

Further guidance on when third party payments will constitute unfair preferences

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Summary

In *Hosking v Extend N Build Pty Ltd* [2018] NSWCA 149, the Court of Appeal considered whether payments made to contractors of an insolvent company by a third party could be deemed to be unfair preferences. The case provides a good summary of the current Federal Court decisions, which deal with this contentious issue and provides guidance for practitioners in identifying whether these payments fall within section 588FA of the *Corporations Act 2001* (Cth) (the Act).

Facts

1. Evolvebuilt Contracting Pty Ltd (the Company) was subcontracted to Built NSW Pty Ltd (Built) to carry out building works.
2. The Company retained secondary contractors to carry out the works on its behalf.
3. The Company failed to pay the secondary contractors.
4. Built received a request from the Company to pay the secondary contractors pursuant to a clause in the contract as between the Company and Built.
5. Built also received a letter from the Union requesting that payments be made to the secondary contractors.
6. Built made an arrangement with the Union for payment to the secondary contractors.
7. Built paid five of the six secondary contractors pursuant to its arrangement with the Union.
8. A sixth secondary contractor received payment directly from the Company.
9. The Company went into liquidation.

The liquidators of the Company commenced recovery proceedings in the Supreme Court of NSW alleging that payments made by Built to the secondary contractors (the defendants in the proceedings) were unfair preferences of the Company pursuant to section 588FA of the Act.

At first instance, Brereton J held that the payments made by Built to the five secondary contractors were not unfair preferences because the Company was not a party to the transactions. The payments to the five secondary contractors were made by Built following negotiations with the Union and were paid from the assets of Built; so it did not follow that the payments were “made by” or “from” the Company. It was also relevant that at the time of each payment, Built did not owe any money to the Company so there were no moneys out of which payment could have been directed by the Company to the secondary contractors.

The issue on appeal

The leading judgment on appeal was handed down by Chief Justice Bathurst (with whom President Beazley and Justice Gleeson agreed).

The two issues on appeal were:

1. Whether the payments made by Built to the five secondary contractors were ‘transactions’ of the Company and recoverable from the secondary contractors as unfair preferences; and
2. Whether the sixth secondary contractor, who was paid directly by the Company and not subject to the arrangement with the Union, could rely on the good faith defence under section 588FG(2) of the Act.

The Law

At first instance, the liquidators relied upon the following Federal Court authorities. On appeal, the liquidators contended that the primary judge had failed to properly

apply the authorities, which examined the circumstances in which payments made by third parties will be liable to be unfair preferences. These cases are summarised below:

Re Emmanuel (No 14) Pty Ltd (in liq); Macks v Blacklaw & Shadforth Pty Ltd (1997) 147 ALR 281

The Federal Court held that a payment by a third party (C) to a creditor (B) of a company that went into liquidation (A) was a payment “from” A to B because C paid B utilising funds that it had agreed to loan A. The payment was held to be a “transaction” of A.

Burness v Supaproducts Pty Ltd [2009] FCA 893

The Federal Court held that payments made by a third party (C) in reduction of a running account between a creditor (B) of the company in liquidation (A) was a “transaction” of A. In this case, A & C had common directors. The Court held that a “course of conduct” was initiated by A to have its debt to B discharged by payments from C. [A also acquiesced in the payment of its debt to B by C].

Commissioner of Taxation v Kassem and Secatore [2012] FCAFC 124

A third party (B) made payment to the Federal Commissioner of Taxation (FCT) to discharge a debt owing to it by a related entity, the company in liquidation (A). On appeal, the Full Court of the Federal Court held that this was a “transaction” of A because B had made the payment to the FCT utilising funds advanced to it by A.

Findings

Bathurst CJ found that the liquidators had not established that the Company was a party to the transactions. In coming to this conclusion, his Honour gave considerable weight to the circumstances surrounding the payments made by Built to the secondary contractors.

Firstly, Built had terminated its contract with the Company prior to making the payments to the secondary contractors. On the evidence, the payments made by Built to the five secondary contractors were pursuant to the arrangement with the Union and were not made following the Company’s request for Built to make the payments under the contract.

Secondly, an adjudicator’s determination supported a finding that Built did not owe any money to the Company. Therefore, the payments were made purely out of the assets of Built.

Significantly, no assets of the Company were affected or diminished as a result of Built making the payments to the five secondary contractors.

The Court of Appeal overturned the primary judge’s finding that the sixth secondary contractor could successfully rely on the good faith defence under section 588FG(2) of the Act. The Court was not satisfied on the evidence that a reasonable person in the position of the sixth secondary contractor could not have had a positive feeling of apprehension or mistrust that the Company would be able to pay its debts at the time the payment was made.

Conclusion

The Court of Appeal’s decision provides some useful guidance on the current state of play in the area of third party payments and unfair preferences. Overall, the decision is another reminder that the Court will look closely at the circumstances surrounding the third party payment to determine whether the payment constitutes a ‘transaction’ of the company before it considers whether the third party payment is liable to be voidable as an unfair preference under the Act.

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