BANKRUPTCY AND INSOLVENCY: CHANGE, POLICY AND THE VITAL ROLE OF INTEGRITY AND PROBITY

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PERSPECTIVES ON THE GFC

It is a privilege to address the members of the Insolvency Practitioners’ Association. My qualifications derive from twenty five years of service in appellate courts of this nation and, before that, ten years service in the Australian Law Reform Commission which included projects on aspects of bankruptcy and insolvency law.

A Justice of the High Court of Australia does not ordinarily get many opportunities to meet the highly talented lawyers, accountants and other professionals who work in the field of insolvency, in all of its diversity. In the High Court, a judge is uniquely privileged or burdened (depending on one’s point of view) to view the entire law of this country, potentially from every angle. The Court addresses a varied diet of legal problems, largely self-selected by the process of special leave. Whereas many lawyers, and even some accountants, will get through their busy lives without more than a passing acquaintance with insolvency law, this has not been the experience of the High Court. From its earliest days, even

before there was federal legislation in 1924, the High Court decided cases on important principles of insolvency law. In the first decade of the Commonwealth, when the new Court was preoccupied with charting the metes and bounds of the Constitution, it still found time to explain and apply the State bankruptcy laws in many important decisions. Unsurprisingly, a number of the cases involved disputes over allegedly fraudulent or improper preferences aimed at defeating bankruptcy.

In the early years of the Commonwealth, it was perhaps natural that insolvency cases would make their way to the High Court, given that, at that time, many appeals lay as of right, judged by the criterion of the amount in issue in the determination. When, in the 1970s, the appellate jurisdiction of the Court switched to a universal system of special leave, it might have been expected that the number of cases in this specialised field would have declined. Certainly, that was the experience of the Court in cases involving contract law, wills, estates and trusts – private law subjects. Yet up to the present time, insolvency cases have continued to attract many grants of special leave.

In the thirteen years of my service on the Court, there were many cases involving aspects of bankruptcy and insolvency law. The fact that the High Court continues to accept these cases indicates a recognition on its part of the objective importance of this field of law to the parties, to legal doctrine and to the proper operation of a market economy. For my own part, I never doubted the significance, for the good governance of

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1 See e.g. *Dobson v Beath* (1904) 2 CLR 277 (act of bankruptcy); *Jack v Smail* (1904) 2 CLR 284 (practice); *Forster v Shackell* (1904) 3 CLR 460; *Savage v Union Bank* (1905) 3 CLR 1170 (security); *Bank of Australasia v Hall* (1906) 4 CLR 1514; *Bayne v Baillieu* (1907) 5 CLR 64 (petition practice); *Hall v Wooll* (1907) 7 CLR 207 (domicile); *Maxwell v Official Assignee* (1907) 8 CLR 553; *Bayne v Blake* (1909) 9 CLR 347 (petition practice).

2 See e.g. *Gow v. White* (1906) 5 CLR 865; *Stuart v Walker* (1907) 5 CLR 110; *Muntz v Smail* (1907) 8 CLR 202.
Australia, of decisions in revenue and insolvency cases. One of the reasons why we enjoy a high standard of living in Australia is that our courts have been rigorous to uphold the rule of law in these fields. Apart from everything else, they can often present interesting legal and factual problems. As every expert in the field will know, they are problems that extend beyond black letter interpretations of statutory provisions. Important questions of legal principle and policy are presented. These can sometimes give rise to strong differences of opinion, as I will show.

One feature of serving for more than a decade on a final national court is the instruction that the experience gives about the obligation to view particular areas of the law in the context of the global and national circumstances in which their problems have to be resolved. An obvious example is the way in which, over the course of the last century, constitutional law in Australia evolved. Old notions of imperial subordination gave way to new concepts of national independence\(^3\). Old ideas concerning the limits of the legislative powers of the Federal Parliament have been adapted to the perceived urgencies of federal governments both in times of war\(^4\) and in times of peace\(^5\).

So it is with insolvency law and practice. To understand its contours, and likely future developments in the current decade, we in Australia must reflect upon the global finance crisis (GFC) and the lesson it affords for this sphere of the law’s operation. Like an earthquake, measured high on the Richter scale, the GFC came with stealth upon

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\(^3\) See e.g. *Sue v Hill* (1999) 199 CLR 462 (the status of British subject).

\(^4\) *South Australia v The Commonwealth* (First Uniform Tax Case) (1942) 65 CLR 373; reaffirmed *Victoria v The Commonwealth* (Second Uniform Tax Case) (1957) 99 CLR 575. See also *Farey v Purvett* (1916) 21 CLR 433 (defence power); *Victorian Chamber of Manufactures v The Commonwealth* (Women’s Employment Case) (1943) 67 CLR 347 at 365, 398 and contrast *The King v Foster* (1949) 79 CLR 43 at 81 (post-war defence power).

