JBC Corporate

Preferences in Liquidations

Preferences are payments or transfers of assets that give a creditor an advantage over other creditors. Any payments or transfers made to a creditor before a liquidation may be recovered by liquidators in certain circumstances. Preferences are usually payments of money, although a variety of transactions could be deemed 'preferential'.

Why Do Liquidators Void Preferential Payments?

The liquidator's main role is to distribute a company's assets between its creditors on an equal basis. Liquidators must determine whether any creditor received treatment, prior to liquidation that was not equitable compared to the distribution to other creditors in the liquidation. Liquidators can void transfers that involve one creditor to make a more equitable distribution to all creditors, including the creditor who received the preference.

What Are the Elements of a Preferential Payment?

When considering whether a payment is preferential, a court must be satisfied that:

- A transaction was entered into between the company and a creditor of the company;
- The transaction happened when the company was insolvent;
- The transaction happened within the statutory period before the liquidation started;
- The transaction gave the creditor an advantage over other creditors; and
- The creditor suspected, or had reason to suspect, that the company was insolvent.

Main Elements of a Preference

1

There must be a debtor-creditor relationship

The transfer of property must have involved or been done at a creditor's direction, and must satisfy a debt that would be a provable debt if the transfer had not been made.

2

There must be a transaction

There must be a transaction between the company and creditor. Commonly, a transfer is a payment from a company's bank account, although any asset passing from a company to a creditor is sufficient to establish a transaction.

3

The transaction must have occurred within the relevant period

The transaction must have occurred during a specific period before the 'relation backday'. The relation-back day is the date that the liquidation is deemed to have started.

The debt must have been unsecured

4 A preference does not apply to a creditor holding a valid and subsisting security over company assets pursuant to the PPSA, where the value of the assets secured is greater than the payment amount.

5 Continuing business relationship.

The business relationship provision is used to determine the amount of any preference received by a particular creditor; it takes into account all transactions between relevant dates. It shows whether the owed debt increased or decreased to the creditor during that period.

6 The creditor must obtain a preference

The creditor must have received more than they would have received if they refunded the monies and proved for that amount in the liquidation process.

What Defences Are Available to Creditors?

Section 588FG of the Corporations Act 2001 provides defences that may be available to creditors who received preferential payments. To rely on a defence, a creditor must be able to satisfy all three conditions of the defence. The onus of proving the defences is on the creditor, it is not for the liquidator to disprove them.

The three conditions of the statutory defence are:

- The creditor gave valuable consideration for the payment;
- The creditor received the payment in good faith; and
- The creditor had no reason to suspect the insolvency of the company.

Should you have any questions or require further information on this subject please don't hesitate to get in touch.

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