCA) 432–42 by Griffith CJ; and the history of judicial interpretation from the time of Lord Mansfield was laid out by Kitto J in *Taylor v White* (1964) 110 CLR 129 (HCA) 142–46. Twentieth century developments were analysed in *Robert Reid Pty Ltd v Cassidy* (1966) 114 CLR 558 (HCA), with Taylor J and Windeyer J taking an expansive view embracing all transfers of value, but Kitto J leading the majority to exclude payments of debt or liquidated sums, counting only deliberate conveyances

V. Curial Extensions of the Statutory Preference Scheme

The long history of interaction between statute, law and equity in the field of insolvency has often been noted by the courts, and stands as a rebuttal of the once-fashionable view that statute law and judge-made law inhabit separate spheres and cannot influence each other. This intense interaction was demonstrated in two cases in the Federal Court of Australia in the early 1990s, reviewing English, Australian and American principles relating to 'preference recapture'. The *Garuda* case dealt with avoidance of transfers made with intent to defraud creditors,[54] for example where a preferential payment harms the recovery chances of a present or anticipated creditor, and fixed on a broad test of *mens rea* including natural inferences from conduct. The *Compass Airlines* case focussed on near-bankruptcy dispositions that have the effect of disrupting the statutory scheme of *pari passu* distribution,[55] independent of party intentions. The Federal Court in *Compass Airlines* relied on a scholarly 1936 judgment of Jordan CJ to drive home the symbiotic relationship between statutory and judicial rules in this area, with the legislature and the courts extending and innovating in the law in a complex to-and-fro relationship:

> In *Page v Commonwealth Life Assurance Society Ltd*,[56] Jordan CJ said that the policy of the bankruptcy law has always been regarded as a useful guide in determining the operation and limitations of the letter of the law. His Honour gave two instances, (i) proceedings which, although within the letter of the law, had been regarded as obnoxious to the policy of the bankruptcy law, and therefore, avoided by it,[57] and (ii) limitations upon the application of the letter of the law which have been extracted from its 'general policy'. Although Jordan CJ did not advert to them, the decisions of Lord Mansfield from which the law of preferences developed illustrate proposition (i). The 'running account' doctrine may perhaps be seen as an illustration of proposition (ii).[58]

In the case of *Page v Commonwealth Life Assurance*, Jordan CJ investigated the insolvency statutes and decisions since the Statute of Elizabeth, and concluded that by analogy with the survival of contractual claims to be proved in an estate, it was possible for a plaintiff to proceed with a tort claim against the assignee in insolvency of a company alleged to have committed the tort of malicious prosecution prior to the insolvency. The fact that the tort claim was unliquidated and

and charges of property. See also *Re Gunsbourg* (1920) 2 KB 426 (CA) on how relation back of the trusteeship on bankruptcy affects a preference which is itself the act of bankruptcy.

[54] *Re PT Garuda Indonesia Limited v Richard John Grellman* (1992) 107 ALR 199 (FCA).

[55] *Compass Airlines* (n 43).

[56] *Page v Commonwealth Life Assurance Society Ltd* (1935–36) 36 SR (NSW) 85 (NSWSC) 89.

[57] Citing *Higinbotham* (n 3); *Re Johns* [1928] 1 Ch 737 (ChD).

[58] *Compass Airlines* (n 43) [73]. The imbrication of statute and equity is also strongly evidenced in *Nelson v Nelson* (1995) 184 CLR 538 (HCA).

judgment was uncertain at the time of insolvency did not mean that the right in action was discharged by the insolvency, and the plaintiff could attempt to prove the claim against the insolvent pool of assets, notwithstanding contrary nineteenth century decisions. Jordan CJ thus demonstrated how the statutory insolvency principles giving discharge were subject to curial extension.

The work of the courts in extending insolvency principles in the common law system also calls into question the orthodoxy that English insolvency law (and by descent that of Australian law) is party-designed, with the agencies of the law used simply to guide and police the ex ante and ex post negotiations. This position is contrasted with the Continental (and perhaps American) approach to insolvency which supposedly is more inclined to use the power of the state coercively to reorder property and contract rights outside party wills.[59] The over-riding of party wills through preference recapture in the common law systems would seem to blur this distinction; the question resolves to *which* party-designed rights will the law allow to stand in an insolvency?

VI. 'Intent to Defraud' and Equitable Fraud—The *Mens Rea* Problem

We must next look more closely at a central question in application of the insolvency doctrines derived from the Statute of Elizabeth; that is, the requisite mind state for finding a preference. One way to conceive this is by comparison with breach of trust. A trustee makes an undertaking to hold an asset for a beneficiary and is subject to an equitable liability that enforces this undertaking by requiring a substitutive payment if an *ultra vires* payment away occurs. A debtor makes an undertaking to repay a loan, and is likewise subject to a liability enforcing that duty, but is free to treat the loan value as his own and need only find a replacement value; unlike a trustee he is *expected* to use the loan value for his own benefit, and will generally not be hemmed in by certain stipulated types of usage. However if the debtor takes action, paying away assets expressly so to prevent a particular creditor having normal recourse against his estate, then this is seen as a species of fraud. In breach of trust cases it has been stated by high authority that no dishonest intent need be found on the part of the trustee to find breach of trust;[60] but this may be a modernising departure from an older equitable approach which

[59] J Sgard, 'Bankruptcy Law, Majority Rule, and Private Ordering in England and France (16th–19th centuries)' (working version at International Society for New Institutional Economics, June 2009, available at http://extranet.isnie.org/uploads/isnie2009/jerome.pdf accessed 17 June 2011); J Sgard, 'Do Legal Origins Matter? The Case of Bankruptcy Laws in Europe 1808–1914' (2006) 10 *European Review of Economic History* 389. The variance between parties' ex ante desire for controlled distribution and ex post desire to grab and run at the expense of overall value is set out in T Jackson, *The Logic and Limits of Bankruptcy Law* (Cambridge, Massachusetts, Harvard University Press, 1986) 7–67.

[60] See, eg *Royal Brunei Airlines v Tan* [1995] 2 AC 378 (PC) 384–85 (Lord Nicholls).

saw wrongful handling of assets or incorrect exercise of powers as themselves a species of fraud; an entrusted person did the wrong thing when he or she *ought* to have known better. It is in a like tradition that a 'fraudulent' intent on the part of the debtor is the gist of the preferences jurisdiction; there may be no malicious intent to do the creditors out of their rights, but debtors ought to know it is wrong voluntarily to transfer away assets when they have an inkling that they cannot pay their debts. The analogy with the breach of trust doctrines of dishonest assistance and knowing receipt grows stronger when one regards the position of the third party assignee of a preference; here bona fide receipt for value will protect the transaction from impeachment, but knowledge of the debtor's fraudulent transaction will lead to the preference being voided. As in trust law, so in preference law presumptions are used to find a culpable mind state of the transacting parties, whether debtor or assignee, and the relevant tests hover between subjective and objective poles, or real versus presumptive fraud.