Australian and the global community. One of the few specialties that would have discerned a silver lining in this crisis was that of practitioners in bankruptcy and insolvency law. Many investors, large and small, who assumed that the economic fortunes of nations such as Australia would sail along, as they had for twenty years, received a shock. From a legal point of view, the shock demonstrated something that I had repeatedly emphasised in the High Court, namely the impact of international law and international events upon the Australian legal culture\textsuperscript{6} and its rules.

But how did this crisis come about? Why did national and international guardians of the market economy fail to detect the coming crisis and to protect the global and national economies, which was its outfall? What are the lessons we should derive from the GFC?

A recent issue of the \textit{University of New South Wales Law Journal} explains the course and challenges presented by the GFC\textsuperscript{7}. The opening chapter by Michael Legg of UNSW and Jason Harris of UTS tells the history under the evocative title: “How the American Dream Became a Global Nightmare”. The authors explain the trajectory of the “largest financial shock since the Great Depression, inflicting heavy damage on markets and institutions at the core of the financial system”. They describe how the United States market in sub-prime mortgages and “low doc” loans emerged. And how problems spread as a result of defaulting loans that led to the collapse of Lehman Brothers and the downward spiral of organisations with the beguiling names of ‘Fannie Mae’ and ‘Freddie Mac’, now burned onto the global consciousness.

\footnotesize \textsuperscript{6} See e.g. \textit{Al-Kateb v Godwin} (2004) 219 CLR 563 at 662 [169].
\footnotesize \textsuperscript{7} (2009) 32 \textit{Uni of NSW Law Journal} 338.
The technology that underpins science and contemporary knowledge, that facilitates airline and telecommunications systems, and promotes the global movements of capital, quickly spread the impact of the GFC from the United States to Britain, where the largest bank, HSBC, in March 2008, reported a $US17.2 billion loss on write-downs of its US mortgage portfolio. A similar impact on the largest retail bank in France, Crédit Agricole, demonstrated, in a tangible way, that no country in the contemporary world was entirely immune from such a crisis. In Australia, the receivership of what the authors called “two of the boom share market darlings” (ABC Learning and Allco) illustrated the fact that we too were not exempt.

The unfolding crisis quickly disclosed serious regulatory gaps. Millions of jobs were lost across the developed world. Many large corporations failed. Some were once thought too big to collapse. A common theme of the recriminations (some of them resulting in legal claims) was the failure of financial institutions to disclose essential information to investors and shareholders. It is at this point of events that the legal consequences of the GFC tend to meet the national legal systems as the losers seek to spread their risks of loss to financial advisers, auditors and regulatory authorities who did not warn that the GFC tsunami was coming.8

A second article in the same journal by Cynthia Williams and Frank Van De Graff explores the “intellectual foundations of the global financial crisis”9. Their analysis includes the astonishing admission of former U.S. Reserve chairman Alan Greenspan: “Those of us who look to the self-

8 (2009) UNSWLJ 338 at .
interest of lending institutions to protect shareholder equity have to be in a state of shocked disbelief” since “significant parts of today’s financial risk-valuation system failed under stress”. The confidence of neo-liberal proponents in relatively unrestricted market operations, on the footing that the market will always adjust to avoid a destructive crisis, is taken to task by these authors. Their criticism develops themes written earlier by several Nobel Laureates in economics, including Amatya Sen (1998), Joseph Stiglitz (2001) and Paul Krugman (2008).

From the point of view of Australian insolvency practitioners, the most interesting part of this analysis concerns the relative performance in the GFC of the Anglo-American economies and of the North European, Scandinavian, German and Netherlands economies. In the latter, shareholders tend to enjoy greater legal rights than are enjoyed in English-speaking democracies. The United States economy, in particular, had a seemingly unwavering faith in laissez-faire. The authors conclude their analysis with the opinion that “market fundamentalism” was one of the chief causes of the GFC. The self-interest of many of the players (some call it “greed”) was seen as a “key driver of social progress. Under the assumption of full information, the market was assumed to develop towards a certain equilibrium between demand and supply on a consistent basis”. Williams and De Graff, however, conclude that “the deterministic, individualistic, rational view of markets tending to equilibrium has led to neglecting the critical role of social values and change in economic progress.

So how and why did Australia do better, on the whole, than the other major English-speaking economies: the United States and the United Kingdom? This is the subject examined by Ankoor Jain and Cally
Jordan in their article asking whether “Australian [is] still the lucky country?”\textsuperscript{10} Both Australia and the United States are countries where the dream of individual home ownership is a powerful motive force of much political significance. However, for reasons which the authors explain, the sub-prime lending practices and ‘low doc’ policy that flourished in the United States never took on in Australia. Legal and banking prudence is, happily, still a feature of the Australian financial and legal scene. Part of the explanation as to why Australia weathered the GFC better than most countries is, in the opinion of these authors, that we stuck to our colonial legacy of British banking prudence which, as in Canada, influenced the practices of the banking and financial sectors.

