#124

IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV-2009-404-008146

UNDER	the Companies Act 1993
IN THE MATTER OF	Aden Electrical Ltd (In Liquidation)
BETWEEN	PETER REGINALD JOLLANDS AND ROBIN TRISPIN JOLIFFE Plaintiffs
AND	MITCHILL COMMUNICATIONS LTD Defendant

Hearing: 15 December 2010

Appearances: J S Hooper for Plaintiff
B M Nathan for Defendant

Judgment: 18 January 2011 at 11:00 am

JUDGMENT OF ASSOCIATE JUDGE BELL

This judgment was delivered by me on 18 January 2011 at 11:00 am pursuant to Rule 11.5 of the High Court Rules.
Registrar/Deputy Registrar

Date: .....

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[1] Aden Electrical Ltd (in liquidation) was an Auckland electrical contractor. On an application filed on 9 December 2009, an order was made for it to be put into liquidation on 5 March 2010.

[2] In 2008-2009, Aden Electrical Ltd had the contract to carry out the electrical work on the refurbishment of the Westfield Mall at Riccarton, Christchurch.

[3] Mitchill Communications Ltd is a Christchurch company which supplies and installs communication cabling. It was Aden Electrical's data and communication sub-contractor. The amount of its tender was $67,496.75 but in the end the total amount of its invoices was $84,215.98. It received four payments:

a)	24 February 2009	$ 1,204.88
b)	27 March 2009	$25,125.07
c)	27 April 2009	$20,284.03
d)	26 August 2009	$12,840.04
		$59,454.02

[4] The liquidators issued a notice under s 294(1) of the Companies Act 1993 setting aside these payments as voidable transactions under s 292. Mitchill Communications Ltd served a notice of objection within time on the liquidators. The liquidators have now applied under s 294(5) to set aside the transactions.

[5] There are three questions:

a) Was Aden Electrical Ltd unable to pay its debts when it made the payments to Mitchill Communications Ltd?

b) Did these payments enable Mitchill Communications Ltd to receive more towards satisfaction of its debt than it would have received in the liquidation? On this question, there is the related issue whether

the sub-contract was a continuing business relationship under s 292(4B).

c) Does Mitchill Communications Ltd have a defence under s 296(3)?

[6] Under s 292(1), a transaction is voidable by the liquidator if it is an insolvent transaction and is entered into within the specified period. There is no dispute that the payments in this case were made within the specified period, under s 292(5), which began two years before the liquidation application was filed in Court.

[7] Under s 292(2), an insolvent transaction is a transaction by a company that:

a) Is entered into at a time when the company is unable to pay its due debts; and

b) Enables another person to receive more towards its satisfaction of a debt owed by the company than the person would receive or be likely to receive in the company's liquidation.

[8] Under s 292(3)(e) payments are transactions.

Was Aden Electrical Ltd unable to pay its due debts?

[9] There is a presumption under s 292(4A):

> A transaction that is entered into within the restricted period is presumed, unless the contrary is approved, to be entered into at a time when the company is unable to pay its due debts.

[10] The restricted period under s 292(4A) began on 9 June 2009, six months before the liquidation application was filed in Court. The last of the payments is within the restricted period and the presumption applies. There was no evidence to rebut the presumption. For the payments made before the restricted period, the liquidators adduced evidence that Aden Electrical Ltd was no longer able to pay its debts in 2009. They put in evidence a statutory demand served on Aden Electrical Ltd by Mainland Access Ltd showing unpaid accounts going back to 2008. The

amount of the debt in the demand was $9,182. It also put in evidence the proof of debt of the Commissioner of Inland Revenue. The Commissioner proved for $1,445,219.91. $196,577.33 was preferential. The proof of debt showed large amounts of deductions wrongly withheld going back to April and May 2008. This was clear evidence of insolvency. Mitchill Communications Ltd did not adduce any evidence to suggest that Aden Electrical Ltd was in fact solvent at the times of payment. I find that when Aden Electrical Ltd made the payments to Mitchill Communications Ltd, it was unable to pay its due debts.

Preferential effect

[11] Mitchill Communications Ltd received payments totalling $59,454.02 in reduction of the total indebtedness of $84,215.98. Given the large preferential claims in favour of the Commissioner of Inland Revenue, I accept that Mitchill Communications Ltd has received more in satisfaction of its debts than it is likely to receive in the liquidation.

