In the High Court of New Zealand
Wellington Registry

CIV-2018-485- 792

I Te Kōti Matua o Aotearoa
Te Whanganui-ā-Tara Rohe

Under the Receiverships Act 1993 and Part 19 of the High Court Rules

In the matter of Ebert Construction Limited (in receivership and liquidation)

Between

Lara Maree Bennett, John Howard Ross Fisk and Richard Michael Longman

Applicants

and

Ebert Construction Limited (in receivership and liquidation)

Respondent

Submissions for the Applicants in support of:

(a) orders appointing them as receivers to assets held by Ebert Construction Limited (in receivership and liquidation) on trust; and

(b) for directions on how to manage and distribute those assets

Dated: 2 November 2018

For hearing: 8 November 2018

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May it please the Court:

1. Introduction

1.1 This Application concerns how a fund of retention moneys held on trust for subcontractors pursuant to the terms of the Construction Contracts Act 2002 (the **Act**) should be distributed.

1.2 Ebert Construction Limited (in receivership and liquidation) (**Ebert**) was, at the request of its directors, placed into receivership by its bank pursuant to a general security agreement (**GSA**) on 31 July 2018. The Applicants are the receivers of Ebert. Ebert was subsequently placed into liquidation on 3 October 2018.

1.3 Upon receivership, Ebert was holding a fund of approximately $3.678 million held in a bank account (referred to as the **Retentions Account**), comprising retention moneys held on trust for its subcontractors (the **Fund**). It had less than $10,000 in its other bank accounts, which were set off against a credit card debit balances in excess of that amount.[1]

1.4 Ebert reconciled the Fund on 22 June 2018 to hold retention moneys it considered were required to be held on trust under the Act as at 31 May 2018. No moneys were contributed to the Fund after 22 June 2018. That is, the Fund is generally equivalent to the retentions that Ebert understood it was required to hold on trust as at 31 May 2018.[2] It is not equivalent to all retentions Ebert was required to hold on trust as at the date of receivership.

1.5 Upon receivership Ebert owed its trade creditors (including subcontractors) approximately $24.517 million (including GST) and a further $9.324 million (excluding GST) in subcontractor retentions.[3] There will be a significant shortfall in Ebert's insolvency. No amounts are expected to be paid relating to subcontractor claims in the receivership or liquidation, save for those claims to the Fund

[1] Second Affidavit of Lara Bennett in support of Application sworn 1 November 2018 (the **Second Bennett Affidavit**) at 2.2 and 2.4
[2] Second Bennett Affidavit at 6.4
[3] Affidavit of Lara Bennett in support of Application sworn 23 October 2018 (**First Bennett Affidavit**), exhibit A page 6

(assuming no significant recoveries are made by the liquidators pursuant to voidable transactions and the like).

1.6 To the best of the Applicants' knowledge, this is the first time the distribution of a cash retention fund held pursuant to the Act's retentions regime (which was introduced on 31 March 2017) has been considered in an insolvency. As such, it raises a number of issues. The most significant issues are:

(a) whether the Applicants should be appointed by the Court as receivers to manage and distribute the Fund;

(b) which subcontractors have a claim to the Fund and on what basis; and

(c) how to distribute the Fund if, as expected, there is shortfall.

2. Summary of issues and directions sought

2.1 The issues in this application can be split into four categories as follows:

Appointment as Receivers to the Fund

2.2 There is potentially a legal issue as to whether the Applicants, as receivers appointed under a GSA, are entitled to manage and distribute a fund held on trust for subcontractors as part of that role. Moreover, there is a practical issue that the management and distribution of the Fund will not benefit the secured creditor and therefore there is no need for GSA appointed receivers to deal with it.

2.3 To overcome this, the Applicants seek orders that they be appointed separately by the Court as receivers to the Fund.

2.4 This order is not expected to be contentious. It is supported by Ebert's liquidators[4] and represents the most efficient way to manage and distribute the Fund for the benefit of the affected subcontractors.

[4] See affidavit of David Ian Ruscoe sworn 2 November 2018

Who has a claim to the Fund?

2.5 The key issue in this Application is which subcontractors have a claim to the Fund and on what basis. As mentioned above, if a subcontractor does not have a claim to the Fund, it is unlikely to receive any payment from Ebert's receivership and liquidation (in the absence of recoveries in the liquidation, such as from voidable transactions).

2.6 There are four groups for whom the Fund could be held on trust:

(a) **Subcontractors with Reconciled and Transferred Retentions.** Reconciled and Transferred Retentions are those retentions for which Ebert calculated and then transferred money representing that amount into the Retentions Account (as at 31 May 2018) and which remain in that account. The amount of Reconciled and Transferred Retentions is equivalent to the amount of the Fund, being $3.678 million. 131 Subcontractors are within this category.[5]

(b) **Subcontractors with Calculated but Not Transferred Retentions.** Calculated but Not Transferred Retentions are those retentions in respect of claims made by subcontractors in June 2018 for which Ebert:

(i) had determined how much was payable under the commercial construction contract (**CCC**);

(ii) issued a Buyer Created Tax Invoice (**BCTI**) which recorded the amount to be withheld as retention money;

but did not transfer into the Retentions Account. The amount of Calculated but Not Transferred Retentions is approximately $475,000. 80 Subcontractors are within this category.[6]

(c) **Subcontractors with Uncalculated and Not Transferred Retentions.** Uncalculated and Not Transferred Retentions are

[5] Second Bennett Affidavit at 6.4
[6] Second Bennett Affidavit at 6.9

those retentions in respect of claims made by subcontractors in July 2018 for which Ebert had not, upon receivership:

(i) determined how much was payable under the CCC or how much could be withheld as retention money;

(ii) issued a BCTI in respect of those claims; or

(iii) paid any moneys into the Retentions Account in respect of these retentions.

The amount of Uncalculated and Not Transferred Retentions is approximately $380,000. 70 Subcontractors are within this category.[7]

(d) **Subcontractors with retentions under Wrongly Classified Subcontracts.** The retentions regime in the Act only applied to CCCs entered into on or after 31 March 2017. Retentions retained under CCCs entered into prior to that date were not required to be held on trust and accordingly, Ebert did not hold such retentions in the Retentions Account.[8]

Ebert incorrectly classified 14 subcontracts in its computer system as entered into before 31 March 2017. As a result, it incorrectly treated retentions under these subcontracts as retentions to which the Act's retentions regime did not apply. The amount of retentions under Wrongly Classified Subcontracts to 31 July 2018 is approximately $170,000.[9]

2.7 Subcontractors may be included in more than one category above in respect of one or more CCC.

Orders as to distribution

2.8 Depending on the Court's orders, there is likely to be a shortfall to the Fund.

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[7] Second Bennett Affidavit at 6.10
[8] Ebert had withheld $4.86 million of retention money pursuant to CCCs entered into prior to 31 March 2017 and to which the Act's retentions regime did not apply. See Second Bennett Affidavit at 6.15. The Applicants do not consider there is any basis for subcontractors to have a claim to the Fund in respect of these retentions.
[9] Second Bennett Affidavit at 7.1 and 7.12

2.9 The Applicants seek orders to enable them to pay valid claims to the Fund promptly, including by way of an interim distribution, on a *pari passu* basis and on a basis that does not include any interest payable on claims. These orders are not expected to be contentious.

Ancillary orders

2.10 Two ancillary orders are sought. First, that the Receivers are entitled to deduct their remuneration, costs and expenses from the Fund, on the usual basis for court-appointed Receivers. Second, the Receivers seek leave to return to the Court for further directions relating to the distribution of the Fund, if needed.

Roadmap of submissions

2.11 These submissions have the following parts:

(a) Factual Background.

(b) Background to retentions regime in the Act.