Other explanations are cited, including the protection of banking competition; the powerful role of the Reserve Bank of Australia; and the monetary and fiscal policies observed by successive federal governments. Other authors, analysing the GFC from an Australian perspective, emphasise the importance of transparency of corporate governance as the key to confidence in financial products and the avoidancy of sharp swings in the incidence of insolvency and individual bankruptcy. The existence of strong and independent financial regulators and the application of stern legal requirements to corporate directors, obliging them to avoid trading whilst insolvent, may sometimes reduce innovative and imaginative corporate risk-taking. However, as the differential experience of Australia when measured against that of the United States and Britain indicate, the only test that matters in the performance of risk-taking is one measured in the long term. Too many failed enterprises, and too much work for liquidators, receivers, trustees

\textsuperscript{10} (2009) 32 UNSWLJ 338.
and other insolvency officeholders and practitioners, is not good for the long term viability and social stability of a nation. Putting it bluntly, there is a success ratio for insolvency practitioners that means there should not be too much work for them, although they are needed certainly for the vital tasks they perform where failure occurs or is threatened.

Each of the two main political groupings in Australia claim that they are best able to deliver the essential equilibrium of desirable market regulation that retains a cohort of suitable size amongst the nation’s insolvency practitioners but avoids the individual and corporate failures that would necessitate excessive numbers working in your industry. Each side of politics dresses up its assertions in the language of political rhetoric.

Thus, Prime Minister Kevin Rudd, in September 2009, poured scorn on what he painted as the ideological commitment of his opponent to stern market correction. This would work, he acknowledged, “so long as you are prepared to accept hundreds of thousands of Australians as collateral damage as a consequence ...”\(^\text{11}\). On the Coalition side, spokesmen urged that the only reason Australia could survive the GFC so well was because of economic reforms pioneered by the Coalition government of John Howard\(^\text{12}\). The truth probably lies somewhere between these two assertions. In the brilliant legal idea that led to the invention of the corporation independent from its shareholders, there remains a fundamental dilemma. It is one that lies at the heart of opportunities and functions of insolvency practitioners, called in to pick

\(^{11}\) Hon. K.M. Rudd, “Drive to Reform is not Bipartisan”, extracted *The Australian*, 8 September 2009, 12 (extract from a speech of the Prime Minister at the launch of the *March of Patriots* by Paul Kelly, 2009, given on 7 September 2009, Canberra.

up the pieces where corporations, as the major players in a market economy, fail.

The dilemma is this. An economy such as ours must, to some extent, allow corporations and their officers to take risks. Without risk-taking, inventiveness will atrophy. Job and capital creation will shrink. Yet we must face the fact that some risks do not pay off. Some risk-takers are fraudulent. Others are simply ill-informed, unwise, or suffer from that greatest of human maladies, bad luck. Somehow, we have to encourage and promote reasonable risk-taking; redress fraud; and address the distribution of assets, where bad luck results in failure. Facing squarely the down side of risk-taking, but imposing regulations that do not end up suffocating risk-taking, is the central challenge that all nations must address if they are to learn the abiding lessons of the GFC.

YEARS IN LAW REFORM

Before my quarter century in appellate courts, I had the privilege to serve as foundation chairman of the Australian Law Reform Commission (ALRC) (1975-84). A decade before that Commission embarked on its major investigation of insololvency law reform which produced the influential and successful Harmer report, it tackled a particular aspect of bankruptcy law as it concerned “small or consumer debtors” who were unable to pay their debts. The result of the enquiry was the sixth report of the Commission: Insolvency – The Regular Payment of Debts. The report’s recommendations were substantially implemented by amendments to the Bankruptcy Act 1966 (Cth) in the Bankruptcy

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Amendment Act 1980 (Cth). Essentially, the ALRC proposal initiated a shift toward more informal debt agreements. In the intervening years, the use of this solution in cases of temporary incapacity to pay debts has expanded in accordance with the provision found in Part IX of the Bankruptcy Act 1966 (Cth).

In cases to which they apply, there is little doubt that debt agreements return, on average, a much better dividend for creditors than bankruptcy: about a 76% return which is substantially greater than the average return in a bankruptcy of only approximately 1.6%\textsuperscript{15}. The circumstances in which debt agreements should be encouraged, in place of resort to bankruptcy, is still a matter of lively debate in Australia. That debate broke out in response to the Bankruptcy Legislation Amendment Bill 2009 (Cth). That Bill proposes an increase in the threshold requirement for a creditor’s petition in bankruptcy in Australia from $2,000 to $10,000.

