

The Long Arm of the Liquidator: Recovery of “Unfair Preference Payments” from Stressed Debtors

With continuing market volatility a number of companies remain under financial pressure.

Businesses or individuals receiving payments from companies that might be financially distressed should be aware of the ability of a liquidator to apply to a court under the *Corporations Act 2001* (Cth) (**Corporations Act**) to recover payments made to creditors in the six months prior to the appointment of a liquidator/administrator on the grounds the payment constituted an “unfair preference”.

Quick Recap on the Relevant Provisions

This article focuses the legislative provisions governing transactions which are voidable as “unfair preferences”, and the associated court order for repayment of monies received under section 588FF of the Corporations Act. Claims made by a liquidator under these provisions are commonly called “relation back claims”.

The “unfair preference” rule applies to transactions which take place in the six months before the commencement of the administration. The rule applies if payment is received for an unsecured debt and results in the creditor receiving more than they would have received in a liquidation.

A business or individual faced with a relation back claim has a potential defence if it can be shown that:

- they received the payment in good faith;
- at the time they received the payment they had no reasonable grounds for suspecting that the company was insolvent; and a reasonable person in the creditor’s circumstances would have no such ground for so suspecting; and
- the creditor provided valuable consideration under the transaction or has changed its position in reliance on the transaction

(section 588FG of the Corporations Act).

Practical Considerations

While the process of establishing a company was insolvent at the relevant time is often a complex process, many relation back claims turn on this defence and focus on what the creditor which received payment knew about the financial state of the debtor.

A creditor will not have a defence to a liquidator recovering payments made where that creditor suspected, or should have suspected that the debtor company was insolvent at the time that the payment was made.

Accordingly, if you begin to suspect that a debtor company is in financial trouble and you are about to provide that company with goods or services, you need to start thinking about the risk of that any payment you receive for such future works might be the subject of a relation back claim. Often a relation back claim is made many months, sometimes years, after the payment was received.

If you have already provided goods or services and nothing further is to be provided, then there is little to do. You can pursue payment and if it is received, be aware a claim may be made. However, if you are being asked to provide goods or services in the future you should consider things further.

To be able to avail yourself of the defence to an unfair preference claim you cannot stick your head in the sand and ignore obvious warning signs of a company in a perilous financial position and remain confident you can rely on the defence. Nor is it sufficient to simply accept whatever story is given by a company as to why they may be slow in making payment or require more time for payment. The court is interested in both what you suspected but also what a reasonable person in your shoes would have suspected in the given circumstances.

This is not to say you need to jump to ask about a client’s financial health at every turn. However, if you are about to provide goods or services and you reasonably suspect that a company is in serious financial difficulty you should consider whether to make enquiries keeping your mind on the steps and issues that will be relevant to a defence under s588FG. The enquiries you make will be considered in light of the circumstances. Keep in mind, however, that often the request for information to satisfy yourself of financial health is itself evidence of your suspicion that the company is in financial distress, so how you frame any request should be carefully considered. If care is not taken you could easily undermine a defence by loose language. What is said in internal email exchanges is also often very important. Once you have a response you should consider whether, based upon the response you receive, you can avail yourself of the defence if ultimately the company does not survive.

If you are not happy with the response there are several options you can consider:

1. Refuse to provide any further goods and services.
2. Seek security for any future debts. The unfair preference provisions in the Corporations Act only apply to unsecured debts, therefore if you obtain security, payment of that debt will not be an unfair preference. This would only apply to future debts not existing debts.
3. Along the same lines as option 2, you can require pre-payment before the goods or services are supplied. Provided the pre-payment is for the specific goods or services (and not inflated) pre-payment should not be considered to be an unfair preference.

Contacts

Graeme Slattery

Partner

T +61 8 9429 7576

E graeme.slattery@squirepb.com

Michael Ferguson

Partner

T +61 8 9429 7402

E michael.ferguson@squirepb.com

Amanda Banton

Partner

T +61 2 8248 7850

E amanda.banton@squirepb.com

The contents of this update are not intended to serve as legal advice related to individual situations or as legal opinions concerning such situations nor should they be considered a substitute for taking legal advice.

© Squire Patton Boggs.