(c) Statutory obligation to hold retentions moneys on trust.

(d) Appointment as court-appointed receivers.

(e) For which subcontractors are the fund held on trust?

(f) Wrongly Classified Subcontracts.

(g) Orders as to distribution of the Fund.

(h) Costs.

3. Factual background

3.1 Ebert's contracts with its subcontractors permitted Ebert to withhold a specified portion of the amounts otherwise payable for work completed, as security for the performance of the subcontractors' obligations under the contract. The standard subcontract would generally provide for retentions of 10%, with:

(a) 50% being released upon Practical Completion or Taking Over as defined under the Head Contract; and

(b) the remaining 50% being released after the expiry of the defects liability period;

provided that there were no defects which arose in the subcontractor's work or other defaults by the subcontractor during that time.[10]

The usual practice for processing retentions

3.2 As explained in more detail below, where a subcontract was entered into on or after 31 March 2017, any retentions held by Ebert under that subcontract were required to be held on trust for the subcontractors concerned.

3.3 Ebert's usual practice for processing retentions in order to comply with its obligations to hold them on trust under the Act was as follows:[11]

(a) The subcontractor would raise a claim for payment based on work completed during the prior period (generally the previous month).

(b) Ebert would consider whether the claim was in accordance with what it considered was owing under the CCC.

(c) Once Ebert had determined how much it considered was payable under the CCC, it created a BCTI which recorded the amount to be paid to the subcontractor and the amount which was being retained (usually 10% of the amount payable).

(d) Once the BCTIs were processed, Ebert would conduct a reconciliation process. Ebert would determine the net movement in retentions subject to the Act for the month, comprising:

[10] Second Bennett Affidavit at 4.5 to 4.14
[11] Second Bennett Affidavit at 5.2 to 5.9

(i) the quantum of "new" retentions being held from that months' invoices; and

(ii) from the retentions already withheld and reconciled to the Retentions Account, the quantum which were to be released from trust under the terms of the relevant CCC and the Act through either:

(A) payment to the subcontractor; or

(B) transfer back into Ebert's general accounts as amounts Ebert was entitled to deduct from the retention in respect of defaults by the subcontractor

(**Released Retentions**).

(e) To effect the reconciliation Ebert would run a report in its accounting / job costing system (a system called "CHEOPS") on retentions held in respect of CCCs which were recorded in the system as signed on or after 31 March 2017. This report would then be compared with the previous months' figures to ascertain the net movement in retentions.

(f) If the net movement was positive funds comprising the net movement would be transferred from Ebert's general account to the Retentions Account.

(g) If the net movement was negative funds comprising the net movement would be transferred from the Retentions Account into Ebert's general accounts.

3.4 However, in the month prior to the appointment of receivers, Ebert did not complete this process.

May Claims

3.5 Ebert followed its usual processes up to 22 June 2018 in respect of claims made by subcontractors in May for work completed up to and including in May 2018.

3.6 The last transfer of retention payments from Ebert's general account to the Retention Account was on 22 June 2018. Following that transfer, the amounts in the Retention Account comprised retentions held (and reconciled) by Ebert up to the end of May 2018. That is, the moneys in the Retention Account was equivalent to the Reconciled and Transferred Retentions. [12]

June Claims

3.7 Ebert did not complete the usual process in respect of claims made by subcontractors in June 2018 for work completed up to and including in June 2018.

3.8 During July 2018 Ebert had determined how much it considered was payable under the CCCs for such claims and had created the requisite BCTIs (the **June BCTIs**).

3.9 The June BCTIs recorded the amount to be paid to the subcontractor and the amount which was being retained in the usual way.

3.10 However:

(a) the amounts payable to the subcontractor under the June BCTIs were (in most cases) not paid; and

(b) no amounts were transferred from the general account to the Retention Account in respect of these retentions.[13]

These amounts are the Calculated but Not Transferred Retentions.

July Claims

3.11 Ebert did not complete the usual process in respect of claims made by subcontractors in July 2018 for work completed up to and including in July 2018. That is, Ebert did not do any of the following:[14]

[12] Second Bennett Affidavit at 6.2 to 6.4
[13] Second Bennett Affidavit at 6.5 to 6.9
[14] Second Bennett Affidavit at 6.10

(a) complete the assessment of all claims and issuance of BCTIs for services provided by its subcontractors in or around July 2018;

(b) pay amounts to associated Subcontractors in respect of those services;

(c) calculate the confirmed retentions in respect of those services; or

(d) pay any monies into the Retention Account relating to services provided by the Subcontractors in or around July 2018.

The retentions which Ebert was entitled to hold in respect of these services are the Uncalculated and Not Transferred Retentions.

Affected Projects

3.12 The claims to the Fund relate to 21 Projects. Those Projects were at various stages. By way of overview:[15]

(a) Ten Projects had achieved Practical Completion or Taking Over (including one of the active projects); nine of which are still within contractual defects liability periods.

(b) Eleven Projects had not achieved Practical Completion or Taking Over at the time of Receivership: Some were 95% completed, others had only just commenced or were at various mid stages. One project was days from Taking Over and subsequently achieved this with the co-operation and assistance of the Receivers.

3.13 Some subcontractors have claims against the Fund which are currently due and owing. However, currently no-one is administering and distributing the Fund and therefore those claims to the Fund have not been paid.[16]

[15] First Bennett Affidavit at 2.21
[16] Second Bennett Affidavit at 2.5 and 8.2

4. Background to the retentions regime in the Act

4.1 The retentions regime was introduced following the collapse of the Mainzeal Group in February 2013. Upon its collapse, retentions in respect of Mainzeal's subcontractors, totalling around $18 million, were unpaid. This highlighted a concern that subcontractor retentions were being used as working capital by Head Contractors and that upon the failure of the Head Contractor, subcontractors were simply unsecured creditors in respect of the amounts owing to them, including retentions.

4.2 The retentions regime in the Act was introduced through the Construction Contracts Amendment Act 2015. The initial Construction Contracts Amendment Bill (the **Bill**) was introduced in January 2013 – before the Mainzeal collapse. It did not contain any changes affecting retentions. However, during the Select Committee process (post Mainzeal collapse) it rapidly became apparent that one of the biggest issues for submitters was security of retentions. Accordingly, in March 2015 the Government introduced a Supplementary Order Paper to amend the Bill to include the new retentions regime (**SOP 52**).[17]

4.3 It should also be noted that between the Mainzeal collapse and the introduction of SOP 52, Labour and the Greens tabled Supplementary Order Papers to deal with retentions. In April 2014 Labour proposed requiring the retentions be paid into an independent trust account.[18] In May 2014 the Greens simply proposed that the retentions "must be held in trust for the benefit of the payee" but did not provide any detail on this.[19]

[17] Supplementary Order Paper 97-2/SOP No 52. There were further amendments to this SOP, resulting in SOP 52 being replaced by Supplementary Order Paper 97-2/SOP No 106 (**SOP 106**). The only changes in SOP 106 to the changes proposed in SOP 52 were to introduce s18C(2) which provided that "Retention money may be held in the form of cash or other liquid assets that are readily converted to cash" and to amend the date the retentions regime would come into effect from 31 March 2016 (as proposed in SOP 52) to 31 March 2017.
[18] Supplementary Order Paper 97-2/SOP No 439
[19] Supplementary Order Paper 97-2/SOP No 446

4.4 The Government apparently thought the Labour proposal may have been too compliance heavy.[20]

4.5 The purpose of the new regime was summarised by the Honourable Dr Nick Smith (the then Minister for Building and Housing) during the Committee stage as follows:

> *At the moment, if a large construction company goes broke and there are retentions owing, the subcontractors are unsecured creditors are at the back of the queue. The key change that is made in this Bill is that those funds are deemed to be held in trust, and that means that those funds are, are firstly, paid out of the circumstance – and I will take the higher profile example of Mainzeal, where there was about $20 million worth of retentions. All of those subbies would have got paid ahead of either the secured creditors like the banks or ahead of things such as the taxes, the wages and other things that normally occur where there is a liquidation of a company. So that is a big gain.*[21]

4.6 Dr Nick Smith refers to funds being **deemed** to be held on trust under the new regime. The key provisions of the Act will be addressed below but it does not appear that they create a deemed trust. Rather, they create an obligation for the Head Contractor to hold those moneys on trust for the affected subcontractors and envisage various ways in which that obligation may be discharged (or even transferred to another party). It is notable that the Explanatory Note to SOP 52 described the new regime as one which "required a party who withholds retention money to hold that money on trust."[22]

4.7 By the third reading of the Bill, Dr Nick Smith described the trust arrangement for retentions as follows:

> *The significance of requiring [retentions] be held on trust is that they will be treated preferentially in any business failure, akin to wages and taxes. This is appropriate. The balance we have attempted to strike in this law is maximising the security of these payments for subbies*

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[20] See debates at (12 March 2015) 703 NZPD 2243 and (22 September 2015) 709 NZPD 6839

[21] (12 March 2015) 703 NZPD 2243

[22] Supplementary Order Paper 97-2/SOP No 52, Explanatory Note page 3.

while minimising the extra compliance costs that go with these provisions

It is important for the record that I set out how these new provisions will work. Retentions are to be held on trust. Payers can hold those retentions in liquid assets such as accounts receivables, but if they do not get paid they are still obliged to meet those payments. The trust ends when the retentions are either paid out in full or used to fix defective work.[23]

4.8 To the best of the Applicants' knowledge, this Application is the first time the retentions regime has been considered by the High Court in the context of an insolvency of a construction business.

5. Statutory obligation to hold retention moneys on trust

5.1 In order to ascertain the meaning of an enactment, the Court must look to the purpose of the Act itself. This approach is enshrined in section 5(1) of the Interpretation Act 1999, which provides:

> *The meaning of an enactment must be ascertained from its text and in light of its purpose.*

5.2 The Court of Appeal summarised the purposive approach to statutory interpretation in *SMW Consortium (Golden Bay) Ltd v The Chief Executive of the Ministry of Fisheries*[24] as follows:

> *...we note that in interpreting the relevant provisions of the Act, we ascertain their meaning from their text and in light of their purpose. In determining purpose we have regard to both the immediate and general legislative context, as well as the social, commercial and other objectives of the Act. We also recognise that the legislation should be interpreted in a realistic and practical way in order to make it work.*

5.3 The purpose of the Act (as set out in section 3) was not amended following the inclusion of the retention regime.

5.4 The retentions regime of the Act came into force on 31 March 2017 and does not apply to commercial construction contracts entered into

[23] (20 October 2015) 709 NZPD 7347
[24] [2013] NZCA 95 at [23]

before that date.[25] While the overall legislative intention is clear in a general way, the language of the provisions is imprecise given their importance to those involved in the construction industry (including head contractors, subcontractors, employees and financiers). There are also obvious gaps in the regime.

5.5 "Retention money" for the purpose of the Act is defined in section 18A as:

> *an amount withheld by a party to a construction contract **(party A)** from an amount payable to another party to the contract **(party B)** as security for the performance of party B's obligations under the contract.*

5.6 While these words are sufficient to describe the nature of retentions in a general way, they lack legal precision. In terms of contractual law a retention is an agreed conditional deferral of part of a chose in action (i.e. a debt). So, the words "an amount withheld" are more conceptual ("money in the bank" is of course not money as such but again simply a chose in action) rather than legal. Party A may not even have funds available equivalent to the "amount withheld". For example, it may be operating in overdraft. This is important to understand for what follows.

5.7 The core obligation to hold retentions money on trust is set out in section 18C of the Act:

> ***18C Default Arrangement: Trust Over Retention Money***
>
> *(1) All retention money must be held on trust by party A as trustee, for the benefit of party B.*
>
> *(1A) However, see section 18D (which allows for an alternative arrangement, involving a complying instrument, to protect payment to party B if party A fails to pay).*
>
> *(2) Retention money held on trust may be held in the form of cash or other liquid assets that are readily converted into cash.*

[25] Construction Contracts Act 2002, section 11A(3). The retentions regime will apply to contracts entered into prior to 31 March 2017 where the contract is renewed for a further term on or after 31 March 2017 or the parties agree that the retentions regime will apply.

(3) A trust over retention money ends when –

(a) the money is paid to party B; or

(b) party B, in writing, agrees to give up any claim to the money; or

(c) the money ceases to be payable to party B under the contract or otherwise by operation of law.

5.8 The overall scheme of this section is:

(a) Party A must hold on trust property which is equivalent to the amount of the "retention money".

(b) But it does not have to do so if it makes an alternative arrangement pursuant to section 18D (in effect, a third party bond or letter of credit).

(c) The trust property may be cash or other liquid assets that are readily converted to cash. Even this aspect is uncertain. Presumably the legislature did not mean cash literally as this would require Party A to hold large amounts of bank notes. "Cash", in context and given the wording of s18E(2), presumably means a positive balance in a bank account i.e. a chose in action owed by a bank.

5.9 Consistent with the trust arrangement, the use of Retention Money is restricted. Section 18E provides:

18E Use of Retention Money

(1) Party A must not appropriate any retention money held on trust to a use other than to remedy defects in the performance of party B's obligations under the contract.

5.10 However, despite the retention money (property i.e. "cash" or other liquid assets) being held on trust for party B, they do not need to be held separate from other moneys held by party A. In particular, section 18E(2) of the Act provides:

(2) Retention money held in trust by party A –

(a) does not need to be paid into a separate trust account; and

(b) may be co-mingled with other moneys.

5.11 Such an arrangement, while unusual, is consistent with authorities such as *Re Hallet's Estate.*[26] That is, if a wrongdoer mixes other people's money with its own then the presumption is that any withdrawals from the account are treated first as those of the wrongdoer. It is uncertain how the "lowest intermediate balance" rule would apply if the co-mingled account fell below the level of retentions at any time. The legislative intent must be that Party A does not allow this situation to occur.

5.12 Section 18F also permits Party A to invest the retention moneys. It provides that if this investment results in a loss then Party A must make up the difference of that loss; but if the reverse occurs then Party B may keep the profit. This reinforces the unusual nature of this statutory trust arrangement as:

(a) The section envisages part of the trust arrangement becoming a debtor-creditor relationship instead (i.e. if the investment suffers a loss).

(b) A trustee is not usually entitled to retain for itself the profits arising from trust investments. Indeed, equity usually prohibits such a situation and provides a range of remedies for it.

5.13 What is clear from sections 18C, 18E, 18F and 18FB is that Party A has a range of alternatives, and considerable flexibility, as to how it satisfies its obligation to hold on trust an amount of liquid assets equivalent to the amount of the retention moneys.

5.14 Finally, section 18FC provides "audit rights" for Party B in respect of the property held on trust.[27]

5.15 This regime is therefore entirely at odds with a "deemed trust" arrangement. For example, if the legislative intent was to deem Party A's assets (liquid or otherwise) to be held on trust up to the amount of the retention money then there would be no need for:

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[26] (1879) 13 Ch D 696

[27] Once again the wording of this section is imprecise. The "audit rights" should really be to the cash or liquid assets rather than the "retention moneys" which are conceptual rather than real.

(a) a menu of how Party A may discharge (or transfer) its trust obligations;

(b) an audit right for Party B to ensure the property was held on trust; or

(c) a power for Party A to invest the trust property.