At the objective end of the spectrum in presuming a fraudulent preferential intent lies the decision of Lord Hatherley LC in *Freeman v Pope* in 1870, a case concerning a voluntary settlement of a clergyman's life policy on a third party when the settlor was already in financial distress. Lord Hatherley began with the famous statement: 'The principle on which the statute of 13 Eliz 1, c 5 proceeds is this, that persons must be just before they are generous, and that debts must be paid before gifts can be made'.[61] He continued:

> [I]n the absence of … direct proof of intention, if a person owing debts makes a settlement which subtracts from the property which is the proper fund for the payment of those debts, an amount without which the debts cannot be paid, then, since it is the necessary consequence of the settlement (supposing it effectual) that some creditors must remain unpaid, it would be the duty of the Judge to direct the jury that they must infer the intent of the settlor to have been to defeat or delay his creditors, and that the case is within the statute.[62]

At the other subjectivist end we have the approach of Lord Esher MR in *Re Wise* in 1886:

> It must be recollected that the statute of Elizabeth applies, and may make a deed void, even though the grantor never becomes a bankrupt. But this case was at first argued not upon that footing, but upon the assumption that, if the natural or necessary effect of what the settlor did was to defeat or delay his creditors, the court must find that he actually had that intent. That proposition or doctrine I entirely abjure.[63]

Australian courts have tended to the first view, with the High Court and Federal Court recently approving the inferential approach of *Freeman v Pope*;[64] but in

[61] *Freeman* (n 4) 540.

[62] Ibid 541.

[63] *Re Wise* (1886) LR 17 QBD 290 (CA) 299. See further G Moffat, *Trusts Law*, 4th edn (Cambridge, Cambridge University Press, 2005) 278–87.

[64] *Marcolongo v Chen* [2011] HCA 3, (2011) 85 ALJR 380; *G and M Aldridge Pty Ltd v Walsh* [2001] HCA 27, (2001) 203 CLR 662 [29]–[30]; *Cannane v J Cannane Pty Ltd (in liq)* [1998] HCA 26, (1998)

earlier cases the High Court could tilt to the second, stricter view. In a 1934 case concerning a fraudulent preference aiming to defeat creditors, Starke J held that '[f]raud … is not to be presumed: the burden of proof is upon those who impeach the disposition',[65] and Dixon J held that:

> [a] real intent to defeat or delay creditors must exist, and the question always is whether, upon all the circumstances of the transaction, the transfer or other disposition was in fact made with that intent. The burden of proof is upon those alleging that it was so made.[66]

The debate has turned on the classical equitable question of the degree to which a *mens rea* may be inferred from circumstances, and whether 'fraud' connotes a falling below a due prudential standard of common honesty or connotes something worse involving personal viciousness. When bankruptcy earlier had connotations of criminal dishonesty (with incarceration for unpaid debts being supplemented by more extreme sanctions including mutilation and even execution in the seventeenth and eighteenth centuries)[67] it was natural that a stronger proof of subjective intent to a criminal justice standard should be sought. Like requirements pertain today in areas such as corporate directors' personal liability for continuing to trade when insolvent, where super-added criminal liability is on the menu of sanctions: here 'the intent to defraud creditors must be express or actual and real: nothing constructive imputed or implied will do'.[68] But where the core sanction is simply avoidance of a bad transaction, which after all is a core remedy of civil equity jurisdiction, the *mens rea* may not be so demanding.

After lengthy debates weighing the rival formulations, the Federal Court and the High Court have now decided that the modern test for inferring a fraudulent preference was the contextual approach set out by Lord Hatherley in *Freeman v Pope*.[69] But the courts have also acknowledged that there cannot be one uniform test for all preferences across the gamut of bankruptcy and insolvency. It is worth noting here some of the complex effects of federalism on Australian law in this area.[70] The Constitution s 51 (xvii), together with s 109, allows the Commonwealth to legislate in the field of bankruptcy and insolvency so as to occupy the field. The Commonwealth's bankruptcy legislation until 1996 reproduced the old English formula of 'intent to defraud' etc,[71] but after 1996 was amended to revolve around a debtor's 'main purpose' being to defeat creditors' rights under a statutory distribution. In any case the legislation could only operate if there was an actual

192 CLR 557 [12] (Brennan CJ and McHugh J); *Compass Airlines* (n 43); *Garuda* (n 54); *Noakes v Harvy Holmes* (1979) 26 ALR 297 (FCA) 303 (Brennan J).

[65] *Williams v Lloyd* (1934) 50 CLR 341 (HCA) 361.

[66] Ibid 372.

[67] E Kadens, 'The Last Bankrupt Hanged: Balancing Incentives in the Development of Bankruptcy Law' (2010) 59 *Duke Law Journal* 1229.

[68] *Hardie v Hanson* (1960) 105 CLR 451 (HCA) 458 (Dixon CJ).

[69] See cases cited in n 64.

[70] See, eg *Gould v Brown* (1998) 193 CLR 346 (HCA).

[71] Bankruptcy Act 1966, s 121.

bankruptcy, so bringing Commonwealth powers into play. It appears that once bankruptcy occurs, State laws must give way to the Commonwealth bankruptcy scheme; but State laws can govern near-bankruptcy situations where a conveyance prejudices a creditor's interests prior to a bankruptcy.[72] To further complicate matters, States also provided rules for corporate insolvency by reference to the Commonwealth bankruptcy rules for natural persons; but these State insolvency jurisdictions have now been replaced by the Corporations Act 2001 (Cth), passed by the Commonwealth after a referral of power by the States.

