Can a landlord who calls on a bank guarantee due to the insolvency of its tenant be subject to an unfair preference claim by a liquidator?

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On Friday, 13 July 2018 the New South Wales Court of Appeal delivered its decision in Hosking v Extend N Build Pty Ltd1 (Hosking). That decision considered the reach of the term “transaction” for the purposes of determining when a payment by a third party to an unsecured creditor might be an unfair preference for the purposes of the Corporations Act 2001 (Cth) (Act). As the Court of Appeal noted “a “transaction” for the purpose of [the Act] can be a “composite” transaction and that the debtor company and the creditor need not be a party to each part. ” This raises an interesting question for landlords, namely: if a landlord calls on a bank guarantee of an insolvent corporate tenant, is the payment by the bank to the landlord susceptible to a later claim by the tenant’s liquidator that the payment is an unfair preference?

For the reasons that follow, the answer to this question is: no. The payment by the bank pursuant to its obligations under the terms of the bank guarantee may well be a “transaction” for the purposes of the Act, but it is not a payment which the landlord receives from its tenant. That fact is significant as it means that a liquidator will be unable to establish an essential element of an unfair preference claim.

The nature of a bank guarantee
Broadly, bank guarantees are either “cash-backed” by the tenant (with the cash deposited in an account with the tenant’s bank) or treated as a contingent liability secured pursuant to a facility entered into between the tenant and its bank.

In either scenario, the terms of the bank guarantee require the bank to pay out the guarantee from its own funds if demanded by the landlord, without regard to the tenant’s direction (subject of course to the tenant obtaining an injunction restraining any payment to the landlord). Following payment out, the bank seeks repayment from the tenant pursuant to its “cash-backed” facility or the terms of its security.

The nature of an unfair preference
The insolvency law in Australia permits a liquidator to seek to recover payments made by a company to an unsecured creditor 6 months prior to the company’s liquidation (provided certain elements are established, some of which (such as proof of insolvency) are not relevant for the purposes of this article).

Section 588FA of the Corporations Act 2001 (Cth) provides as follows (emphasis added):

(1) A transaction is an unfair preference given by a company to a creditor of the company if, and only if:

(a) the company and the creditor are parties to the transaction (even if someone else is also a party); and

(b) the transaction results in the creditor receiving from the company, in respect of an unsecured debt that the company owes to the creditor, more than the creditor would receive from the company in respect of the debt if the transaction were set aside and the creditor were to prove for the debt in a winding up of the company;

even if the transaction is entered into, is given effect to, or is required to be given effect to, because of an order of an
It is immediately apparent that in the context of considering whether the full or partial satisfaction of a bank guarantee in a landlord’s favour might be an unfair preference, two issues must be considered:

1. Can a payment by a third party (bank) to a creditor (landlord) be a transaction of the debtor (tenant) company and creditor?
2. If so, is a payment by a bank to a landlord pursuant to a bank guarantee a payment received from the (tenant) company?

1. Can a payment by a third party (bank) to a creditor (landlord) be a transaction of the debtor (tenant) company and creditor?

In *Re Emanuel (No 14) Pty Ltd; Macks v Blacklaw & Shadforth Pty Ltd* (Emanuel), the company was in dispute with a third party (EFG), a dispute which it resolved pursuant to a deed of settlement.

One of the terms of that deed was that EFG would pay Emanuel some money, but also pay one Emanuel’s creditors, Blacklaw, an agreed sum. Emanuel later entered liquidation and its liquidator sought to recover the payment Blacklaw received pursuant to the deed as a preference.

The Full Court of the Federal Court determined that the payment to Blacklaw was a transaction for the purposes of section 588FA notwithstanding that Blacklaw received the payment from EFG and not the company Emanuel.

The Court observed as follows (emphasis added):

“We confine our observations for present purposes simply to a course of dealing initiated by a debtor for the purpose of, and having the effect of, extinguishing a debt. It is not apparent to us why it should not be said that, where a debtor so acts and extinguishes a debt, the relevant “transaction” is the totality of the dealings through which the debtor procures the intended outcome, irrespective of whether one or more of the dealings in the sequence in question does not involve or require the participation of the debtor but does require that of a third party. The transaction, in other words, is the totality of the dealings initiated by the debtor so as to achieve the intended purpose of extinguishing the debt.