5.16 The separate trust arrangement is reinforced by section 18FA of the Act which provides:

> ***18FA Protection of Retention Money***
>
> *Retention money is held on trust –*
>
> *(a) is not available for the payment of debts of any creditor of party A (other than party B);*
>
> *(b) is not liable to be attached or taken in execution under the order or process of any court at the instance of any creditor of party A (other than party B).*

6. Appointment as Court-appointed receivers

6.1 The application to be appointed as receivers to the Fund is made pursuant to the Court's inherent equitable jurisdiction to appoint a receiver. It is again a notable feature of the Act that the legislature did not, in a practical sense, address who would deal with property held on trust in an insolvency situation (which, of course, is the very situation which the retentions regime is aimed at).

6.2 The Court's inherent jurisdiction to appoint receivers was preserved through section 16 of the Judicature Act 1908 (now repealed) and section 12 of the Senior Courts Act 2016. It is also recognised by section 2(1) of the Receiverships Act 1993, which defines "receiver" as:

> *a receiver, or a manger, or a receiver and manager in respect of any property appointed –*
>
> *(a) by or under any deed or agreement; or*

(b) by the court in the exercise of a power conferred on the court or in the exercise of its inherent jurisdiction;

whether or not the person appointed is empowered to sell any of the property in receivership…

6.3 Before considering the grounds for the appointment order, these submissions first explain why the order is necessary.

Is the order necessary?

6.4 The Applicants' ability to manage and distribute the Fund, as receivers appointed pursuant to a security agreement (**GSA receivers**), is legally uncertain.

(a) Legal title to the Fund (being the chose in action relating to the Fund and the accompanying powers as a trustee) is held by Ebert and as such is, presumably, an asset subject to the bank's GSA. On this basis, the Applicants as GSA receivers may, *prima facie*, be entitled to manage the Fund.

(b) However, if the Applicants, as GSA receivers, were to manage the Fund for the benefit of affected subcontractors, there would be an issue as to whether they were:

(i) exercising their powers for a proper purpose pursuant to section 18(1) of the Receiverships Act 1993; and/or

(ii) exercising their powers in a manner which they believed on reasonable grounds to be in the best interests of the person in whose interest they were appointed (i.e. the secured creditor) pursuant to section 18(2) of the Receiverships Act.

6.5 The secured creditor has a limited (if any) interest in the Fund, as such moneys are held on trust for affected subcontractors. While there might be some instances where a default by the subcontractor under the subcontract meant retentions could be released and paid to Ebert (and therefore claimed by the secured creditor), one would expect such instances to be quite limited. Assuming there are no

defaults by subcontractors, the secured creditor would not be entitled to any of the Fund. On a cost-benefit basis it has no economic interest in the Fund.

6.6 In *Downsview Nominees Limited v First City Corp Limited*[28] Lord Templeman held:

> *But since a mortgage is only security for a debt, a receiver and manager commits a breach of his duty if he abuses his powers by exercising them otherwise than "for the special purpose of enabling the assets comprised in the debenture holder's security to be preserved and realised" for the benefit of the debenture holder.*

6.7 The High Court applied this principle in *Downsview Nominees Limited v Official Assignee.*[29] In that case, the receiver was appointed by a secured creditor in respect of a debt owing by the company of approximately $1,000. The receiver was in office for four years and incurred fees of over $21,000. During that time, the only amounts received in the receivership totalled $11,500 received in the first two years. The Court found the receiver breached his obligations to the company as his activities as receiver were not directly related to obtaining repayment of the debt. Rather the activity was directed towards administering the company, filing returns, preparing annual accounts and correspondence.

6.8 The Court held:

> *Any further costs, not being related to the preservation or realisation of the security would, in my view, not be justified in these circumstances and if incurred, were in breach of the duty the receiver had to the company. Once the limited nature of the assets had been ascertained, and certainly after receipt of the proceeds of the sale of the stock, the receiver should have ceased to act, and left the winding up of the company to the liquidator.*[30]

6.9 Accordingly, given that the Fund is held on trust for the subcontractors, if the Applicants were to actively manage the Fund, they would not be acting for the purpose of realising or enforcing the

[28] [1993] 1 NZLR 513 at 523
[29] (1994) 7 NZCLC 260,605
[30] At 260,610

secured creditors' security. While there could be no suggestion that they were not acting in good faith, the question of a "proper purpose" could remain.

6.10 Even if the Applicants were satisfied there was no issue as to whether they were acting for a proper purpose, there is a further question as to whether a GSA receiver could deduct the costs of dealing with the Fund from the Fund itself.

6.11 Under the terms of the Act, Ebert could not recover its costs of managing and distributing the Fund from the Fund itself.

(a) Section 18E of the Act provides that Ebert must not appropriate any retention money held in trust to a use other than to remedy defects in the performance of party B's obligations under the contract.

(b) Section 18I provides that any term in a construction contract is void that purports to require party B to pay any fees or costs for administering a trust under the retentions regime of the Act.

6.12 A GSA receiver acts as agent of the company.[31] Therefore, if Ebert cannot recover its costs in administering the Fund from the Fund itself, presumably its agent is likewise precluded from recovering administration costs from the Fund. (As explained in Part 10, the position is different for a court-appointed receiver.)

6.13 This raises both a legal issue and a practical issue.

(a) If the Applicants cannot deduct their costs from the Fund, it cannot be said to be in the best interests of the secured creditor that the Applicants, as GSA receivers, incur costs in respect of administering a Fund in which the secured creditor likely has no financial interest.

(b) The Applicants do not wish to be in a position where they incur the costs of administering the Fund in circumstances where it is ultimately unclear who (if anyone) is liable to pay those costs.

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[31] See for example *First City Corp Limited v Downsview Nominees Limited* [1990] 3 NZLR 265 (CA) at 274

6.14 Relatedly, there is a practical matter of timing. There is a real prospect that the GSA receivership may come to an end, before distribution of the Fund is completed. The final distribution of the Fund is expected to take longer to resolve than the realisation of other assets subject to the GSA. Accordingly, it is expected that once the other secured assets have been realised, the GSA receivership will end. [32]

6.15 This would then require someone else (presumably the Liquidators) to step into the void and finish what the Applicants had started. This will invariably involve some duplication of work (and cost) as the Liquidators are required to come up to speed with the Fund, the claims to the Fund and progress on distribution to date. No doubt the Liquidators would themselves have to seek the status of Court appointed receivers for the same reason that the current receivers do so (certainty of power and certainty of cost recovery). This would be to the prejudice of the subcontractors, as it would increase costs to the Fund and further delay the payment of claims.

6.16 Therefore, the Applicants consider it necessary that they be appointed receivers to the Fund itself.

Principles on which the Court will exercise its inherent jurisdiction to appoint a receiver

6.17 The Courts have previously commented that receivers have historically been appointed by the Court pursuant to its equitable jurisdiction in two situations, namely where:

(a) there was a need for the interim protection of property (and the income of property), including disputes about rights to the property; and

(b) to facilitate execution of judgments where no remedy by execution at law is open to an entitled party or is likely to be

[32] Second Bennett Affidavit at 3.16

ineffective owing to the peculiar nature of the property of the liable party.[33]

6.18 The second of those two categories has been more expansively described as "To enable persons to possess rights over property to obtain the benefit of those rights and to preserve the property pending realisation, where ordinary legal remedies are defective."[34] The cases tend to adopt the more narrow description where the application is being made at the request of a creditor,[35] which is not the situation here.