Supporting this proposal, the Federal Attorney-General pointed out that money had lost value since the $2,000 threshold had been set in 1996; that only 20% of sequestration orders in the last financial year were for debts between $20,000 and $10,000; that bankruptcy orders leave a permanent record which can blight the lives of young debtors, impeding them in securing essential assets such as houses and cars; and that the returns on bankruptcies are so low as to warrant encouraging the use of procedures involving agreement rather than invoking coercive proceedings in bankruptcy. The Attorney-General expressed his

concern that “too many creditors are using bankruptcy as a tool in debt collection as opposed to a last resort”\textsuperscript{16}.

The comments on this relatively straight-forward legislative proposal reflect many of the policy debates that were addressed to the Australian Law Reform Commission in 1976. In his article on the suggested reforms, Mark Worsnop put it this way\textsuperscript{17}:

“The proposed increase to the bankruptcy threshold for creditors, only, to $10,000 is unlikely to please either camp in the ongoing philosophical debate between debtors and creditors. Debtors argue that bankruptcy should not be seen as a debt collection process, but they fail to take into account that often the threat of bankruptcy remains the only practicable means for a creditor to enforce a judgment debt. ... The increased threshold may prove a saving to some creditors chasing genuinely impecunious ‘small’ debtors, but reduces the most effective means of recovery against the rest, while increasing the total debt that individual debtors can carry.

Until alternative enforcement processes are made more effective, disarming judgment creditors should be done with great care, to avoid court judgments being reduced to nothing more than pieces of paper.”

As I read these remarks, they took me back to the disputes we had in 1976 in framing the ALRC’s response to issues of small consumer debt recovery. The Commission recorded that, even in those days, “Creditors rarely bring petitions against non-business debtors, partly because of the costs involved, partly because credit providers believe it may provide bad publicity and detrimentally affect future business. The insolvency procedures of the Bankruptcy Act are available only to business debtors.

\textsuperscript{16} R. McClelland, Attorney-General, reported \textit{Australian Financial Review}, 27 August 2009, 1.

\textsuperscript{17} Worsnop, above n15, 32.
For reasons which are substantially explained, they are rarely used by non-business debtors\textsuperscript{18}.

In seeking to design a workable alternative, the Commission faced squarely the fundamental problem of the differing objectives of federal bankruptcy and insolvency laws and of State and Territorial laws for debt recovery\textsuperscript{19}:

“The original purpose of the early bankruptcy statutes was to ensure for creditors a more effective means of recourse against a debtor’s property than was provided by execution at common law. The debtor who was made bankrupt did not obtain discharge for his debts. To the extent that his debts were not satisfied by distribution of the proceeds of his property, they remained debts in respect of which execution might subsequently be had or [imprisonment imposed] ... This parlous state of affairs, in which thousands of debtors were imprisoned for indefinite periods, continued for centuries. Insolvency laws, dealing with the composition of debts and voluntary surrender of property, first developed as a means of enabling debtors to obtain their release from imprisonment at common law. In part, these laws were concerned with composition of debts. But their major contribution was in providing poor debtors with a means of release from prison on surrender of their property for the benefit of their creditors ... Only in the 19\textsuperscript{th} century did bankruptcy laws first come to be available in respect of non-traders, and on the debtor’s own petition as well as that of his creditors.”

A major element of the ALRC’s scheme was to update Australian law which was found to lag far behind that of other jurisdictions, notably Canada and New Zealand, and to provide a means by which insolvent debtors could re-arrange their debts and avoid bankruptcy in a speedy, economical, efficient and informal way. Provision for, and training of, debt counsellors was an important part of the Commission’s scheme to

\textsuperscript{18} ALRC 6, 5 [8].
\textsuperscript{19} ALRC 6, 6 [11].
try to address the basic incapacities and defaults that led to credit mistakes and incompetence in the first place.

Drawing upon the reasons of Chief Justice Latham in Lowenstein’s Case\textsuperscript{20}, the ALRC suggested that a broad meaning would be given to the constitutional grant of power with respect to “bankruptcy and insolvency”\textsuperscript{21}:

“If the Commonwealth parliament may, under the power with respect to bankruptcy, deal with conduct which frequently leads to bankruptcy [failure to keep books], presumably it may, under the insolvency power, deal with conduct which frequently leads to insolvency. It follows that the Commonwealth parliament’s power extends to the regulation of credit, collection and recovery practices which are frequently connected with, or which tend to increase the likelihood of, insolvency. All that is necessary is that there be a significant general relationship between insolvency and the matter regulated. Causal connection in the individual case or in all cases is not required.”\textsuperscript{22}

In subsequent provisions of the Bankruptcy Act and of other federal legislation dealing with insolvency, this broad ambit of the constitutional power enjoyed by the Federal Parliament appears to have been assumed by the Parliament.