In the recent case of *Marcolongo v Chen*,[73] the older statutory concept of 'intent to defraud' was interpreted differently by the New South Wales Court of Appeal and the High Court. The facts of the case were that during a litigation over damage to land the plaintiff gave notice of a property preservation order over other lands owned by the alleged tortfeasor, so as to ensure there were assets available to satisfy any judgment. The owner nonetheless sold the land for value to a third party. On winning the tort action the plaintiff could not satisfy the judgment debt against the owner's remaining assets, and so sought to reverse the land transfer to the third party under section 37A of the Conveyancing Act 1919 (NSW), which states that 'every alienation of property, made … with intent to defraud creditors, shall be voidable at the instance of any person thereby prejudiced', unless the purchaser acquired in good faith and without notice of such intent to defraud. The plaintiff succeeded at trial on the basis that the owner's motives in transferring the land ahead of the judgment satisfied the legislative test. In the Court of Appeal Allsop P and Young JA each investigated the various formulae for preferential intent arising from the tangled State and Commonwealth statutes, and found that the judicial interpretations of the necessary intention in one legislative context might not map onto another legislative context. In particular, the Commonwealth jurisdiction to police assignments subverting the post-bankruptcy distribution (ie that jurisdiction descended from Lord Mansfield's extension of Elizabethan preference law) might allow an easier inference of intention than the state law's concern with pre-bankruptcy subversion of creditor rights, derived directly from the Statute of Elizabeth, where a stronger intention amounting to dishonesty might have to be proved to a standard beyond inference from the natural effect of conduct. By this move the Court of Appeal revived and adopted the tougher Dixonian test for state bankruptcy laws based on the Statute of Elizabeth, though there are interesting questions of *stare decisis* at work here. *Noakes* in the Federal Court,[74] which formed the basis for the doctrine of inferred intentionality in *Garuda*[75] and *Cannane*,[76] at least dealt with a law of similar provenance to the New South Wales preference law, being the Norfolk Island version of the good old

[72] See further W Lee, 'Trusts and Bankruptcy' (1973) 47 *Australian Law Journal* 365, 365–67.
[73] *Marcolongo* (n 64), reversing *Chen v Marcolongo* [2009] NSWCA 326.
[74] *Noakes* (n 64).
[75] *Garuda* (n 54).
[76] *Cannane* (n 64).

1571 Act. But the later Federal Court and High Court decisions in *Garuda* and *Cannane* did concern the operation of preferences in defiance of the statutory bankruptcy scheme, not those prejudicial to particular creditors. The 'Mansfield' form of preference recapture has connotations of a public law or police action, the 'Statute of Elizabeth' form a breach of a duty to private persons.[77] The Court of Appeal in *Marcolongo* allowed the appeal, finding no preference in the absence of a directly proven subjective motive to defraud creditors; but this decision was vulnerable for relying on the wrong stream of preference authority in stating the subjective *mens rea* test.

On further appeal the High Court restored the trial result in *Marcolongo*, and swung the test of intentionality back to one of objective inference from conduct. The plurality accepted that fraud in common law and equity had multiple shades of meaning, betokening any falling down in prescribed standards of conduct including wrongful exercise of powers; much depended on the context of the inquiry. In the context of the anti-preference jurisdiction the basic notion of an 'intention to defraud' had also attracted multiple meanings, depending in many cases on the precise statutory wording. Nonetheless the majority found that according to the main trend of judicial interpretation of the legislation, 'the term "defraud" was designed to reproduce the meaning of the expression "delay, hinder or defraud" in the Elizabethan Statute',[78] and moreover that as a question of policy the modern legislative provisions 'should receive a liberal construction in effecting their purpose of suppressing fraud'.[79] Authority for this liberal approach came from a Privy Council appeal[80] from a New South Wales case that in turn had adopted Kindersley V-C's statement in *Thompson v Webster* that in testing for intent to defraud, 'the Court is to decide in each particular case whether, on all the circumstances, it can come to the conclusion that the *intention* of the settlor, in making the settlement, was to defeat, hinder or delay his creditors'.[81] The High Court plurality also favoured Kindersley V-C's view that something more than a voluntary conveyance was necessary, but also that the necessary intent could be found from the circumstances of a pre-insolvency transaction. The onus of proof lay on the party seeking to avoid that transaction, but they did not, as the Court of Appeal supposed, have to show an active dishonesty or deceit, in the sense of an 'actual and real intention' to defraud or cause harm or loss to the creditor. It was enough if, by an ordinary process of civil proof, the court could find an intention on the part of the transferor to hinder, delay or defeat creditors, even if no active thought of harming the creditor was present; this was the very type of objective dishonesty that equity characteristically suppressed in its fraud jurisdiction, and

[77] See the comments on fraudulent preference as a 'breach of duty' engaging limitation statutes in *Giles v Rhind* [2008] EWCA Civ 118, [2008] 3 WLR 1233 [36]–[55] (Arden LJ).

[78] *Marcolongo* (n 64) [19].

[79] Ibid [20].

[80] *Godfrey v Poole* (1888) 13 App Cas 497 (PC) 503.

[81] *Thompson v Webster* (1859) 4 Drewry 628, 632; 62 ER 241, 242 (emphasis in original).

was familiar enough from areas such as dishonest assistance. The Court's prior decision in *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* made this very point:

> As a matter of ordinary understanding, and as reflected in the criminal law in Australia…, a person may have acted dishonestly, judged by the standards of ordinary, decent people, without appreciating that the act in question was dishonest by those standards.[82]

The earlier authority of *Cannane* then had to be quarantined, where Brennan CJ and McHugh J had spoken of 'the onus of proving an actual intent'. The *Marcolongo* plurality seemed to think that the application of this test involved a distinction between implied intent in fact and constructive intent as a legal implication, commenting that in *Cannane* 'their Honours were adding the word "actual" as a periphrasis to emphasise that, while the existence of the intent might be inferred from the evidence, it was to be found as a fact'.[83]

Moreover the intent only had to be operative, not dominant: the statute 'does not require for its operation that the proscribed intent to defraud be the sole intent'.[84] The *Marcolongo* plurality's approach therefore leads to these conclusions: the intent to delay, hinder etc through a transfer is to be found, circumstantially if necessary, as a question of fact; it must be an operative but not necessarily a sole or predominant intention; it is to be proved by the claimant seeking to void the transaction; but the characterisation of the transferor's intent as fraud triggering the statutory jurisdiction is determined via an objective test. This shifted the law away from the Court of Appeal's subjectivist test and ensured a favourable result for the plaintiff. On the facts of the case, both transferor and transferee obviously knew of the pending tort claim and expedited the land transfer to defeat it, and so the statutory tests were amply met. This also meant that the proviso defence of bona fide purchase was inapplicable since there was notice. Heydon J in a separate judgment agreed that the appeal should be allowed, but did not need to refine the statutory test since on the facts it 'was as "actual" and "dishonest" an intent as it is possible to have'.[85] At any rate, the plurality result in *Marcolongo* gives a clear enough restatement of the relevant test, which is to pull the statutory pre-insolvency preference scheme into alignment with equity's mixed objective-subjective understandings of fraud, and there for now the law of Australia rests.