6.19 This does not mean that these categories are closed. The Court in *Te Runanganui o Ngati Kahungunu v Scott*[36] adopted with approval the following quote from the Lord Chancellor in *Owen v Homan* (1853) 4 HL Cas 997:

> *No positive unvarying rule can be laid down as to whether the Court will or will not interfere by this kind of interim protection of the property. Where indeed the property is as it were* in medio, *in the enjoyment of no one, the Court can hardly do wrong in taking possession. It is in the common interest of all parties that the Court should prevent a scramble. ... No one is in the actual lawful enjoyment of the property so circumstances, and no wrong can be done to any one by taking and preserving it for the benefit of the successful litigant.*

6.20 This is the position of the Fund today. No one is actively managing the Fund. Subcontractors have claims to the Fund, some of which could be paid out promptly. However, in the absence of someone actively managing the Fund, the reality is that those claims will not be paid.[37]

6.21 The recent liquidation of Ebert means there are two logical parties who could manage and distribute the Fund:

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[33] See for example *Rea v Omana Ranch Limited* [2013] 1 NZLR 587 at 590
[34] See *Re Tisco Holdings (NZ) Limited* (1995) 8 PRNZ 698 at 699 to 701 adopting the description on *Kerr on Receivers and Administrators*.
[35] See *Re Tisco* at 701 and *Blanchard & Gedye's Law of Private Receivers of Companies in New Zealand* (2008) Lexis Nexis at 33.
[36] [1995] 1 NZLR 250
[37] Second Bennett Affidavit at 2.5

(a) the Applicants; and

(b) the Liquidators.

6.22 Prior to the appointment of the Liquidators, the Applicants had undertaken a significant amount of work in order to ascertain the position of the Fund, including the possible claims to the Fund. This included:[38]

(a) a significant amount of reconciliation to determine the possible claims to the Fund;

(b) discussions with Principals as to the progress of their projects, including resolution of any defects raised to date and proposals for dealing with retentions moneys which would otherwise be required to be held for lengthy periods of time; and

(c) discussions with affected Subcontractors regarding their claims to the Fund.

6.23 The Applicants have already completed over 100 hours of work in respect of the Fund. To the extent this work overlapped with their duties as GSA receivers it accordingly would be of no cost to the Fund.[39]

6.24 If the Liquidators were to assume the role of managing and distributing the Fund, there would likely be significant duplication of work (and associated costs), as the Liquidators were brought up to speed on the work the Applicants had done to date. This duplication is in neither the creditors' nor the Subcontractors' interests.

6.25 Significantly, the Liquidators of Ebert recognise this and support the Applicants being appointed receivers to the Fund.[40]

6.26 Finally, the Courts have emphasised that the jurisdiction should be exercised sparingly and only when no other practical solution can be

[38] Second Bennett Affidavit at 3.2 to 3.12
[39] Second Bennett Affidavit at 3.13 and 10.2
[40] See affidavit of David Ian Ruscoe sworn 2 November 2018

obtained.[41] The only other realistic solution is that the Liquidators manage and distribute the Fund. However, for the reasons explained above, this is not sensible – it would likely increase the costs of dealing with the Fund, to the detriment of the Subcontractors with claims to the Fund.

6.27 Accordingly, it is in the interests of all persons with a claim to the Fund that the Applicants are appointed Receivers to the Fund.

7. For which subcontractors are the Fund held on trust?

7.1 The remaining orders sought are requested as directions by receivers pursuant to section 34 of the Receiverships Act 1993. Section 34(1) provides:

> *The Court may, on the application of a receiver:*
>
> *(a) give directions in relation to any matter arising the connection with the performance of the functions of the receiver;*
>
> *(b) revoke or vary any such directions.*

7.2 As explained above, there are three categories of possible claims by subcontractors to the Fund, based on:

(a) the Reconciled and Transferred Retentions;

(b) the Calculated but Not Transferred Retentions; and

(c) the Uncalculated and Not Transferred Retentions.

Subcontractors may have claims in respect of more than one category.

7.3 There is also the position of the Wrongly Classified Subcontracts. These are conceptually distinct from the three categories above and are therefore addressed in a separate section below.

7.4 It is useful to start with a recap of the analysis of the Act's retention regime as above.

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[41] *Steel v Matatoki International Limited* (1988) 4 NZCLC 64,710 and *Te Runanganui o Ngati Kahungunu v Scott* at 253

Recap

7.5 The overall scheme of the retentions regime in the Act is:

(a) Party A has an obligation to hold on trust property which is equivalent to the amount of the "retention money". ("Retention money" being a conceptual description. In law it is an agreed conditional deferral of part of a chose in action i.e. a debt.)

(b) Party A may transfer this trust obligation if it makes an alternative arrangement pursuant to section 18D (in effect, a third party bond or letter of credit).

(c) The trust property which is to be held may be cash or other liquid assets that are readily converted to cash.

(d) The trust property does not need to be held separately from other moneys held by Party A. Party A can also invest the trust property and keep any profits.

(e) Party A therefore has a range of alternatives as to how it satisfies (or transfers) its obligation to hold on trust an amount of liquid assets equivalent to the amount of the retention moneys.

(f) Party B has "audit rights" for Party B in respect of the property held on trust.

(g) There is no general statutory deemed trust over Party A's assets. The statutory provisions are entirely at odds with such a concept.

Reconciled and Transferred Retentions

7.6 It is clear that the Fund is held on trust for, at least, those subcontractors with Reconciled and Transferred Retentions. They have a claim to the Fund for the amount of those Reconciled and Transferred Retentions.

7.7 It is useful, given the statutory obligation to hold property on trust, to use the classic three trust certainties to analyse the position:

(a) intention to create a trust;

(b) subject matter of the trust; and

(c) object (or beneficiaries) of the trust.[42]

7.8 Each of these elements is easily met for subcontractors with claims based on the Reconciled and Transferred Retentions. This is because:

(a) The Retention Account was specifically created and used by Ebert to discharge its trust obligations. Ebert intended to hold the Reconciled and Transferred Retentions separate from its general assets and on trust for the subcontractors concerned. Accordingly, the intention and subject matter of the trust is clear – it is the Fund.

(b) The amount of the Reconciled and Transferred Retentions were property which was equivalent to the retention moneys i.e. in terms of the language of the Act, if not in legal terms, amounts withheld by Ebert from amounts otherwise payable to those subcontractors under a CCC as security for the performance of those subcontractors' contractual obligations.

(c) Ebert deliberately transferred money (to use a colloquial rather than legal term) into the Retentions Account specifically representing the Reconciled and Transferred Retentions. This reinforces the intention to hold the Reconciled and Transferred Retentions on trust.

(d) As part of the reconciliation process Ebert specifically identified those subcontractors with retention moneys to be held on trust under the Act and then paid amounts equivalent to the retentions payable to those subcontractors into the Retentions Accounts. The Receivers can therefore clearly identify those subcontractors for whom Ebert intended to hold property on trust. That is, there is certainty that those subcontractors (at least) are the object of – or beneficiaries to - the Fund.

[42] Butler (ed) *Equity and Trusts in New Zealand* (Brookers, Wellington, 2009) at 4.2.1

7.9 The real issue is whether claims in respect of Reconciled and Transferred Retentions are the **only claims** to the Fund.

Calculated but Not Transferred Retentions

7.10 The position of subcontractors with Calculated but Not Transferred Retentions raises three issues:

(a) Whether calculated retentions in respect of unpaid June BCTIs are "retention moneys" for the purpose of the Act.

(b) Whether there was the requisite intent to create a trust in respect of retention moneys under the June BCTIs.

(c) Whether the Act prevents Calculated but Not Transferred Retentions being paid from the Fund.

Are they retention moneys?

7.11 The definition of "retention money" involves amounts **withheld**. While this is legally imprecise the legislative intention in this regard is clear. The definition suggests that the amounts payable under the subcontract which were not retention moneys were paid to the subcontractor. Or, in legal terms, that the agreed conditional deferral of part of the chose in action was accompanied by a discharge (payment) of the balance of that chose in action.