The encouragement of agreements between creditors and debtors; facilities for accumulation and regular payment of debts; and steps taken to address the fundamental problem of credit incompetence, proposed by the ALRC, rested essentially on concerns about the down side of

\textsuperscript{20} R v Federal Court of Bankruptcy; Ex Parte Lowenstein (1938) 58 CLR 556 at 571-2. See ALRC 6, 76 [159].
\textsuperscript{21} Australian Constitution, s51(xvii).
\textsuperscript{22} Reference was made to the restrictive reading of the power by Barwick CJ in Sandell v Porter (1966) 115 CLR 666 at 670.
bankruptcy affecting individual debtors and of very small recovery otherwise secured by creditors in a typical bankruptcy administration. A schedule published in the ALRC report showed that, in about 250 bankruptcies analysed, the dividends paid to creditors ranged, on average, between 7.92 cents in a dollar and 1.82 cents, depending on the State or Territory concerned.

Reports from studies in Canada and the United States were found to deliver similar outcomes\(^\text{23}\). On the other hand, the cases analysed may not be an entirely representative sample. In 1976, as now, the threat of bankruptcy and insolvency (which still has a reputational sting for individual debtors and for company directors), will sometimes produce a speedy resolution that avoids resort to the formal procedures set in train once bankruptcy or insolvency applies. We cannot banish this reality from the dialogue about bankruptcy and insolvency. Debtors must, it is true, be protected from the misuse of statutory procedures as an aid to what is effectively no more than simple debt recover. By the same token, creditors need to be protected from debtor fraud, incompetency or indifference. Securing the right mixture of statutory provisions will always be controversial. As in most such controversies, there are arguments on both sides. This was understood by the ALRC in 1976. Doubtless it is appreciated by the Federal Attorney-General in 2010.

**CASE DECISIONS AND DIVISIONS**

Soon after my arrival at the High Court of Australia, I participated in an interesting appeal concerned with a suggested fraudulent transaction designed to defeat creditors. The problem arose in *Cannane v J.*

\(^{23}\) See ALRC 6, 73 [153], Table 25.
Cannane Pty Ltd. The facts were not specially complicated. Mr. John Cannane and a family company he controlled each held one $1 share in a shelf company. This was its entire issued capital. On 15 May 1991, when Mr. Cannane and the family company were in financial difficulties, they transferred their shares in the shelf company to one of Mr. Cannane’s sons and to his wife, in each case for consideration of $1. Mr. Cannane had been involved in a proposal for a “back door listing” of another company (CCI), of which he was a director. The shelf company bought the shares in CCI and subsequently sold them to a listed company in consideration for an issue of shares. The venture was profitable for the shelf company.

Mr. Cannane was subsequently made bankrupt. The family company was wound up. The trustee of Mr. Cannane’s bankrupt estate and the liquidator of the family company applied to have the transfer to the son and wife declared void as an impermissible preference. The trial judge (Justice Tamberlin) found that the value of the shares at the time of their transfer was no more than $1. Mr. Cannane gave evidence that, at the time of the transfers, (a) he intended and contemplated that the shelf company would be the vehicle by which the company acquired an interest in CCI if anything came to pass as he hoped; (b) he proposed to do everything he could to ensure that the deal was delivered in substance to the shelf company; (c) he contemplated the possibility of his bankruptcy and the winding up of the family company; and (d) he was concerned to ensure that, if those events came to pass, neither his creditors nor those of the family company, would have access to the shelf company shares.

Following the trial judge’s holding that the transfers were void on the basis that they were made with an intent to defraud, defeat or delay creditors and further that it had not been established that either transferee had acted in good faith, an appeal was lodged to the Full Federal Court.

In that Court, Justices Beaumont and Hill (with Justice Lehane dissenting) dismissed the appeal. All judges in the Full Court upheld the finding that the value of the shares at the time of their transfer was no more than $1. They also upheld the trial judge’s dismissal of a claim based on s120 of the Bankruptcy Act. But Mr. Cannane, his wife and son, then appealed by special leave to the High Court.

The majority of the High Court (Chief Justice Brennan and Justices Gaudron, McHugh and Gummow) held that the transfers to the son and wife were not void under s121(1) of the Bankruptcy Act or s565(1) of the Corporations Law. Their Honours so concluded because, they held, there was no intent to defraud creditors within s121(1). Further, there was no intention to deny creditors the benefit of assets in which they would have been entitled but for the challenged disposition. The foundation for this holding was a dictum of Chief Justice Dixon in Hardie v Hanson that ‘intent to defraud creditors of the company’ suggests “that present or future creditors of the company will, if the intent is effectuated, be cheated of their rights”. I dissented from this majority opinion.

The analysis of the meaning of “intent”, in the bankruptcy context in Cannane, centred on the so-called “financially neutral effect of the

25 (1960 105 CLR 351 at 456.)
transfer”. Justice Gummow, in his reasons in Cannane, held that the full present value of the two shares (namely $2) was received. The later increase in the value of those shares in the hands of the transferees was the result of other activities. The transfer of the shares for their full present value was therefore held not to have depleted the debtor’s assets, or prejudiced the creditors in any way.