[12] To avoid this, Mitchill Communications Ltd says that it comes within s 292(4B) of the Companies Act. It says that, for commercial purposes, the payments were integral parts of a continuing business relationship:

> (4B) Where—
>
> (a) a transaction is, for commercial purposes, an integral part of a continuing business relationship (for example, a running account) between a company and a creditor of the company (including a relationship to which other persons are parties); and
>
> (b) in the course of the relationship, the level of the company's net indebtedness to the creditor is increased and reduced from time to time as the result of a series of transactions forming part of the relationship;
>
> then—
>
> (c) subsection (1) applies in relation to all the transactions forming part of the relationship as if they together constituted a single transaction; and
>
> (d) the transaction referred to in paragraph (a) may only be taken to be an insolvent transaction voidable by the liquidator if the effect of applying subsection (1) in accordance with paragraph (c) is that the single transaction referred to in paragraph (c) is taken to be an insolvent transaction voidable by the liquidator.

[13] In *Airservices Australia v Ferrier* (1996) 185 CLR 483 at 501-502, Dawson, Gaudron and McHugh JJ described the basis for recognising that running account cases do not always involve preferences:

> If a payment is part of a wider transaction or a "running account" between the debtor and the creditor, the purpose for which the payment was made and received will usually determine whether the payment has the effect of giving the creditor a preference, priority or advantage over other creditors. If the sole purpose of the payment is to discharge an existing debt, the effect of the payment is to give the creditor preference over other creditors unless the debtor is able to pay all of his or her debts as they fall due. But if the purpose of the payment is to induce the creditor to provide further goods or services as well as to discharge an existing indebtedness, the payment will not be a preference unless the payment exceeds the value of the goods or services acquired. In such a case a court, exercising jurisdiction under s 122 of the *Bankruptcy Act*, looks to the ultimate effect of the transaction. Whether the payment is or is not a preference has to be "decided not by considering its immediate effect only but by considering what effect it ultimately produced in fact".

And at 503:

> The court looks to the business effect of the parties' dealings which almost invariably proceed on the understanding, sometimes expressed but more often assumed, that the creditor will continue to supply goods or services to the debtor on a credit basis as long as the debtor substantially adheres to their credit arrangements.
>
> If at the end of a series of dealings, the creditor has supplied goods to a greater value than the payments made to it during that period, the general body of creditors are not disadvantaged by the transaction – they may even be better off. The supplying creditor, therefore, has received no preference. Consequently, a debtor does not prefer a creditor merely because it makes irregular payments under an express or tacit arrangement with the creditor that, while the debtor makes payments, the creditor will continue to supply goods. In such a situation, the court does not regard the individual payments as preferences even though they were unrelated to any specific delivery of goods or services and may ultimately have had the effect of reducing the amount of indebtedness of a debtor at the beginning of the six month period. If the effect of the payments is to reduce the initial indebtedness, only the amount of the reduction will be regarded as a preferential payment.

And at 505:

> If the record of the dealings of the parties fits the description of a "running account", that record will usually provide a solid ground for concluding that they conducted their dealings on the basis that they had a continuing business relationship and that goods or services would be provided and paid for on the credit terms ordinarily applicable in the creditor's business. When that is so, a court will usually be able to conclude that the parties mutually assumed that from a business point of view each particular payment was

> connected with the subsequent provision of goods or services in that account. ... Thus, it is not the label "running account" but the conclusion that the payments in the account were connected with the future supply of goods or services that is relevant, because it is that connection which indicates a continuing relationship of debtor and creditor. It is this conclusion which makes it necessary to consider the ultimate and not the immediate effect of individual payments.

[14] Since then, this "running account" doctrine has been enacted in s 588FA Corporations Act 2001 (Australia) and reproduced in s 292(4B) of the Companies Act 1993. Earlier cases such as *Airservices Australia v Ferrier* are useful guidance and are referred to in applying s 292(4B) and its Australian counterpart.

[15] In this case, Mitchill Communications Ltd said that its sub-contract with Aden Electrical Ltd was a continuing business relationship. It says that everything done under the sub-contract must be viewed as a whole and, when that is done, it will be seen as a single transaction. It says that the sub-contract was a continuing business relationship for a specified purpose and period of time. When it has supplied goods and services to the value of $84,215.89 but has only been paid $59,454.02, it says that it has not been preferred.