7.12 The amounts due and owing to most (but not all) subcontractors under the June BCTIs were not paid.[43] While Ebert calculated the amount **to be withheld**, where no payments payable under those BCTIs were made, Ebert has not "withheld" the amounts calculated to be the retention money; rather it has simply defaulted on its payment obligations as a whole. On this basis, June BCTIs which were not paid by Ebert would not have any retention moneys associated with them.

7.13 To adopt a different interpretation treats a straightforward failure to comply with the payment provisions of a contract into (at least for a portion of it) as a conscious decision by Ebert to withhold payment of

[43] Second Bennett Affidavit at 6.8

specified amounts under the contract. Inferring such a decision in this instance would be artificial and fails to reflect Ebert's usual practice and its actual approach to the June BCTIs.

No trust was created

7.14 The scheme of the Act is not one of a deemed trust. It does not deem certain funds to be held on trust for subcontractors in respect of claims for retentions. Rather, it places an obligation on Party A (i.e. Ebert) to hold equivalent property on trust.

7.15 Significantly, Ebert did not take any active steps to hold any amount equivalent to the retention moneys for the subcontractors in this category on trust.

7.16 Ebert's specific practice was to transfer retention moneys to be held on trust into the Retention Account after calculating those amounts. Ebert's failure to transfer the Calculated but Not Transferred Retentions indicates that there was no intention to place those moneys on trust at that time. This is supported by Ebert's failure to make payment of (most of) the amounts owing under the June BCTIs.

7.17 There may well have been an intention by Ebert to withhold the retention moneys and place those moneys on trust at a later time, for example, when it made payment of the June BCTIs. However, that had not occurred at the time the Applicants were appointed receivers. An intention to create a trust upon a future event, where that future event does not occur, cannot suffice to establish certainty of intention.

The Act precludes subcontractors with Calculated but Not Transferred Retentions claiming against the Fund

7.18 The specific terms of the Act support that the Calculated but Not Transferred Retentions do not have a claim to the Fund.

7.19 The way in which Ebert processed its retentions, and in particular, by specifically reconciling retentions with the Retentions Account on a monthly basis, means there is no ambiguity as to which retention moneys funded the Fund. In particular:

(a) No payments were made (i.e. property set aside) by Ebert into the Retention Account or otherwise after 22 June 2018.[44]

(b) As at 22 June 2018, the Retentions Account represented all retention moneys recorded by Ebert as relating to CCCs entered into on or after 31 March 2017 and withheld for the period up to 31 May 2018.[45]

Therefore, it is clear that Ebert paid no moneys into the Retentions Account representing retention moneys under the June BCTIs.

7.20 The Act provides that retention moneys held on trust for "Party B" is "not available for the payment of debts of any creditor of Party A [i.e. Ebert] (other than Party B)".

7.21 The Fund comprises property equivalent to the amount of retentions moneys withheld under CCCs with subcontractors with Reconciled and Transferred Retentions. It does not comprise – in any part – Calculated but Not Transferred Retentions. Accordingly, allowing subcontractors with claims in respect of Calculated but Not Transferred Retentions to claim against the Fund would therefore be contrary to this express provision.

7.22 The scheme of the Act is clear – retention money withheld under a CCC with B

(a) is held on trust for B only; and

(b) can only be:

(i) paid out to B; or

(ii) applied to remedy defects in the performance of B's obligations under the contract.

Such retention money cannot be applied for any other purpose.

7.23 This is consistent with general principles of trust law. See for example the decision of *Foskett v McKeown* where the appropriate

[44] Second Bennett Affidavit at 6.3
[45] Second Bennett Affidavit at 6.4

distribution of a mixed trust fund was considered. As Lord Millett held:

(a) innocent contributors to a mixed trust fund must be treated equally; and

(b) where a beneficiary's claim is in competition with the claim of other innocent contributors to the fund, there is no basis upon which any of the claims can be subordinated to any of the others – all must share rateably in the fund.[46]

There was no suggestion that innocent creditors who did not contribute to the fund could also have a claim to the fund. Rather, it was restricted to only those who contributed to the fund.

7.24 As the Calculated but Not Transferred Retentions were not contributed to the Fund, subcontractors cannot have a claim to the fund in respect of those retentions.

The contrary position

7.25 For completeness, the subcontractors in this category could assert, in contrast to the above:

(a) The Act does create a statutory deemed trust, such that they would have a claim to the Fund.

(b) Ebert in fact did hold property on trust in respect of its retention obligations and therefore they should have a claim to the Fund.

(c) The overall statutory intention was to protect subcontractors by having trust assets available in the event of insolvency. It is therefore necessary to read the Act purposively to ensure that this occurs and that they share in those trust assets.

Uncalculated and Not Transferred Retentions

7.26 It is difficult to see a basis for subcontractors with Uncalculated and Not Transferred Retentions having a claim to the Fund for those retentions.

[46] [2001] 1 AC 102 (HL) at 132

7.27 Ebert did not take any steps in respect of the Uncalculated and Not Transferred Retentions.

7.28 Upon the Applicants' appointment on 31 July 2018 Ebert had not completed its reconciliation process for July 2018. In particular, Ebert had not:[47]

(a) completed the assessment of all claims and issued BCTIs in respect of claims for services carried out by its subcontractors in or around July 2018;

(b) paid any amounts to its Subcontractors in respect of those services;

(c) calculated the retentions in respect of these services; or

(d) paid any moneys into the Retentions Account in respect of services provided by Subcontractors in or around July 2018.

7.29 Ebert was not even aware of the amount of property which it was to hold on trust for the subcontractors in this category as it had not even calculated the amount of the "retention money". As a result, it could not have set aside an equivalent amount of property on trust.

7.30 The steps necessary to calculate retentions in respect of services provided in or around July 2018 was carried out by the Applicants, not Ebert. The affidavit of Ms Bennett makes clear that in doing so, the Applicants' purpose was:

(a) to ascertain the extent of Ebert's creditors; and

(b) to establish which parties could have a claim to the Fund and the value of those claims.[48]

The Applicants have been conscious to preserve the position of creditors, but not to improve any creditors' priority to any funds. The Applicants have not taken any steps to place any moneys on trust for subcontractors with claims in respect of Uncalculated and Not Transferred Retentions.

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[47] Second Bennett Affidavit at 6.10
[48] Second Bennett Affidavit at 3.7

7.31 Accordingly, subcontractors should not have a claim to the Fund in respect of the Uncalculated and Not Transferred Retentions.

The contrary position

7.32 For completeness, the subcontractors in this category could assert, in contrast to the above:

(a) The Act does create a statutory deemed trust, such that they would have a claim to the Fund.

(b) Ebert in fact did hold property on trust in respect of its retention obligations and therefore they should have a claim to the Fund.

(c) The overall statutory intention was to protect subcontractors by having trust assets available in the event of insolvency. It is therefore necessary to read the Act purposively to ensure that this occurs and that they share in those trust assets.

8. Wrongly Classified Subcontracts

8.1 The legal position as to whether Subcontractors in respect of Wrongly Classified Subcontracts have a claim to the Fund is difficult. The sum involved is $170,340.39 (for retentions to 31 July 2018; $160,018.17 is retentions to 31 May 2018).[49]

8.2 This legal position is difficult because:

(a) Ebert had an obligation to hold on trust property which is equivalent to the amount of the "retention money".

(b) Ebert transferred moneys into the Retention Account, which it believed was equivalent to the amount of "retention money" for CCCs subject to the Act up to 31 May 2018.