We cannot be entirely sure that the mixed objective-subjective preference test will always apply, however, since legislative variations will continue to bedevil the system. An added complexity in the Australian federal context arises from a third raft of legislation dealing with a special case, namely where a debtor contemplates bankruptcy or is within a short time period of bankruptcy. Here a different legislative test has been applied, namely whether the *effect* of the conveyance would be to give one creditor a preference over other creditors. A colonial version of this provision from New South Wales was interpreted by the Privy Council in 1861

[82] *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* [2007] HCA 22, (2007) 230 CLR 89 [173].
[83] *Marcolongo* (n 64) [34].
[84] Ibid [57].
[85] Ibid [87].

to require nonetheless a fraudulent intention to prefer,[86] drawing on subjectivist streams of past preference case law; but the High Court of Australia, interpreting a similar provision of the Federal Bankruptcy Act in 1933, produced a strict liability interpretation. After referring to the subjectivist views of the Privy Council and other courts, Starke J stated:

> Whatever assistance, however, we may derive from these decisions upon other Acts, the decision of this Court in the present case depends upon the true construction of the *Federal Bankruptcy Act 1924–1930*. Now that Act says nothing about the view or intention of the debtor nor about any choice or selection by him. It simply declares that a conveyance, transfer or assignment, made within a certain time before bankruptcy, having the effect of giving the creditor a preference, shall be void. It looks to the effect of the transaction and not to the intent, or state of mind, of the debtor.[87]

Rich and Dixon JJ ruled that despite the similarity of the old New South Wales legislative language decided by the Privy Council in 1861, the very different context of the federal legislation meant that its view of the words' meaning was irrelevant.[88]

VII. *Actus Reus*, Voluntarism and Mixed Motives in Assessing Preferences

A further key idea in the courts' exegesis of preference law is that a conveyance can only amount to a fraudulent preference if entirely voluntary on the part of the debtor, on the basis that to 'prefer' another person must involve an elective intention directly to favour or advance the interests of that person by some freely chosen path. Hence a debtor cannot be said to prefer a creditor in a fraudulent manner, to choose to advance the one creditor at the expense of other creditors, if the debtor's mind was driven by an entirely different motive when making the disposition. So for example any trace of coercion including threat of litigation by a creditor, or even a request for payment implying disturbances to supplies if not met, might exclude the operation of the preference doctrine. This proviso is notably vague, and so has given great discretion to the courts in protecting creditor–debtor transactions which divorced from intentions nonetheless do have the effect of advantaging one creditor at others' expense. It adds yet another complication to the search for an intention triggering preference recapture.

Where there is an assignment of future property it would seem that the correct moment to assess the intentionality and voluntarism of the debtor would be at the time of the entering into the contract, as that would be the moment when the

[86] *Bank of Australasia v Harris* (1861) 15 Moo PCC 97, 15 ER 429 (PC) (Knight Bruce LJ).
[87] *S Richards & Co Ltd v Lloyd* (1933) 49 CLR 49 (HCA) 62.
[88] Ibid 59–60.

assignee is vested with the 'higher right' automatically to receive the assets when acquired. No further assurance of the property is later required once that property falls in; the property automatically 'feeds the equity', and the voluntary state of the assignor is irrelevant.[89] If there is still a lingering question whether the consideration moving from the assignee has to be executed fully before that higher right is perfected, then it may be that intention has to be tested up to the moment of perfection by payment of the entire consideration. Formalities rules for the shifting of equitable interests through assignments for value do not give a clear answer to the question when the constructive trust vehicle effecting a disposition of the beneficial interest is constituted, and so do no more than suggest some useful analogies.[90]

A detailed discussion of the correct test for voluntarism of preference arose in the 1909 High Court case of *Muntz v Smail*.[91] The case is interesting at a number of levels: Griffith CJ, Barton and O'Connor JJ each gave judgments looking at direct intention rather than motive as the key test for voluntary preference, whilst Isaacs J vehemently argued for a motive test admitting a much greater range of pressures as factors that might protect a conveyance from avoidance for fraud. The policy choices expressed in these judgments are subtle; Isaacs J on the one hand uses subjective tests and embraces extrinsic materials such as the bargaining power of the parties in order to deny the autonomy of their choices, but does so in order to protect their constrained choices from triggering redistribution through preference recapture, and hence in a sense is protecting party autonomy from control by the state. By contrast, in the 1920 case of *Commissioner of Stamp Duties (Qld) v Jolliffe*,[92] Isaacs J in a powerful dissent pushed hard for a strictly objective test of trust constitution, refusing to admit evidence of subjective motive, and so exposing the trust holder of an illegal bank account to extensive fiscal imposts. Perhaps the facts of *Muntz* explain why Isaacs J inconsistently chose a subjective approach on the preference front. A cattle dealer, Eyles, relied on external credit to finance his buying and selling of stock, and fell into payment difficulties. He owed Smail money he could not repay on a promissory note shortly due; Muntz was another creditor. Eyles was preparing to declare bankruptcy when a buyer presented by Smail offered him a price on his stock sufficient to retire the debt to Smail. Eyles was worried that to accept the sale would be unfair to the other creditors, but Smail indicated that he would pay a good price to ease Eyles' indebtedness and at the moment of decision told Eyles 'that I expected him to carry out his contract

[89] *Crofts v Middleton* (1855) 2 Kay & J 194, 203; 69 ER 749, 753; *Eyre v Burmester* (1862) 10 HLC 90, 11 ER 959 (HL).

[90] See the discussion of *Oughtred v IRC* [1960] AC 206 (HL) and *Neville v Wilson* [1997] Ch 144 (CA) in Meagher, Heydon and Leeming, *Meagher, Gummow and Lehane* (n 16) paras [7–155]–[7–195].

[91] *Muntz v Smail* (1909) 8 CLR 262 (HCA).

[92] *Commissioner of Stamp Duties (Qld) v Jolliffe* (1920) 28 CLR 178 (HCA). The majority decision favouring a subjectivist view of intention to constitute a trust was possibly confined in *Kauter v Hilton* (1953) 90 CLR 86 (HCA) 97; *Associated Alloys* (n 9) [27]–[42]; and probably overruled in *Byrnes v Kendle* [2011] HCA 26, especially at [65] (Gummow and Hayne JJ) and [116] (Heydon and Crennan JJ).

with me'. Eyles acceded, instructing his agent to sell and make the proceeds over to Smail. Muntz later sued to avoid the sale as a preference. The court acknowledged that on the evidence Eyles was striving to do the right thing for his creditors, but the majority found that he had acted 'with a view of' creating a preference of one creditor over other creditors, no matter his bona fides, and so triggered a statutory avoidance and recapture. Griffith CJ cited Jessel MR's statement in *Ex parte Griffith; In re Wilcoxon that* 'that the mind of the debtor was influenced not by the demand of the creditor for a preference, but by his desire to accede to the demand and to give him a preference'.[93] He then gave a careful distinction between intention and motive, drawing on the leading nineteenth century English authorities.[94] He concluded:

> These cases establish that the question to be determined, so far as it depends on the state of mind of the debtor, is: What was the substantial object which he desired to achieve by the act alleged to be a preference? The words 'intention,' 'view,' 'object,' 'motive,' 'purpose,' have all been used by learned Judges in different cases, sometimes as if they were synonymous, and confusion has arisen from not distinguishing between an intention and the motive which induces that intention. But I think that the phrase 'substantial object which he desired to achieve' expresses what was meant by all of them.
>
> In the case of *Sharp v Jackson*[95] the disposition attacked was the conveyance of an estate to make good a breach of trust which had been committed by the debtor, and the Court held, on the evidence, that the question of preferring the beneficiaries was not substantially present to his mind at all. It is a matter of daily experience that men often do acts desiring to achieve a particular object, and incidentally achieve a result quite different from that which was contemplated. It is quite possible for a man to be impelled to do an act that results in a preference to a creditor by a desire to achieve a quite different result. The fact may be difficult of proof, but if it is established he cannot be said to have acted with the view to prefer. In my opinion it is essential to bear in mind the distinction between the motive or reason which induces a man to desire to achieve a particular object and the desire itself. The object desired is alone relevant for the present purpose.[96]

Griffith CJ then addressed a clever argument of Hayden Starke, counsel acting for Smail, to the effect that Eyles had not sold his stock to Smail but had made an assignment of the content of any future fund that might accrue from a sale, and that following Parke J's judgment in *Hunt v Mortimer*,[97] such an assignment of a futurity fell out of the definition of a fraudulent preference. Griffith CJ held that what Eyles had agreed to was a sale with a collateral agreement to pay the proceeds through an intermediary, and there was no evidence that 'the idea of assigning the future purchase money itself was present to the mind of either party'; hence *Hunt v Mortimer* could not apply. In any case any such putative assignment of a

[93] *Ex parte Griffith; In re Wilcoxon* (1883) 23 Ch D 69 (CA) 72.
[94] *Muntz* (n 91) 271–76.
[95] *Sharp v Jackson* [1899] AC 419 (HL).
[96] *Muntz* (n 91) 273–74.
[97] *Hunt v Mortimer* (1829) 10 Barn & Cress 44, 109 ER 367.

book debt would have failed for want of registration (an objection explored more thoroughly in Barton J's judgment). However, Griffith CJ did not reject outright Starke's theory that an assignment of a future interest inherently could not be a preference.

Perhaps Griffith CJ in *Muntz* did not quite explain the full significance of Parke J's decision on assignment in *Hunt v Mortimer*. The decision was issued in 1829, 33 years before *Holroyd v Marshall*. Note also that this was one of Parke's early judgments as a new justice of King's Bench, before he went on to the Exchequer and then the House of Lords as Wensleydale. In *Hunt v Mortimer* an insolvent trader had borrowed in order to fill a large order from the East India Company, taking the money from a creditor who knew him to be insolvent or nearly so, and agreeing that he would transfer back to the creditor the proceeds of the future sales to the Company in order to acquit the debt. Parke J stated that the assignment of future profit was safe from preference recapture because the credit injection, being given in return for an assignment of the profits from its use in trade, had never joined the debtor's general assets:

> There is no pretence for calling this a fraudulent preference. The money was not lent by the defendants on the general credit of the bankrupts, but on the faith of the monies which were to be received from the East India Company; and the arrangement between the bankrupt and the defendant had the effect of an equitable assignment of that particular fund, to which the plaintiffs (who as assignees are entitled only to such effects as the bankrupt had both legally and equitably) have no claim. In this case, it is true, there was no notice of the arrangement to the East India Company; but notice is not necessary in such cases to give an effect to an equitable assignment between the parties, though it is so for the purpose of preventing the title of assignees attaching, on the ground of the bankrupt being the apparent owner of that fund at the time of the act of bankruptcy, within the meaning of that clause of the late Bankrupt Act, founded on the repealed Statute of the 21 Jac. 1. Here no notice was required, because the monies received from the East India Company were paid over to the defendants long before the act of bankruptcy of both bankrupts. I think therefore that the direction and the verdict were right.[98]

In effect Parke J was here identifying something resembling a *Quistclose* trust, being a secret injection of credit into a distressed debtor with an equity to recover with super-priority against the proceeds should the rescue fail. The reputed ownership doctrine then extant[99] prevented him from a full partitioning of the initial credit fund itself, but he could use the equitable assignment to partition the profit stream from the insolvent estate.

We turn now from the magisterial Griffith CJ in *Muntz* to the mercurial Isaacs J. Now Isaacs J is always interesting whether in dissent or leading the court, most

[98] Ibid 46–47, 368–69.

[99] See, eg *Dearle v Hall* (1823) 3 Russ 1, 20–24; 38 ER 475, 482–84 (Sir Thomas Plumer MR), building on *Ryall* (n 51), in turn building on Elizabethan and Jacobean insolvency statutes: see J Getzler and M Macnair, 'The Firm as an Entity before the Companies Acts' (n 51) 272–76.

particularly, as in *Muntz*, when he is in dissent and writing at the top of his voice. He began his judgment abruptly by kicking away Starke's assignment theory:

> Whether the agreement made between Eyles and Smail constituted an equitable charge which, after insolvency and apart from the order and disposition clause, would have given Smail a right to specific performance, or whether it was merely a personal undertaking to resell through Smail, leaving Smail to collect the purchase money, and alternatively an undertaking to re-sell through another agent approved by Smail, the proceeds being handed to Smail, is, I think, perfectly immaterial on the point of fraudulent preference.[100]

He then assailed the whole tenor of Griffith CJ's analysis, emphasising positive law rather than abstractions concerning mind states:

> The whole matter depends on the construction of a few words in sec. 73 of the *Insolvency Act 1890*, namely, 'with a view of giving such creditor a preference over the other creditors.'
>
> A good deal of argument was addressed to us with respect to the expression 'with a view,' as to whether 'view' meant 'intention' or 'motive,' or some similar word. In my opinion not very much turns on the difference between these words. There is probably a subtle distinction between all of them which may have its value in the field of metaphysics, but for the purpose of fraudulent preference is really immaterial. The phrase 'with a view' was not newly coined for the occasion of the *English Bankruptcy Act 1869*; it was employed by Lord *Mansfield* in the very first of the series of cases in which he laid the foundations of this branch of the law—*Alderson v Temple*[101] (in 1768), and in *Rust v Cooper*[102](1777).[103]

After reviewing the authorities back to Mansfield, Isaacs J concluded:

> It is the will or wish—the *voluntas*—of the debtor to select for preferential treatment one creditor in order to favour him at the expense of the rest—the state of mind of the debtor which causes him to 'prefer' one creditor to another—which is the 'view to give a preference' struck at by the Statute. If the appellant be right—that the mere deliberate payment in full is enough to stamp it as a fraudulent preference—then all the cases as to pressure and mixed motive have been wrongly decided. There is really no escape from this dilemma.[104]

Isaacs J then listed authorities showing that a sense of legal obligation to pay a debt could of itself exclude any finding of a fraudulent preference: 'where the debtor's dominant motive was to fulfil a previous obligation contracted while solvent, or an obligation which he *bona fide* believed to exist, it negatived the supposition of his acting with a view of giving a "preference".'[105] This shows that Isaacs J regarded

[100] *Muntz* (n 91) 291.
[101] *Alderson* (n 2).
[102] *Rust v Cooper* (1777) 2 Cowp 629, 98 ER 1277.
[103] *Muntz* (n 91) 292.
[104] *Muntz* (n 91) 297.
[105] Ibid 302–03.

this particular branch of preference recapture as entirely separate from the cases of near-bankruptcy or evasion of the statutory scheme.

The final element of Isaacs J's dissent concerned the Starke theory of equitable assignment, and here too he was receptive to the debtor's viewpoint:

> If it be necessary to determine whether the agreement amounted to an equitable charge upon the proceeds, I am of opinion it did. The basis of the transaction of Eyles' purchase was that the proceeds of the cattle should be applied in payment of the notes. That necessitated, according to the natural course of things, that the notes should not be dishonoured, and therefore that some time before their due dates the cattle should be resold either through Smail or some other agent approved by him, and the proceeds appropriated in the first instance to discharge the notes. Eyles says 'The proceeds were to go to him.' Without this term of the agreement, the bargain would never have been made, the cattle never bought, and they or their proceeds would not have come into the estate. The sale was not made upon Eyles' general credit (see *Hunt v Mortimer*). It was, in my opinion, an equitable assignment to secure Smail. Being verbal it is not struck by Part VI. of the *Instruments Act 1890*. Applying not to any 'debt' owing by a possible purchaser, but to the proceeds when either in the hands of Eyles or his agent, it was not concerning a 'book debt' within the meaning of the *Book Debts Act 1896*. Consequently it was an assignment which, on the principle of *Alexander v Steinhardt, Walker & Co*,[106] and *Palmer v Culverwell, Brooks & Co*,[107] and other cases of that class gave, as between Smail and Eyles, an equitable security to Smail.[108]

This passage is very hard to credit. In *Hunt* the assignment of sale profits was given in return for new money injected to fund new trading activity, and this was why the assigned proceeds were held to be separate from the general estate. No such analysis could pertain in *Muntz.* And Isaacs J does not bother to explain what magic makes an assignment of future profits fall outside the statutory preference prohibition. The two commercial cases he cited simply affirm that the equity of a forward assignment for value arises at the time of contractual assurance and hence can give priority in a later insolvency; preferences were never at issue in those authorities.

VIII. New Money and Running Accounts in Pre-Insolvency

Later Australian courts clarified the tools to be used where transacting involving new money occurs in the run up to a bankruptcy. The basic idea is that new money, or credit that cycles through the business, of its nature leaves the level of assets at a neutral or even higher level, and so does not extract preferential payments from

[106] *Alexander v Steinhardt, Walker & Co* [1903] 2 KB 208 (KBD).
[107] *Palmer v Culverwell, Brooks & Co* (1902) 85 LT 758.
[108] *Muntz* (n 91) 304–05.

the general estate of the trader.[109] The High Court has exempted from preference recapture one-off transactions that are made not with the intent to reduce overall assets but which maintain or enlarge the asset pool, as demonstrated in the 1959 decision in *Burns v Stapleton*.[110] This case concerned securities over an equity of redemption that were issued by a trader in a near-bankruptcy context. The Court found that the effect of an equitable mortgage given in order to bring fresh stock into the debtor's business for immediate resale had not adversely affected the pool of assets available post-bankruptcy and hence could stand outside preference recapture; but the court did avoid certain other charges issued at the same time by the debtor in an attempt to secure extant unsecured debts; these were clearly preferences reducing the estate in a context where the creditors knew of the debtor's distress and hence could not claim a defence of bona fide receipt. In a twist on this analysis, the High Court has more latterly found that a secured creditor with a right to take the assets of a defaulting company that chooses through a receiver to keep the company as a going concern and continue to pay traders from the insolvent company's capital resources commits no preference, as that secured capital was never available for distribution to the unsecured pool.[111] By a 3:2 decision the High Court has also held that an equitable lien arising on tender of consideration relating to some identified property is immunised from preference recapture; the equity arises outside the will of the parties by operation of law in order to protect the consideration, and by so taking value out of the general estate trumps the preference recapture regime.[112]

The second category of exemption involves the distinctive Australian doctrine of the 'running account', which allows repayments of debt made to level a fluctuating credit account, so as to maintain the mutual exchange of goods and credit within an established and continuous commercial relationship. Again the basis for this exception is that such mutual transfers do not purport to create a preference, and do not in effect diminish the final pool of assets available to the assignee but might instead enlarge that pool or leave it in a neutral state.[113]

Isaacs J had another and better opportunity to explore the workings of future assignments on insolvency some fifteen years after *Muntz*, in the 1924 case of *Carey v Palmer*.[114] This time he had Smail's counsel, now Starke J, alongside him on the bench to help him make the majority. The facts were that Carey provided credit to Johnstone, an importer, for the express purpose of purchasing goods to trade, with the contract providing that Johnstone should sell the goods on without

[109] English authorities supporting this approach are adduced in L Smith, 'Security' in A Burrows (ed), *English Private Law*, 2nd edn (Oxford, Oxford University Press, 2007) paras [5.159]–[5.160]. A theoretical and empirical case for allowing new money credit to attach to collateral ahead of prior creditors is given in S Schwarcz, 'The Easy Case for the Priority of Secured Claims in Bankruptcy' (1997) 47 *Duke Law Journal* 425.

[110] *Burns v Stapleton* (1959) 102 CLR 97 (HCA).

[111] *Sheahan v Carrier Air Conditioning Pty Ltd* (1997) 189 CLR 407 (HCA).

[112] *Hewett* (n 15).

[113] *Compass Airlines* (n 43).