... We conclude, then, that a course of dealing initiated by a debtor that is intended to, and does, extinguish a creditor’s debt can in its totality be a transaction for the purposes of Pt 5.7B of the Corporations Law notwithstanding that the achievement of that end can only be realised through the participation of a third party in a particular dealing (or dealings) within the overall transaction, being a particular dealing (or dealings) to which the debtor is not or may not be a party”.

The import of the passage above is that a transaction for the purposes of the unfair preference law can be a composite transaction and does not need to be one in which both debtor and creditor are involved in each step in the chain of events which comprise the relevant dealing.

It can immediately be seen how such a finding might apply to a situation where a tenant, in consideration of obtaining a lease from a landlord, procures a bank guarantee from its bank in favour of the landlord and the bank makes payment pursuant to the terms of that guarantee to the landlord.
Given the findings in Emanuel, the fact that the tenant might not then itself make the payment does not necessarily place the relevant events outside the definition of a “transaction” for the purposes of considering whether any payment made by the bank might be an unfair preference in the landlord’s hands. That the tenant (and indeed the landlord) are not involved in each step of the relevant transaction does not take the dealing outside the definition of “transaction” under the Act.

However, as noted earlier, the second limb of section 588FA must also be satisfied. That is, the payment pursuant to the transaction must be a payment which the creditor receives from the company.

2. Is a payment by a bank to a landlord pursuant to a bank guarantee a payment received from the (tenant) company?

In Emanuel, in addition to finding that the facts disclosed a transaction for the purposes of the Act, the court determined that the payment by EFG to Blacklaw was a payment received from Emanuel, despite the fact that EFG made the payment, and not Emanuel.

As the Court observed (emphasis added):

“What Blacklaw received from the company was the actual benefit of a valuable chose in action… owned by Emanuel... what Emanuel provided to Blacklaw, and what Blacklaw received from Emanuel was the actual enjoyment of the benefit secured to Emanuel by its contractual provision with EFG. That actual benefit took the form of a monetary payment which partially discharged Emanuel’s debt”.

In the recent decision of Commissioner of Taxation v Kassem and Secatore\(^3\) (Kassem) a company (Antqip) paid a related company’s (Mortlake) debts to the Commissioner of Taxation at Mortlake’s direction. The transaction was recorded as a loan from Antqip to Mortlake. Mortlake later entered liquidation and the liquidator pursued the Commissioner for the payment received on the basis that it was an unfair preference.

The Full Court of the Federal Court of Australia considered that, given those facts, the payment was received from the company (now in liquidation).

As the Court observed (emphasis added):

“It is clear, as the primary judge found, that the originating source of the payments to the Commissioner was, on each occasion, the bank account of Mortlake’s related entity, Antqip. But, as the primary judge found, this was a clear example of a lender paying moneys advanced to a creditor of the borrower in accordance with the borrower’s directions.

The position as between Mortlake and Antquip was no different from a drawing by Mortlake on an overdraft from its bank with a direction to the bank to pay the creditor directly. Such a payment constitutes a loan by the bank to its customer.”

What these cases confirm is the fact that a creditor receives a benefit from the transaction is not determinative of whether a payment is received from the company. It must also be established that the payment is from the company’s assets, whether that be by way of a chose in action (Re Emanuel) or from its own funds e.g. an overdraft with a bank (Kassem).

As noted earlier, absent proof of this fact, a payment received from a third party will not be a potential unfair
preference in the hands of a creditor.

In the matter of Evolvebuilt Pty Limited⁴ (Evolvebuilt) was a case which demonstrates this very point.

In that case a head contractor (Built) made payment to certain sub-contractors of the insolvent company Evolvebuilt. The liquidator later sought to recover those payments from those subcontractors on the basis that they were unfair preferences.

The liquidator’s claim was unsuccessful because, on the facts, the head contractor Built paid the sub-contractor’s debts out of its own funds and pursuant to industrial pressure applied by the CFMEU and not as a result of any request or direction by Evolvebuilt. It was also relevant that Built owed nothing to Evolvebuilt (there having been an earlier adjudication assessing a claim asserted by Evolvebuilt against Built at $nil).