(c) The amount of retentions held pursuant to the Wrongly Classified Subcontracts was omitted from the calculation of retentions to be held in the reconciliation process by error –

[49] Second Bennett Affidavit at 7.12

simply because the date was incorrectly (or not) recorded in Ebert's computer system.[50]

8.3 So while there is a trust fund which was intended by Ebert to have been set aside in respect of all retention moneys held under CCCs subject to the Act as at 31 May 2018, in fact Ebert did not fully discharge this obligation as a result of its own errors.

8.4 The following points can be made in support of subcontractors having Wrongly Classified Subcontracts having a claim to the Fund:

(a) Ebert did hold property on trust in order to meet its retention obligations as at 31 May 2018.

(b) This trust property still exists.

(c) "Retention moneys" is a concept. There is never an identifiable sum of money that is actually held back.

(d) The audit rights provided for in s18FC(1) of the Act do not extend to reconciling the retentions held to specific amounts held for specific subcontractors. This can be contrasted with the position for instruments in s18FC(2). The focus must therefore be on the overall Fund generally rather than specifically for whom it is held.

(e) Utilising the classic three certainties of trust set out above, Ebert intended to create a trust in respect of the Fund for those subcontractors holding Wrongly Classified Subcontracts, as they were, in fact, CCCs entered into on or after 31 March 2017. That is, it was intending to create a trust to discharge its retention obligations under the Act. The fact that the Wrongly Classified Subcontracts were not included in the reconciliation process does not override this intention where:

(i) determining the CCCs to be included in the reconciliation process in a particular month was a mechanical process involving a report being run in a computer system; that is,

[50] Second Bennett Affidavit at 7.11

Ebert did not actively turn its mind to which CCCs were included in the report produced by the CHEOPS system for the reconciliation process in any particular month; and

(ii) the reason they were not included in this process was due, in most cases, to a typo or no data as to date signed being entered into the computer system.

(f) Any mistakes Ebert made in calculating the amount of trust property it was meant to hold is irrelevant. The simple fact is that there was trust property set aside as at 31 May 2018 and, as Ebert's obligation extended to the Wrongly Classified Subcontracts, then the relevant subcontractors should be able to share in that fund.

8.5 The following points can be made against this:

(a) A contrary view of intention from that set out above is that there was no intention by Ebert to create a trust in respect of the Fund for those subcontractors holding Wrongly Classified Subcontracts. The reconciliation process and calculation of retention moneys that were to be held did not extend to them.

(b) Relatedly, the reconciliation process enables the Applicants to identify specifically which retentions were intended to be held for which subcontractors. The retention moneys under the Wrongly Classified Subcontracts were not included in the Fund. No equivalent amount of property was held on trust for them. As the Wrongly Classified Subcontractors did not contribute to the Fund (even if due to an inadvertent error by Ebert), then they should not be allowed to claim against it.

(c) Sections 18E(2) and 18FA support this strict approach. They make clear that there is a focus on for whom the retention moneys are held. It is not open to the Court to now find that retentions moneys recorded by Ebert as being held on trust for party B in fact are also held on trust for Party C.

9. Orders as to the distribution of the Fund

9.1 The Applicants seek four orders as to the distribution of the Fund:

(a) that the Applicants may determine and pay valid claims to the Fund, including by way of interim distribution, in accordance with the terms of the relevant subcontract, the Act and the Court's orders;

(b) that the Fund is to be distributed to, for, or in respect of valid claims from the subcontractors:

(i) on a *pari passu* basis in relation to their respective retention amounts; and

(ii) on a basis which does not pay any interest claims on any retention moneys from the date they became due and owing; and

(c) that leave be reserved to apply to the Court for further directions.

These submissions address each in turn.

Power to determine and pay valid claims

9.2 The Applicants seek orders to enable them to determine and pay valid claims from the Fund, including on an interim basis.

9.3 The Applicants are conscious of the significant financial pressure subcontractors are under following the insolvency of Ebert and are hoping to pay out valid claims to the Fund without delay.

9.4 If the orders sought are granted, the Applicants intend to:

(a) write to each Subcontractor:

(i) setting out the position for each of their CCCs and the Applicants' proposed treatment of the retentions relating to those CCCs; and

(ii) seeking their agreement to the proposed treatment of their retentions and/or inviting their comments if the position is not straightforward.

(b) If the position is not straightforward, where applicable the Applicants may also write to the Principals, seeking a tripartite agreement as to how the relevant retentions be resolved.[51]

9.5 Adopting this approach, the Applicants consider that they would be in a position to make payments towards claims of approximately $1.4 million to $2.0 million in respect of specific Projects to affected subcontractors promptly, and ideally before Christmas.[52]

9.6 The Applicants expect however there may be some further legal and practical issues which will need to be considered between the parties before some claims to the Fund can be paid out. If a negotiated outcome cannot be achieved, they may make a further application to the Court for directions in the New Year.[53]

Payment of claims on a *pari passu* basis

9.7 In the event that this Court orders one of more of the following:

(a) that Ebert holds the Fund on trust in respect of Subcontractors with Reconciled and Transferred Retentions and either or both of Subcontractors with Calculated but Not Transferred Retentions and Subcontractors with Uncalculated and Not Transferred Retentions;

(b) the subcontractors in respect of the Wrongly Classified Subcontracts have a claim to the Fund;

(c) that the Applicants are entitled to be paid from the Fund their remuneration, costs and expenses of administering the Fund;

there will be a shortfall of assets in the Fund to pay claims on the Fund.

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[51] Second Bennett Affidavit at 8.4
[52] Second Bennett Affidavit para 8.5
[53] Second Bennett Affidavit para 8.6

9.8 In the event of a shortfall, the Applicants propose that claims be paid out on a *pari passu* basis.

9.9 Such an approach is the fairest way to distribute the Fund to claimants and is consistent with insolvency principles generally.

(a) In *Stotter v Equiticorp* the Court held:

> *First, the way in which an insolvent's estate is to be distributed among the general body of unsecured creditors begins with the fundamental principle that claims rank equally among themselves and abate rateably in the event of a deficiency: see 313(1) of the Companies Act 1993 (the pari passu principle). All creditors suffer in an insolvent liquidation. The presumption is that the burden should be spread rateably between them.*[54]

(b) See also *Foskett v McKeown* where Lord Millett held:

> *Innocent contributors, however, must be treated equally inter se. Where the beneficiaries' claim is in competition with the claims of other innocent contributors, there is no basis upon which any of the claims can be subordinated to any of the others. Where the fund is deficient, the beneficiary is not entitled to enforce a lien for his contributions; all must share rateably in the fund.*[55]

9.10 It would also be the most efficient way to distribute the Fund and would give the certainty to those Subcontractors with a claim to the Fund.

Interest

9.11 The Applicants seek orders that no interest be paid from the Fund in respect of any claims to the Fund which are already due and owing or in due course will become due and owing.

9.12 There is no general entitlement for Subcontractors to receive interest earned on retentions held in the Fund. This is clear from section 18F of the Act which provides that Ebert can retain the benefit of any interest earned on retention moneys on or before the date on which

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[54] *Stotter v Equiticorp Australia Limited (in liquidation)* [2002] 2 NZLR 686 (HC) at [36]
[55] [2001] 1 AC 102 (HL) at 132

those moneys are payable under the CCC. However, section 18G of the Act envisages that a subcontractor could have a claim to interest on retentions which are payable under the CCC, from the date they are due and owing.

9.13 There is a preliminary legal question as to whether there is any entitlement by the Subcontractors to interest in respect of retentions which are already due and owing from the Fund under the terms of the particular CCC but have not yet been paid.

9.14 Ebert's standard subcontract did not provide for any contractual entitlement to interest on retentions due and owing but paid late.

