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Insolvency – Claims by Liquidators

Uncommercial Transactions Insolvent Transactions

Businesses receive and bank payments from clients and customers on a daily basis.

Most businesses would not think twice about the risk of a future claim for repayment when they receive payment for goods and services that they have provided.

If a corporate customer becomes insolvent, certain payments made by the customer, sometimes several years ago, can be brought into question.

Over the recent past, an average of 29 companies registered in the Northern Territory were placed in external administration each year.

Certain transactions made during the period leading up to the appointment of the liquidator (the relation back period) may be reversed (and you may be asked to repay amounts):

- it might be up to three years before you are contacted by a liquidator (after their appointment) seeking repayment.
- the transaction may have been any time up to ten years before the liquidator's appointment.
- for most arm's length transactions, the period will be 6 months before the liquidator's appointment.

Companies and corporations

The discussion here deals with the insolvency of companies and corporations under the *Corporations Act*.

Similar precautions would apply to people with whom you deal in their individual or personal capacity. The insolvency of individuals is dealt with under the *Bankruptcy Act*.

External Administrators

A company can be placed in liquidation because it has insufficient money to pay its debts or fails to satisfy a statutory demand from a creditor.

When a company is placed in liquidation, an external administrator (liquidator) is appointed. A meeting of creditors is held at which the size of the debt owing, and the available assets to satisfy the debts is considered. If there are insufficient funds to pay creditors, the liquidator will examine payments made by the company in the lead up to liquidation.

The liquidator will be looking for payments made by the insolvent company that are **unfair preferences**, **uncommercial transactions** or **insolvent transactions**.

Unfair Preferences Section 588FA

An unfair preference arises if the payment you received is more than you would have in a winding up of a company; particularly if the payment gives you priority or advantage and reduces the assets available to pay creditors.

Uncommercial Transactions Section 588FB

A transaction is uncommercial if it was not reasonable for the company in liquidation to enter into the transaction with you in normal circumstances. This takes into account the costs and benefits to both you and the company in liquidation.

The liquidator will look for transactions that cannot be explained by normal commercial practice.

Insolvent Transactions Section 588FC

A transaction of a company is an insolvent transaction if the company was insolvent at the time of the transaction or became insolvent as a result of the transaction.

Claim by the Liquidator

In the case of unfair preferences and uncommercial transactions the liquidator can claim back payments made in the 6 months leading up to liquidation (up to 4 years for related parties and 10 years if the purpose of the transaction was to disadvantage other creditors).

The liquidator can claim back insolvent transactions that are also an uncommercial transactions made in the 2 years leading up to liquidation.

Defences

Good faith S588FG

The liquidator cannot claim a payment (that would otherwise have to be repaid) if you received it in good faith and had no reasonable grounds for suspecting that the company was or would become insolvent.

You must have acted with propriety and honesty and on the basis that it was a normal commercial transaction. You cannot rely on wilful blindness as evidence of good faith.

You may not have been acting in good faith if you had suspicion that the company was in financial trouble.

Running Account S588FA

A running account is an active account that runs from day to day on the basis that there will be future transactions with the creditor. Typically, the outstanding balance will rise and fall. Each time a payment is made under a running account, it is implicit that the buyer and seller relationship will continue in the future.

If you had a running account, this can reduce the amount you are required to pay back for an unfair preference.

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If a running account is proven, the amount of the preference that must be repaid is calculated on the basis that the running account was a single transaction. The preference is the difference between the outstanding balances at two dates (selected by the court) rather than the total amount paid over that period.

A running account will not reduce the amount you are required to pay back for uncommercial or insolvent transactions.

What can you do to protect yourself?

There are practical steps you can take to provide some protection against claims against by liquidators (often many years after you receive payment):

- regularly monitor your accounts receivable to ensure collections up to date.
- obtain personal guarantees from company directors or other security in relation to the company.
- if you are concerned about a customer's financial position, make reasonable enquiries.
- monitor your systems and review your credit management processes.

If you are contacted by a liquidator seeking repayment, it's often worthwhile seeking legal advice.

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