Chief Justice Brennan and Justice McHugh in their joint reasons observed that the applicable provisions in the Australian Bankruptcy Act could be traced to the original provisions in the Statute of Elizabeth; 13 Eliz 1c5. According to their Honours, it was “clearly established that the party seeking to avoid a disposition of property has the onus of proving an actual intent by the disponor at the time of disposition to defraud creditors”27. To the same effect, was the decision of Justice Gaudron, stressing the need for “a real intent” to be shown.

In my dissenting reasons, I recognised, candidly I hope, that there was a divergence of judicial opinion on the question of legal principle, preceding its examination by the High Court in Cannane:

“The broad approach to the ascertainment of an ‘intent to defraud creditors’ favoured by the Full Court in this case ... is correct. The narrower approach requiring proof of an intention to ‘swindle’ creditors of their entitlements is not appropriate to s121 [of the Bankruptcy Act]. Adopting such an approach would seriously undermine the section’s effectiveness”.

In justifying this opinion, I invoked what I saw as strong practical reasons to support the approach I favoured:

“Even when the distinction between intention and motive is kept in mind, knowledge of subjective intention will ordinarily, or often, be reserved to the person whose interests may be so affected that an assertion, one way or the other, cannot necessarily be accepted at face value. That is why, at least in a provision such as s121, it is not necessary to establish that the transferor of the property in question actually had in mind an intention to defraud creditors if the effect of what the person did would reasonably be expected to have such a consequence. Courts will therefore infer the intention in issue, deciding it as a question of fact. This does not mean that the intention so derived is one imputed by the law. It is not a fiction. It is the real intention of the transferor decided objectively rather than upon protestations of innocence on the part of the debtor or outraged accusations on the part of suspicious creditors.”

One of the few pleasures of a retired appellate judge is to watch his or her dissents and to see how they fare in their own court and in other courts subsequently considering like questions. Supporters of the majority opinion in Cannane would doubtless assert that it was sustained by a close analytical scrutiny of the language of the Act and application of that language to the particular transactions framed by the debtor in the case. Opponents would doubtless argue (as I did) that such an approach was inimical to carrying forward the overall policy objectives of the applicable provisions of the Bankruptcy Act. Indeed, they would risk frustrating the attainment of those objectives.

The question of whether or not to follow the majority approach in Cannane arose in the Supreme Court of New Zealand in the 2009 decision of Castings Ltd v Lightbody\(^{30}\). In that case, the respondent had a jewellery business operated through a company which was incurring large debts to its main supplier. The respondent had guaranteed those

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\(^{29}\) (1998) 192 CLR 557 at 592.
\(^{30}\) [2009] 2 NZLR 433.
debts. He caused his home to be transferred to a trust, ostensibly in consideration of a debt repayable seven years later. However, the debt was progressively forgiven or reduced by sums gifted to the trust by the respondent. The result was that four years later, the debt had been extinguished. All of the judges of the New Zealand court held that, on the evidence, an actual intent to defraud or to frustrate creditors could be inferred. They differed on the extent to which the rule of the common law was applicable in inferring the intent in such a circumstance (*Freeman v Pope*[^31]). Justice Tipping, however, supported the drawing of inferred intent from the circumstances. The language that he used was very similar to that which I had favoured in *Cannane*[^32]:

“[This approach is not] anomalous. It reflects the fact that there is a crucial difference in present circumstances between intent and motive. The motive of the alienor in *Freeman v Pope* may well have been to benefit the alienee without any conscious wish or intent to harm his own creditors. But his intent, he being insolvent, was taken to have been to defraud the creditor concerned as that was the likely consequence of what he was doing. The policy behind this application of the legislation is simple. Insolvent debtors are not allowed to make gifts which prejudice the interests of creditors. That seems to me to be a very salutary rule which should be maintained in the form of the irrebuttable presumption ... The practical basis for the rule ... was the difficulty of contemplating circumstances in which an inference of intent to defraud should not be drawn when an insolvent debtor gives away property.”

The quiet satisfaction that I felt in reading the opinions of the New Zealand judges in *Castings* was enlarged a few months later when I read the unanimous decision of the Court of Final Appeal of Hong Kong. The issue presented by the clash of Commonwealth authority fell to be

[^31]: (1870) 5 Ch App 538.
[^32]: [2009] 2 NZLR 433 at 471 [104].
decided in the decision of that Court in *Tradepower (Holdings) Ltd (In Liq) v Tradepower (Hong Kong) Ltd*33. Would they follow Cannane or would they follow the New Zealand judges in Castings? All of the judges of the Hong Kong Court (including Lord Walker of Gestingthorpe NPJ, now also a judge of the Supreme Court of the United Kingdom) concurred in the reasons of Justice Ribeiro PJ34. In his opinion, Justice Ribeiro reviewed the clash of decisional authority between the High Court of Australia and the Supreme Court of New Zealand centring around the approach that courts should take to the common law rule. The Hong Kong judges preferred the approach favoured by the New Zealand court and myself in dissent in the High Court to both of which they referred in some detail. Justice Ribeiro said35:

“Where it is objectively shown that a disposition of property unsupported by consideration is made by disponor when insolvent (or who thereby renders himself insolvent) with the result that his creditors (including his future creditors) are clearly subjected at least to a significant risk of being unable to recover their debts in full, such facts ought in virtually every case to be sufficient to justify the inference of an intent to defraud creditors on the disponor’s part. In cases falling outside the rule, that is, in cases where the disposition is made for valuable consideration or where the disponor is not insolvent or where the disposition does not deplete the funds potentially available to the creditors, an actual intent to defraud creditors must be shown as an inference properly to be drawn on the available evidence before [the section] is engaged ... [T]he practical basis for [this] rule is the difficulty of contemplating circumstances in which an inference of intent to defraud should not be drawn when an insolvent debtor gives away property.”

Of course, the law in Australia is still that stated by the majority of the High Court in *Cannane*. But, as a review of the decisions of the High

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34 Bokhary PJ, Chan PJ, with Litton NPJ and Lord Walker NPJ.
35 [2009] HKCFA 5 at [88]-[89].
Court demonstrate, many cases arise in this area of discourse concerning the interpretation of facts and transactions, on the brink of insolvency, which creditors, a trustee or receiver suggest were made with the requisite intent of defeating creditors. This is not a rare problem. Some may think that the position now reached in New Zealand, Hong Kong (and arguably the United Kingdom) has a sound, practical, commercial, reasonable and common sense basis.

The day may come when a suitable case presents this issue for reconsideration by the High Court of Australia and a re-examination of its majority holding in Cannane, measured now against two very strong appellate decisions upon like or identical questions, given by respected final courts outside Australia. Personally, I hope that day comes because it is important to advance unfair preference provisions with common sense, so as to achieve, as far as their language allows, the main policy objective of bankruptcy law.

**IMPORTANCE OF STANDARDS AND PROBITY**

In these remarks, which touch upon only a few of my encounters over 35 years with bankruptcy and insolvency law, I have attempted to show both the importance of the issues that arise and the contestability of some of the conflicts that require professional and judicial decisions.

I pay my respects to the Insolvency Practitioners’ Association of Australia. I acknowledge the high quality of its publication, Australian Insolvency Journal, and the contribution which the Association has made to the expression and maintenance of high standards for professional practice in the field of insolvency. There could not be more pertinent
values to strive for in that field than those expressed by the Association, namely integrity, transparency, accountability and technical proficiency.

If part of the success of the Australian nation, and its economy, has been the provision of law and practices with respect to bankruptcy and insolvency that move with changing times and values. This demonstrates the importance of those who work in this professional field. At times, I am sure that it must seem very technical and occasionally frustrating. However, that is the price paid for observing the rule of law rather than the rule of power, influence or money. As I have sought to show, the issues presented for resolution in this area of the law require more than verbal ability and a detailed knowledge of the relevant statutes. There are contestable arguments concerning the meaning of statutory language, as the decision in Cannane, and the cases that have followed it, show. There is also a significant role for reflection by practitioners on the social policy of the law and on how, in particular cases, the rights of debtors and creditors are to be balanced.

A Senate committee in the Australian Parliament is presently conducting hearings into the regulation of the professionals who work in insolvency. This Association has been responsible for promoting a professional code of conduct36 and for strengthening the performance standards of those practitioners who work in the field. It has done so by formulating the professional code and by promoting co-regulation with the three federal agencies having statutory responsibilities in the field: Insolvency and Trustee Service, Australia (ITSA) and Australian Securities and

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Investments Commission (ASIC) and the Companies Auditors and Liquidators Disciplinary Board (CALDB).

The Senate committee is examining whether a different, and more detailed public, regulatory model should be recommended to the Parliament. At the same time as this investigation is going ahead, consideration is being given to establishing a new national approach to regulation of the Australian legal profession. In both cases, concern has been expressed in some professional circles about the intrusion of more intensive federal regulation of professional activities. In the case of the legal profession, special anxiety has been expressed over any diminution in the important role hitherto played by the superior courts of Australia in the discipline of legal practitioners admitted by, and practising before, them.

There are many reasons, apart from historical ones, for maintaining a substantial role for professions themselves in regulating their members, both in expressing standards and in investigating and deciding cases of suggested misconduct:

* It is the professionals themselves who normally know best the detail and variety of their industry’s activities;

* Professional experts cannot be easily hoodwinked by clever arguments. They know intuitively and quickly when unprofessional errors or omissions have occurred in adhering to high professional standards;

* Typically, at least in recent times, professional bodies have been harder on erring colleagues than generalist tribunals might have been. This may sometimes be because they have a keener
understanding of the enormous damage that reports of errors and neglect can do to the reputation of the entire profession;

* By invoking part-time professional personnel into the regulation and discipline of professional activities, there is an effective delegation of public power which saves the community substantial bureaucratic and official costs and avoids the imposition of high administrative expenses that must otherwise be borne by clients or taxpayers; and

* Close involvement of the profession encourages educative initiatives and continuing professional training. It also allows the profession to learn directly from individual cases and to address systemic difficulties which public administrators might feel fall outside their statutory remit.

