

Protecting against insolvent preference claims

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MEDIA REPORTS OF massive building price spikes abound. This can cause developers to “go under”. The insolvent transaction (preference) provisions of the Companies Act 1993 say that it is unfair for one creditor of an insolvent company to be paid in preference to all others.

Therefore, a developer’s liquidators may claim back payments by insolvent developers to the building contractors for the work the contractors carried out before liquidation. The liquidators must prove that there was a transaction (usually a payment) “by” the insolvent company which enabled the contractor to receive more in the liquidation than it would have otherwise.

This article is a refresher on how the Court of Appeal recently interpreted the insolvent transaction provisions and how building contractors might protect themselves from insolvent transaction/preference claims.

The facts

In 2005, Ebert Construction Limited (Ebert) contracted with a developer named Takapuna Development Ltd (Takapuna) to build 64 apartments in Auckland. To finance the construction, Takapuna entered into a loan agreement with BOSI.

On 3 November 2005, Takapuna entered into a “direct agreement” with Ebert and BOSI whereby:

- On receipt of approved progress payment certificates, BOSI was required to pay the progress payment amounts to Ebert directly.
- BOSI could terminate Takapuna’s facilities, but only if it first paid any due progress payment claims to Ebert.
- Takapuna also irrevocably authorised BOSI to make advances pursuant to the loan agreement for the purpose of paying Ebert.

In April 2008, Ebert completed construction of the apartments. In November 2008, Takapuna acknowledged that it was still

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indebted to Ebert. Takapuna issued two drawdown notices on BOSI to pay Ebert whereby BOSI paid \$1.063 million to Ebert. BOSI recorded the payments as advances to Takapuna.

On 21 November 2008, Takapuna entered into liquidation and the liquidators claimed the payments under the insolvent transaction sections of the Companies Act 1993.

The High Court ordered Ebert to pay the \$1.063 million to Takapuna (amongst other things) on the basis that the payments should be treated as having been made by Takapuna and therefore capable of being insolvent transactions.

Ebert appealed and the Court of Appeal held that the payment from BOSI to Takapuna was neither a transaction by Takapuna nor an insolvent transaction, cf *Ebert Construction Limited v Sanson & Anor* [2017] NZCA 239 [8 June 2017].

In coming to those conclusions, the court noted:

Not a transaction “by” Takapuna

- A transaction’s substance is more important than its form and the substance of this transaction was that BOSI was directly liable to Ebert as principal, not just Takapuna’s agent. Significantly, the obligation was not dependent on Takapuna not being in breach of the loan agreement with BOSI. BOSI was entitled to terminate the direct agreement in certain circumstances, but it could not do so without meeting Ebert’s progress payment claims up to the date and Ebert would then have the right to terminate the construction contract unless satisfactory substitute payment arrangements were made.
- The essence of a voidable preferential payment by Takapuna would be that the funds (or asset conveyed) came from resources available to Takapuna to pay its general creditors. Critically, BOSI was obliged to make these payments to Ebert and its facility could not have been used by Takapuna to make payments to any other person. Therefore, it would be artificial and inconsistent (for the purposes of section 292) to treat the payments as having been made by Takapuna.

Not an insolvent transaction

- To be an insolvent transaction, the payments must have enabled Ebert to receive more towards satisfaction of a debt owed by Takapuna than Ebert would receive, or would be likely to receive, in Takapuna’s liquidation.
- Again, the court noted that because of BOSI’s direct contractual obligation to pay the progress payment to Ebert, this would never be the case. This was because Ebert was always entitled to seek to recover against BOSI whether before or after liquidation. That was the principal benefit to Ebert of the direct agreement.

Conclusion

Contractors will be pleased with the Court of Appeal’s decision. However, the same result may not necessarily apply to all direct payment agreements. Had the direct agreement not created an obligation on BOSI, the payment would have been voidable by the liquidator.

Contractors should analyse the substance of any direct payment agreements to ensure that they contain the same key features as the agreement in this case – the third party is under “a direct liability” to the contractor. 🚧