

Perhaps in a sign of the times, a number of clients have approached Fair Work Lawyers having received letters from liquidators seeking to recover “unfair preference” payments.

Under the *Corporations Act 2001* (the Act), a liquidator is entitled to recover certain payments that are considered to unfairly benefit a creditor. This exposes an unsecured creditor to the unfortunate situation where they stand to not only lose what they were owed (or recover very few cents in the dollar), but also have to repay monies they received before the liquidation.

Unfair preferences and voidable transactions

An [unfair preference](#) occurs when an unsecured creditor enters into a transaction with a company that goes into liquidation, and that results in them receiving more money than they would have received had the debt instead been dealt with as part of the winding up process.

A liquidator is entitled to recover [voidable payments](#) that occur within a certain time period before (and after) the winding up event. There are a different rules relating to different payments, such as [‘uncommercial’ transactions](#), [‘extortionate’ loans](#) and [related party transactions](#). However, the usual situation is an [insolvent transaction](#), which occurs when a creditor receives an unfair preference from a business that was [insolvent](#) and that payment was within 6 months before the [date winding up commences](#) (or made after the date). An application to recover this must be made within [three years](#) of this date without special permission.

Provided the business was insolvent at the time, these elements of an “insolvent transaction” will be met in most business-to-business transactions involving an unsecured creditor that fall within the relevant period.

This leave a business needing to consider whether the payment was received in “good faith” or the transaction formed part of a continuing business relationship.

The good faith defence

The [good faith defence](#) is available to a creditor that accepts payment, in good faith, as part of a contract. However, in order to make out the defence, the creditor must have no reasonable grounds for suspecting that the company was insolvent. A [suspicion](#) requires more than mere idle wondering, although does not require actual proof. In order to make out the defence, a creditor must show that [both](#) subjectively (in their own mind) and objectively (what a reasonable person would consider) they had no reasonable grounds to suspect the insolvency.

Late payment of invoices or payment outside of trading terms is commonly raised as a basis to overcome the defence. This creates particular difficulties in industries such as construction where slow payment of invoices is not necessarily a sign of insolvency but can be a function of many things including disputation, poor contract administration, project delays, design or other issues.

Other [indicia of insolvency](#) include stopping credit, or entering into a (or seeking to enter into)

payment plan, payments of 'rounded sum' amounts, insistence on further supply being COD only, a history of dishonoured cheques, unpaid statutory entitlements and parties issuing demands or court proceedings.

An assessment of reasonability requires consideration of all of the facts. However, because the onus of proof rests with the creditor, it is difficult to confidently predict what a Court would find, particularly taking into account the nuances of particular relationships (such as late payments in the construction context, as described above). As a result, liquidators may seek to issue notices to all parties who received payments in the relevant period to see what they can recover.

The amounts that can be claimed as an unfair preference payment can be considerable and given that this is usually on top of other monies likely to be lost in the liquidation process, Fair Work Lawyers recommend that business seek advice in relation to any unfair preference claim arising from any unexpected insolvency.

Continuing business relationship

Many businesses – such as suppliers – have [continuing business relationships](#) with customers where there are ongoing supplies, and the level of debt with the insolvent company goes up and down over time (often referred to as running accounts). For the purpose of unfair preferences, these transactions are treated as a single transaction, and it will only be an unfair preference if the net level of indebtedness decreases during the period. [However](#), case law suggests the liquidator is entitled to use the most advantageous position during the relevant period to determine the extent to which net indebtedness decreases, and actions such as stopping credit may bring the continuing business relationship to an end, limiting the period that a 'running account' may operate to reduce an unfair preference claim.

Need more information

If you have received correspondence seeking to recover alleged unfair preference payments, or would like further information about this issue, please contact the team at Fair Work Lawyers.



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