On the other hand, the traditional model of leaving professional regulation to the professionals themselves sometimes presents to lawmakers difficulties and weaknesses that lead them to consider a greater role for public regulatory bodies:

* Professionals are occasionally incapable of seeing or reluctant to see the perspective of clients and sometimes they can be overly attentive of the burdens on fellow professionals;

* In the case of insolvency practitioners, the small proportion of creditor funds that is typically paid as a dividend following completion of formal insolvency proceedings inevitably causes creditor anger and puzzlement. Inevitably, creditors sometimes feel that, in the end, it is the insolvency professionals who benefit most from the administration of insolvent estates whilst creditors receive a pittance from the remainder. Yet creditors must approve
practitioners’ remuneration and typically do so by reference to their skill and experience;

* Professional regulation is commonly viewed by critics as lacking in neutrality. The old aphorism that professions are conspiracies against the public is often invoked with a demand for independent regulators who can hold the scales in proper balance; and

* In the case of insolvency practitioners, there is a wide range of skills and professional background at work which means that the coherence that can sometimes support the professional regulation of lawyers and medical practitioners is not so easily available in the case of those disparate activities. Anyway, even the traditional professions are now increasingly supervised by public regulatory bodies which include in their number lay participants who are expected to provide public perspectives that professionals might themselves overlook.

There is little doubt that a significant engine for change towards more public regulation of insolvency practitioners derives from the typically high cost of insolvency administration and the small dividends that are often paid to creditors following the formal administration of insolvent or bankrupt estates. It is not my function to resolve this issue. Upon it, the Senate committee will give its report and make its recommendations. Still, in a cost-conscious age, it is important to keep in mind the advantages of a system of professional and statutory co-regulation. And when complaints are made about low dividend returns, it is necessary for those who decide public policy to remember a number of advantages of co-regulation:

* It tends to be cheaper, quicker, more intuitive and less formalistic;
* If it is replaced by a larger role for public regulators, this has an inescapable cost that has to be funded. That cost becomes yet another economic consequence of insolvency;

* The task of insolvency administration is inherently expensive. Principally this is so because of the intensive nature of the investigation of accounts (sometimes in a shambles and sometimes deliberately deceptive) that the insolvency practitioners must analyse and understand. This is also true of legal costs. All my life, I have known litigants asserting vehemently the justice of their claim, but unwilling to appreciate that securing an outcome is inherently costly. It is unreasonable to demand that skilled professionals should perform their functions at low cost. Dispute resolution has a cost component. Especially where the disputes are complex and contestable, as many involving insolvency are; and

* In any case, insolvency practitioners have particular fiduciary responsibilities. They also have to perform detailed statutory functions. These can extend to preparing briefs of evidence for prosecutors; locating, controlling and selling property under the *Proceeds of Crime Act 2000* (Cth) and the *Customs Act 1901* (Cth); and performing the public duties imposed by the *Bankruptcy Act 1966* and the *Corporations Act 2001* (Cth). Such practitioners are performing crucial public functions which are vital to a well-governed polity and an efficient economy. Unless the public purse is willing to absorb all such costs, a significant burden on creditors is virtually inescapable. Greater efficiency and more realism in the administration of bankrupt and insolvent estates will likely be the way ahead under federal law. Just as the recent federal budget recognised the need for standard deductions to cut a swath
through the individually itemised system of taxpayer assessments, the future directions in insolvency law seem likely to involve more broad strokes. Pernickety administration is inescapably costly.

There is one final consideration that needs to be taken into account in designing a just and efficient system for regulating insolvency professionals in Australia. It is this. Getting the correct balance between entrepreneurial risk-taking and regulatory control of individual and corporate activities is always a work in progress. The recent experience of the global financial crisis suggests that we in Australia have done better in achieving the correct balance than many other lands. Part of the credit for this can undoubtedly be accorded the lawyers, accountants and others, who work in the important field of bankruptcy and insolvency administration. Their integrity, probity and professionalism make a significant contribution to the successful operation of our economy and thus to employment and capital development essential to the success of the nation as a whole.

I am glad that this opportunity has arisen for me, soon after my retirement from judicial life, to meet those whose painstaking work lies behind the refined legal arguments presented in individual cases to the High Court in Canberra. We can all be proud to live in a country that adheres to the rule of law and that upholds skilled professions observing high standards of training, integrity and accountability. Upholding high professional standards and improving efficiency and benefits for creditors are the chief challenges of these professions in the years ahead.

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