[114] *Carey v Palmer* (1924) 34 CLR 380 (HCA).

delay and pay the sale proceeds directly to Carey's bank account, who would then pay over a profit share and issue fresh credit to the borrower. The importer was facing bankruptcy and made a private composition with Carey transferring to him all his stock in trade and fixtures; the trustee in bankruptcy avoided this transfer as a preference. Carey counterclaimed that the original credit agreement made him assignee of all future stock bought with the loan money, hence he could keep the present stock in trade as outside the preference, because never part of the importer's estate. Knox CJ affirmed his own majority doctrine in *Jolliffe's* case[115] requiring that there be a 'real intention' of the parties to make a charge or trust, which was not evinced in the credit-purchase arrangement, and hence found no equitable assignment. Moreover the fraudulent attempt to transfer the stock pre-bankruptcy strongly suggested that the original agreement was not taken to have created any proprietary rights.[116] Hence according to Knox CJ the transfer was to be avoided as a preference; but in this case his was the minority opinion. Isaacs J in the majority did not refer to his own dissenting judgment in *Jolliffe* but in effect applied his objective test for trust intentions from that case to find an equitable assignment based on the content and context of the credit agreement:

> The dominant purpose of the instrument as evident from its tenor was that Carey should not have to rely on the personal undertaking of Johnstone to repay the money lent as a mere unsecured debt. He was to be entrusted with the money only upon the terms that it should be applied exclusively to purchasing goods for the business, that it should be transformed into goods, and that the goods, once purchased, were to be retransformed 'as soon as possible' by business operations into money and that money should be handed *in specie*, that is, the full actual proceeds, to the appellant, and these should be in the sole control of the appellant for distribution according to agreement…. the official assignee became entitled to the goods, but subject to the trust or interest in favour of Carey.[117]

Starke J agreed with this, adding that according to *Tailby* 'the mode or form of the agreement is absolutely immaterial, provided the intention of the parties is clear'.[118] He added that Bills of Sale legislation did not apply to control of a fund or transfers of money.[119] Both judges agreed that neither the bankruptcy nor the avoided later transfer of stock could undermine the equity created years before by the original agreement. On appeal in the case of *Palmer v Carey,* the Privy Council allowed the appeal, and followed Knox CJ's minority judgment in the High Court.[120] Lord Wrenbury held that a duty to pay sale proceeds from a separate fund had to be imposed unequivocally and in such a manner as to be

[115] *Jolliffe* (n 92).

[116] *Carey* (n 114) 388–89. In *Williams* (n 65) 368–72, Dixon J similarly used the technique of refusing to find a valid transfer of beneficial interest by perfected declaration of trust in order to stop a purported preference in its tracks.

[117] Ibid 389–91.

[118] Ibid 392.

[119] Ibid 392–93.

[120] *Palmer v Carey* [1926] AC 703 (PC).

capable of specific performance; only then would an equitable assignment be found. No discussion of the controversy over *Holroyd* was broached. There was, in fact, a midway point between debt as a personal claim and assignment of value as a chose:

> An agreement for valuable consideration that a fund shall be applied in a particular way may found an injunction to restrain its application in another way. But if there be nothing more, such a stipulation will not amount to an equitable assignment.[121]

On the facts Lord Wrenbury found that under the agreement Johnstone was to take as owner the loan monies, the goods and the sale proceeds, and then be subject to a contractual duty to pay over to the account. The key finding of fact seems to be that no separate fund of the proceeds was intentionally charged; the court looks for something more definite than colloquial language of benefit in order to constitute new equitable rights.[122]

IX. Restraining the Preference Jurisdiction: The 1930s

The law of preferences and assignment in Australia took a sharp turn in direction in the 1930s, perhaps reflecting some of the distress of the time in the credit economy. In *Robertson v Grigg*,[123] a case of 1932, a High Court panel of six, now including Dixon J, were able to push the law in the opposite direction to that outlined in *Palmer v Carey*, one far more favourable to creditor freedom. The facts were that Miles, a road builder, took a £1000 loan in early 1929 from a financier Grigg who agreed to back Miles' attempt to win a major set of contracts by tender from the West Australian Main Roads Board. The loan agreement stipulated that the money was to be used only to fund the road contract performances, with 10 per cent interest to be levied and capital to be paid back 'from repayments to be made from progress payments as the work proceeds and the same are due from Main Roads Board'. A few months later a further £1000 was advanced on similar terms, with an oral agreement to continue with fresh cycles of loans and repayments from the forward contract earnings. Miles then wrote to the Board asking them to send all his contract payments automatically to Grigg and with receipt by Grigg counting as full discharge. When Miles was bankrupted in 1930 the trustee in

[121] Ibid 706, citing Lord Truro in *Rodick v Gandell* (1852) 1 DeG M & G 763, 777; 42 ER 749, 754.

[122] *Palmer v Carey* despite its bare reasoning has proved a useful precedent when judges wish to deny that an equitable interest binding third parties has arisen in relation to a specific fund imprinted with a contractual purpose: see, eg *Swiss Bank Corp* (n 3) 596 (Lord Wilberforce), cf Browne-Wilkinson J at first instance: [1979] Ch 548 (ChD) 566–68. *Re Schebsman (dec'd)* [1944] Ch 83 (CA) 100–07 (du Parcq LJ) is the *locus classicus* of the basal doctrine that benefit does not automatically equate with beneficial interest.

[123] *Robertson v Grigg* (1932) 47 CLR 257 (HCA).

bankruptcy sought to recover the payments to Grigg as passing under an unregistered and therefore void assignments of book debts colliding with the bills of sale acts, or else as void preferences. The Court protected the payments on the basis that, even according to a stringent test for a clear and potent intention to charge future receivables as set out in *Palmer v Carey*, the parties' agreements, written and verbal, showed a sufficient substantive intention to make an assignment of Miles' future contract earnings from their first dealings in early 1929. This was a curious finding in that a later course of conduct was used to help characterise the legal nature of an earlier transaction.[124] The Court then asserted that as a matter of statutory interpretation contract earnings were not to be classified as book debts of a business and so escaped registration requirements. No intentional preference was found as Miles and Grigg were really working together to inject regular finance into Miles' ordinary course of business. Finally there could be no application of the statutory rule catching all estate-reducing payments made within six months of the act of bankruptcy independently of intention, because equitable title to the future road profits had been set up in 1929, the year before the insolvency, and the date of the assignment of future earnings, not accrual of those earnings, was the relevant date of the transfer of value to Grigg. This was a patent case of equitable assignment of future rights creating a non-possessory security that other creditors could not easily discover, and then protecting it from all preference recapture. The precise date of Miles' bankruptcy (9 August 1930) may be significant, arousing the sympathy of the Court for unfortunates caught in the downturn. Whatever the merits, later cases have ratified like financial agreements applying assignments of future rights to shift the benefit of credit flows, and to insulate them from the bankruptcy laws.[125]

These issues were rehearsed again in the 1937 case of *Palette Shoes Pty Ltd (in liq) v Krohn*,[126] which provides the last major case of this study. This was another instance of a credit arrangement, this time for manufacture and sale of shoes. The arrangement was a little more complex than that in *Carey v Palmer* or *Robertson v Grigg*, though the basic form was similar. The credit scheme may be represented on a time line as follows:

1. P makes shoes and sells them, to retailers and other customers (R), on credit for £x.
2. P presents a debit note to K, a financier, for £x less sales tax and a 5.5 per cent credit charge. Call this sum £x – (£t + £c) = £n (where t = tax, c = credit charges, and n = net turnover).
3. K immediately pays £n over to P, who uses the money to cover costs and make some operating profit.
4. R eventually pays P the sum of £x, discharging the P – R credit sale at stage 1.