[16] Australian courts have considered whether construction contracts do give rise to a running account or a continuing business relationship. In *Walsh v Salzer Constructions Pty Ltd* (2000) 3 VR 305 (CA), Winneke P at [17] said:

> ... the payments here in question were not, in my view, part of a "running account" as that term has been viewed by the authorities:
>
> > The significance of a running account lies in the inferences which can be drawn from the facts that answer the description of a "running account" rather than the label itself. A running account between traders is merely another name for an active account running from day to day as opposed to an account where future debits are not contemplated. The essential feature of the running account is that it predicates a continuing relationship of debtor and creditor with an expectation that further debits and credits will be recorded (a citation from *Air Services Australia Ltd v Ferrier*).
>
> In my view, this description of a running account does not fit the concept of a building contract where progress claims are made separately and in isolation from each other and following analysis and confirmation of the claim. In such a case no "balance of account" is maintained, nor is the account a "continuing one" in the sense in which that term was described by Barwick CJ in *Queensland Bacon Pty Ltd v Rees*. That building contract which predicates progress payments from time to time for work done, one

> cannot say that the payment of a progress claim is relevantly connected with the future supply of services so as to indicate that there is a mutual assumption by the parties to the contract that there will be a continuance of their relationship of debtor and creditor. Unless that can be established it is not to the point that the payment is made, in a general sense, partly for the purpose of inducing further work.

[17] The above dictum was obiter. In *Wily v Eastern Elevators Pty Ltd* (2003) 21 ACLC 1321, the Supreme Court of New South Wales applied the same approach when the matter was directly in issue. In that case, the reasons that Dunford J gave for not applying the running account provision included:

a) the fact that future services said to be secured by the payment were not of greater value than the amount of the challenged payments; and

b) The transactions between the parties did not result in a fluctuating balance with payments made from time to time against services to be provided. Each payment was specifically related to a specific invoice representing a particular progress payment for past work.

[18] The above considerations apply in this case as well. The sub-contract in this case was a one-off dealing between Aden Electrical Ltd and Mitchill Communications Ltd. Mitchill Communications Ltd had never done any work for Aden Electrical Ltd before and there was no expectation of continuing work after this sub-contract. Mitchill Communications Ltd submitted invoices and Aden Electrical Ltd issued payment schedules under the Construction Contracts Act. Payments made by Aden Electrical Ltd generally matched the amounts stated in payment schedules. Payments were accordingly for past services on the basis that any further work carried out under the contract would be the subject of fresh invoices and fresh payment schedules.

[19] Mitchill Communications Ltd submitted that if the amounts in payments schedules had not been paid, it had a right to suspend work under s 24 of the Construction Contracts Act. The Victoria Court of Appeal addressed that point in *Walsh* when it said:

It is not to the point that the payment is made, in a general sense, partly for the purpose of inducing further work.

[20] Overall, building contracts are not running account cases and this sub-contract does not count as a continuing business relationship under s 292(4B).

[21] Once the defence under 292(4B) is put to one side, the four individual payments were each preferential as enabling Mitchill Communications Ltd to receive more towards satisfaction of its debt than it is likely to receive in the liquidation.

The defence under s 296(3)

[22] Section 296(3) says:

> (3) A court must not order the recovery of property of a company (or its equivalent value) by a liquidator, whether under this Act, any other enactment, or in law or in equity, if the person from whom recovery is sought (**A**) proves that when A received the property—
>
> (a) A acted in good faith; and
>
> (b) A reasonable person in A's position would not have suspected, and A did not have reasonable grounds for suspecting, that the company was, or would become, insolvent; and
>
> (c) A gave value for the property or altered A's position in the reasonably held belief that the transfer of the property to A was valid and would not be set aside.

[23] Mr Hill, a director of Mitchill Communications Ltd, says that his company had never before dealt with Aden Electrical Ltd. They were aware that Aden Electrical Ltd had carried out other large projects for Westfield in similar refurbishments at malls owned by Westfield in Auckland. From the outset there were difficulties with receiving payment from Aden Electrical Ltd but Mr Hill says Mitchill Communications Ltd had no knowledge of the financial difficulties apparently affecting Aden Electrical Ltd. He records how Aden Electrical Ltd put invoices on hold because retentions had been overlooked. He says that Mitchill Communications Ltd instructed their lawyers in March 2009 and later in June 2009 to write to Aden Electrical Ltd to press for payment. Aden Electrical Ltd was slow in making payments. The last payment was a post-dated cheque. He summarises:

> At no stage throughout this process did I consider or have any knowledge of the fact that Aden Electrical Ltd was insolvent. It is fair to say I considered Aden Electrical to be difficult to deal with and this was very frustrating. However I did not have any reason to believe that Aden Electrical Ltd was insolvent.