As Brereton J of the Supreme Court of New South Wales noted:

“although it may well be that the payments by Built had the effect of discharging Evolvebuilt’s indebtedness – either because Evolvebuilt assented to them, or because the liquidators subsequently did so – it does not follow that they were made by or received from Evolvebuilt. The payments were made out of Built’s assets, and not out of any asset to the benefit of which Evolvebuilt was otherwise entitled. Thus they were made by, and received by the defendants from, Built and not Evolvebuilt. This is so, even if making the payment gave Built some right to restitution against Evolvebuilt. If it were otherwise, then the satisfaction of a creditor’s debt by the debtor’s guarantor would constitute a payment on behalf of the debtor and be liable to be avoided as a preference.”

In its decision last week in Hosking (which was an appeal from the decision in Evolvebuilt), the Court of Appeal did not specifically consider this issue further, observing that on the facts of the case the dealings between Evolvebuilt, its subcontractors and Built was not a transaction for the purposes of the Act; and therefore did not decide the issue as to whether the payments to those subcontractors were received from Evolvebuilt.

Given the nature of a bank guarantee, a payment to a landlord pursuant to a call on the guarantee is not susceptible to recovery as a preference

As noted at the outset, a bank guarantee is ordinarily obtained by a tenant in one of two ways: either cash backed, or under certain facilities with its bank.

However, the mechanics of how the bank guarantee is paid by the bank to the landlord demonstrate that although the payment might well be a transaction for the purposes of the unfair preference laws, the funds are not received from the company.

We say that for these reasons:

1. When a bank guarantee is called by a landlord, the call is made directly on the bank. The payment is then made by the bank directly to the landlord from its own funds. The bank then calls on its customer to reimburse it. What happens is distinguishable from a case like Kassem where the Court found that the payment was from the company’s own assets (e.g. funds available to it). The fact that the bank made the payment was therefore irrelevant.

2. Further to the point above, a case like Emanuel is distinguishable for the same reason: the payment by the bank is not pursuant to any asset belonging to the tenant. That is also illustrated by the fact that in Emanuel the company directed the payment to its creditor. In a bank guarantee scenario the bank is compelled to make the payment if requested by the landlord. A bank does not need to seek the consent or direction of the company. It is difficult to see in such a scenario how such a payment has any of the hallmarks of a payment “received from the company”.

3. The case of a payment pursuant to a bank guarantee is therefore far closer to the outcome in Evolvebuilt. The payment by a bank pursuant to a bank guarantee is from its assets and not that of the company. As the court...
noted in Evolvebuilt, the fact that the payer might then have a restitutionary (or, we would add, even contractual) claim against the company is irrelevant in determining the question of whether or not the creditor receives the money from the company. (That said, the Court of Appeal in Hosking appeared to query that reasoning without deciding the point. On one analysis then, the point is arguably still open. In any event, points 1 and 2 above would appear to conclusively deal with the issue).

Conclusion

For the reasons articulated above, a payment to a landlord pursuant to a bank guarantee provided by a corporate tenant is not liable to later be recovered as an unfairly preferential transaction.

Given the nature of a bank guarantee, even if payment pursuant to a call on it can be considered a transaction for the purposes of the Act, it is not a payment which the creditor receives from the company and therefore does not satisfy an essential element of section 588FA of the Act.

1. [2018] NSWCA 149
2. [1997] FCA 667
3. [2012] FCAFC 124
4. [2017] NSWSC 901

Your Key Contacts

Emma Hodgman
Partner, Sydney
D +61 2 9931 4898
M +61 418 671 362
emma.hodgman@dentons.com

Scott Guthrie
Partner, Brisbane
D +61 7 3074 1132
M +61 421 369 861
scott.guthrie@dentons.com

Justin Kang
Partner, Sydney
D +61 2 9931 4771
M +61 417 482 408
justin.kang@dentons.com

Jennifer Andrews
Partner, Sydney
D +61 2 9931 4895
jennifer.andrews@dentons.com