9.15 The Act appears to envisage that interest will be payable on the late payment of payable retentions even where there is no contractual entitlement.

9.16 Section 18G provides that:

(a) interest on retention money is payable to Party B from the date on which it is payable under the CCC until the date on which it is paid; and

(b) such interest is payable at the rate agreed under the CCC or if the parties have not agreed a rate under the CCC, at the date or rates prescribed in regulations.

9.17 Therefore, where the parties have not agreed contractual interest provisions, section 18G appears to provide for a default entitlement to interest on late payment to Subcontractors of retentions due and owing. However, no regulations as to interest have yet been passed. Therefore, even if the Court were to find the Act created such a default obligation, there is no relevant interest rate.

9.18 Even if a Subcontractor could have a claim for interest in respect of retentions due and owing from the Fund but not yet paid the position seems clear that interest claims would not be paid from the Fund itself. Rather, the subcontractor would have a claim for any interest owing as an unsecured creditor in Ebert's liquidation.

9.19 This is because:

(a) Ebert retains the benefit of any interest earned on retention money on or before the date on which it is payable under the CCC (section 18F).

(b) Interest on retention money payable to party B from the date on which it is payable under the CCC is at the rate specified in the CCC or the default rate as provided for in regulations (of which there are none). It is not the interest rate that may apply to any retention moneys invested (section 18G).

(c) As the Fund is funded entirely by retentions in respect of the Subcontractors, payment of any interest claims from the Fund would be applying the Fund for a purpose other than to remedy defects in the performance of a Subcontractors' obligations under the contract in breach of sections 18(E)(1) and 18FA(a).

Leave to apply for further directions

9.20 Some claims to the Fund will be straightforward and will be able to be paid promptly. Others may be more complex. This is particularly the case where the project is part finished or the project is concluded but the defects liability period still has some months to run.

9.1 The Applicants are not seeking to have those more complex issues determined as part of this Application. If the orders sought are granted, the Applicants intend to:

(a) pay out straightforward valid claims to the Fund promptly; and

(b) negotiate an agreement between the relevant parties in respect of other claims to the Fund.[56]

If agreement cannot be reached, the Applicants may need to return to the Court for further directions in the New Year.

9.2 The Applicants therefore seek orders that leave be reserved to apply for further directions in respect of distribution of the Fund.

[56] Second Bennett Affidavit at 8.5 and 8.6

10. Costs

10.1 The Applicants seeks orders that their costs relating to the distribution and management of the Fund (including those costs relating to this Application) be deducted from the Fund.

10.2 Such an order is consistent with the usual approach that a Court-appointed receiver is entitled to deduct its remuneration, costs and expenses from the receivership assets.

10.3 This usual approach was discussed in the decision of *Rea v Omana Ranch Limited* [2013] 1 NZLR 587. In that decision, the question arose as to whether court appointed receivers in a protracted family court proceeding were entitled to have their cost deducted from the assets in receivership, or whether their costs were to be paid by the parties. Justice Katz held that the necessary starting point was the proposition that a court appointed receivers was entitled to his or her remuneration, costs and expenses out of the receivership assets.[57]

10.4 The Court quoted with approval from the House of Lords decision of *Capewell v Her Majesty's Revenue & Customs*[58] as follows:

> It has always been a basic principle of receivership that the receiver is entitled to be indemnified in respect of his costs and expenses, and his remuneration if he is entitled to be remunerated, out of the assets in his hands as a receiver. Warrington J stated the principle in a well known passage in *Boehm v Goodall* [1911] 1 CH 155, 161:
>
> > "Such a receivers and manager [that is one appointed by the Court] is not the agent of the parties, he is not a trustee for them, and they cannot control him. He may, as far as they are concerned incur expenses or liabilities without their having a say in the matter. I think it is of the utmost importance that receivers and managers in this position should know that they must look for their indemnity to the assets which are under control of the Court. The Court itself cannot indemnity receivers, but it can, and will, so do out the assets, as far as they extend for expenses properly incurred; but it cannot go

[57] *Rea* at 591.
[58] [2007] 2 All ER 370 at [21]

further. It would be an extreme hardship in most cases to parties to an action if they were to be held personally liable for expenses incurred by receivers and managers over which they have no control.

10.5 The Court in *Rea* considered that the provisions of the Receiverships Act 1993 are consistent with the common law position that receivers' costs, expenses and remuneration are a preferential claim on the assets in receivership.[59] In particular, section 30D(2) of the Receiverships Act defines "net proceeds" as meaning the net proceeds of the disposal after deducting:

(a) the receiver's expenses and remuneration; and

(b) any amount or the monetary value of any obligation, as the case may be, secured by any security interest that ranks in priority to the security interest granted to the person in whose interests the receivers was appointed; and

(c) any other preferential claims or priority claims according to law.

10.6 Accordingly, the orders sought reflect the usual position for court-appointed receivers.

10.7 The Applicants draw the Court's attention to the fact that the Act envisages that Ebert could not recover its costs of managing and distributing the Fund from the Fund itself. See the discussion as to Section 18E and 18I of the Act at paragraphs 6.11 and 6.12 above.

10.8 However, those provisions do not apply to negate the usual position that the Applicants would be entitled to deduct their costs from the Fund.

(a) Those provisions prevent **Ebert** only from recovering the costs of administering the Fund from the Fund.

(b) As noted above, Court-appointed receivers and liquidators are not agents of the company. Accordingly, section 18E of the Act simply does not apply to them.

[59] *Rea* at 592

10.9 Nor is section 18FA applicable to the issue of recovery of the costs of a court-appointed receiver. Section 18FA provides that the retention money is not available for the payment of debts of any creditor of party A (other than party B). A court-appointed receiver would not be a creditor of Ebert as it would have no recourse to Ebert itself for its costs (unless the Court specifically ordered otherwise).

10.10 If the Applicants – and if they were not appointed as receivers to the Fund, the liquidators of Ebert – were unable to recover from the Fund their costs of administering the Fund, they would be placed in a very difficult position. There is expected to be a shortfall to secured creditors. Accordingly, Ebert has no other assets which could be applied to meet these costs. Therefore, in the absence of the costs orders sought, the Applicants (or alternatively the Liquidators) would be unlikely to take any steps in relation to the Fund as such steps will have a material cost yet not benefit the secured or unsecured creditors.

10.11 Finally, the cost orders sought are consistent with the usual approach in a liquidation involving trust funds. The Court has an inherent jurisdiction to allow the payment of expenses to liquidators out of trust assets to meet the costs of trust administration, where there are insufficient assets in the company to meet those costs.[60]

10.12 There is no reason why the usual approach should not apply, that the Applicants be permitted to deduct their remuneration, costs and expenses relating to the Fund (as distinct from the receivership of Ebert more generally) from the Fund itself (to the extent that interest on the Fund is not sufficient; see section 18F(3) in this regard).

10.13 One subcontractor has raised a concern that the costs to be deducted from the Fund could be of such an amount that it would significantly deplete the funds available for subcontractors.

10.14 This is not the case. The Applicants estimate that the costs to be deducted from the Fund (being the costs of this Application and to administer and distribute the Fund) to be less than $150,000 (or 4%

[60] *Re Ararimu Holdings Limited* [1989] 3 NZLR 487 at 504.

of the Fund). This estimate assumes that there are no significant disputes as to claims to the Fund, which need to be addressed.[61]

10.15 However, to address any subcontractor concerns as to the quantum of costs to be deducted from the Fund, the Applicant propose that the Court:

(a) grant the orders sought as to costs; but

(b) require the Applicants submit to the Court a final report detailing their costs to be deducted from the Fund, for final approval.

M G Colson / R L Pinny
Counsel for the Applicants

2 November 2018

[61] Second Bennett Affidavit at 10.8 and 10.9