[124] Cf *Paul v Constance* [1977] 1 WLR 527 (CA).

[125] *Re Ferdinando Antonio Puntoriero and Tonetta Puntorier Ex Parte: Nickpack Pty Limited v Richard Andrew Gagie* [1992] FCA 257.

[126] *Palette Shoes Pty Ltd (in liq) v Krohn* (1937) 58 CLR 1 (HCA).

5. P immediately pays £x over to K.
6. K divides £x up according to the agreed distribution, to pay £t to the state and to retire the debt £n paid over earlier to P; K retains £c as the credit charge or profit on the loan. The credit cycle then starts again to generate £n' and £c' etc.
7. P becomes insolvent owing large debts to other creditors, and with K having invested £n' in P's business. After the insolvency R stands ready to pay £x'. K claims £x' as committed to K under the credit agreement, such that the receivables are made subject to an equitable claim on accrual and so come out of the insolvent estate, P's liquidator claims that £x' should go into the trust for insolvency to be made available to the general creditors.

Latham CJ thought it crucial that P had a duty to pay the whole proceeds of the credit sale (ie £x sums) over to K:

> There was not to be any subsequent adjustment as in *Palmer v Carey*. It is evident that the moneys were to be kept separate from the moneys of the company….in such circumstances, the beneficial interest in the moneys, when received by the company, belonged to the plaintiffs and never to the company and that the company held the moneys in trust for the plaintiffs.[127]

It is not clear why the splitting of profits by Carey and transfer back to Johnstone in the case of *Palmer v Carey* was inconsistent with a trust. But Latham CJ had a second string:

> If, contrary to what I have said, the moneys did become the property of the company upon receipt from the customers, the agreement, being made for consideration, constituted a good equitable assignment of the fund. No particular form is required to constitute an assignment of future personal property. A promise for consideration to assign future property, such property being capable of ascertainment or identification, operates to bind the conscience of the assignor and to bind the property itself from the moment when the contract becomes capable of being performed. The principle that is applied is not a principle depending upon the possibility of a court of equity decreeing specific performance, as had been stated by Lord *Westbury* LC in *Holroyd v Marshall*. The relevant principle is that equity considers as done that which ought to be done. See *Tailby v Official Receiver*, per Lord *Macnaghten*, and the discussion of the question in *In re Lind* … There is no reason why this principle should not be applied to money where it is clear that the money is to be kept separate by the assignee from his own moneys and where it can be identified…. [Whether a trust or an assignment of future value], [i]n neither case is there any assignment of a book debt and Part IX of the Instruments Act is not applicable.[128]

Dixon J analysed rather more carefully the statutory history as to why companies should have to register assignments of book debts in the same manner as traders,

[127] Ibid 14–15 (footnote omitted).
[128] Ibid 16–17 (footnotes omitted).

without corporate exemption. This was important because if K's right to the proceeds of P's sales amounted to an assignment of book debts then K would fail to assert his interest due to want of registration. Dixon J then adopted the *Re Lind* gloss on *Tailby* to describe how assignment of future interests worked, putting the matter in terms of an equity arising because full value has passed from the creditor to bind over the debtor to convey property once vested:

> As the subject to be made over does not exist, the matter primarily rests in contract. Because value has been given on the one side, the conscience of the other party is bound when the subject comes into existence, that is, when, as is generally the case, the legal property vests in him. Because his conscience is bound in respect of a subject of property, equity fastens upon the property itself and makes him a trustee of the legal rights or ownership for the assignee. But, although the matter rests primarily in contract, the prospective right in property which the assignee obtains 'is a higher right than the right to have specific performance of a contract,' and it may survive the assignor's bankruptcy because it attaches without more *eo instanti* when the property arises and gives the assignee an equitable interest therein.[129]

The next question was how to characterise the P-K credit relationship. Agency and trust could be excluded since K never had any right to the shoes nor to the immediate proceeds of their sale. This was why legislative registration requirements pertaining to bills of sale and assignment of book debts did not apply. However elements of these relationships pertained in that P had to keep £x, the sale proceeds, in a separate fund, as if P had an agent or trustee's duty to account. P then had a duty to pay the proceeds in the fund to K who had given valuable consideration for them. By introducing the idea of future proceeds segregated in a fund, with the equitable assignment acting upon the future contents of the fund, Dixon J could justify enforcing their transfer by the agreement as assets outside the company's beneficial estate, and hence outside the insolvency. The question of preference did not overtly arise in this case, but the policy implications of the decision were troubling, as instead of having to defend a preferential effect of payment, the creditor had instead succeeded in winning priority for an unregistered and thus well-nigh undiscoverable assignment of the *value* of book debts. With such a powerful hidden security over future value available to tilt priorities in one's direction, the rival creditors were placed in an inferior position, in breach of the spirit if not the letter of the insolvency laws. *Palette Shoes v Krohn* remains a *locus classicus* of Australian equity, and the case demonstrates how equity can not only enlarge the policy of a statute, or prevent the wrongful use of a statute, but can also undermine a considered statutory policy. Whether this last type of operation of equity can be justified is both a doctrinal and a political question.

[129] Ibid 26–27.

X. Conclusion: New Statute, Old Story?

A new chapter is set to open in the relationship between equity and statute in Australia when the Personal Property Securities Act 2009 (Cth) comes into operation in early 2012. The new legislation promotes the free assignability of debt and is likely to encourage post facto collateralisation and securitisation of future interests. At the core of the new securities regime will be an integrated national system of registration and notice, and a key question will be how assignments of present and future debts will be fitted into that system. If the past is any guide, we can confidently expect that trusts and equitable assignment will add new layers of complexity to the already intricate legislative scheme, just as equity penetrated the Torrens system of land registration almost from its inception. The cycle of interaction between equity and statute in the credit economy, familiar since the time of the Tudors, is set to continue.