[24] I am satisfied that Mitchill Communications Ltd acted in good faith. It says it carried out its job under the contract. It pressed for payment. It received payments late. There is no evidence to suggest that it did not act in good faith at any time. The liquidators did not suggest that it did.

[25] On suspicion, there is a two-fold test. Mitchill must show that a reasonable persopn in the position of Mitchill Communications Ltd would not have suspected that Aden Electrical Ltd was insolvent, and Mitchill Communications Ltd must also show that it did not have reasonable grounds for suspecting the insolvency.

[26] In *Queensland Bacon Pty Ltd v Rees* (1966) 115 CLR 266, Kitto J at 303 said:

> ... the precise force of the word "suspect" needs to be noted. A suspicion that something exists is more than a mere idle wondering whether it exists or not; it is a positive feeling of actual apprehension or mistrust, amounting to "a slight opinion, but without sufficient evidence", as Chambers's Dictionary expresses it. Consequently, a reason to suspect that a fact exists is more than a reason to consider or look into the possibility of its existence. The notion which "reason to suspect" expresses ... is, I think, of something which in all the circumstances would create in the mind of a reasonable person in the position of the payee an actual apprehension or fear that the situation of the payer is in actual fact that which the subsection describes – a mistrust of the payer's ability to pay his debts as they become due and of the effect which acceptance for the payment would have as between the payee and the other creditors.

[27] Also useful is Kitto J's warning against over ready assumptions of insolvency at 302:

> In many situations, of course, the dishonour of a cheque, unless otherwise explained, carries a strong suggestion of insolvency; but in others it may indicate, to those who are constantly dealing with the drawer and know the general course he is pursuing in his business, no more than a policy of wringing the last ounce of credit out of everyone who can be fobbed off with promises.

[28] The evidence shows a certain amount of fobbing off by Aden Electrical Ltd. It bears out Mitchill Communications Ltd's evidence that it found Aden Electrical Ltd difficult to deal with. It clearly decided that it had to take a firm stance with enforcing payment by instructing its lawyers to make demand on its behalf.

[29] "Pay when paid" terms in construction contracts are now ineffective – s 13 Construction Contracts Act 2002. Nevertheless in the construction industry there are delays in making progress payments. Notwithstanding the Construction Contracts Act, some head contractors delay payment if they have not been paid by their principals. Delays in payment do not always point to insolvency.

[30] The liquidators did not submit any evidence to challenge Mr Hill's evidence. They did not require Mr Hill to attend to be cross-examined on his affidavit. I see no reason not to accept what he says in his affidavit. I accept Mr Hill's affidavit that, while he found Aden Electrical Ltd difficult to deal with and slow in making payments, he did not have grounds to suspect that Aden Electrical Ltd was insolvent. Similarly, I accept that any contractor in the position of Mitchill Communications Ltd would not have had the requisite suspicion, as described by Kitto J in the *Queensland Bacon* case. It is, of course, necessary not to apply a hindsight judgment. On the information available to Mitchill Communications Ltd, it could not suspect that Aden Electrical Ltd was facing serious financial problems and would shortly be facing an application to be put into liquidation.

[31] Mitchill Communications Ltd has also established that it reasonably believed that the payments were valid and would not be set aside. It had no idea that liquidation was so imminent.

[32] It also gave some value for the payments it received. Here, I adopt an analysis made by the liquidators. Mr Jollands has analysed the payments and subsequent invoices to determine the extent to which Mitchill Communications Ltd provided value after it received the payments. Mitchill Communications Ltd provided services far in excess of the payment of $1,204.88 on 24 February 2009. The liquidator left that payment out of his analysis. For the payments made from 27 March 2009 onwards, which total $58,249.14, the liquidator identifies further

invoices amounting to $16,910.72. As Mitchill Communications Ltd has given value only to the extent of $16,910.72, the remaining balance, $41,338.42, does not fall within s 296(3)(c). To that extent Mitchill was preferred. That sum remains recoverable by the liquidators.

[33] Accordingly, I make these orders:

a) The payments of 27 March 2009, 27 April 2009 and 26 August 2009 to the extent of $41,338.42 are set aside;

b) The defendant shall pay the liquidators $41,338.42;

c) The defendant will pay the liquidators interest at 5% from 20 July 2010 (the date of the setting aside notices) until the date of this judgment. Interest on the judgment runs at 5%;

d) The defendant will pay the plaintiff costs of this application on a 2B basis with disbursements as approved by the Registrar.

[34] I record that this application was heard in Court.

R M Bell
Associate Judge