

Understanding Preferences

ARITA
AUSTRALIAN RESTRUCTURING INSOLVENCY & TURNAROUND ASSOCIATION

ARITA, the professional body for registered liquidators in Australia, has developed this guide to assist those who receive a preference claim from a liquidator to understand why you have been asked to repay money that you've previously been paid for a debt you were owed. This guide explains what a preference is, what your rights are, and what obligations the liquidator must also meet in claiming a preference recovery.

Insolvency law is highly complex, and so you may wish to seek your own legal advice. If you do seek legal advice, we urge you to seek it from a lawyer who is an ARITA Professional Member – this ensures they are properly trained in insolvency law.

1. WHAT IS A PREFERENCE?

In a liquidation, when a company is winding up its affairs, all creditors are meant to share the available money equally. However, some creditors, such as employees and "secured creditors" (e.g., lenders with special arrangements), do receive payments in a higher priority. To ensure that all creditors are treated fairly, the law dictates that if a creditor receives more money than others in the six months leading up to the liquidation, they may be deemed to have received a "preference" payment – that is a payment above what you should have fairly received compared to others.

If you, as a creditor, receive a preference, the liquidator, the person overseeing the company's liquidation, can ask you to repay the amount of the preference for the benefit of all other creditors.

2. WHY HAVE I RECEIVED THIS LETTER?

After investigating aspects of the collapse of the company, the liquidator has reason to believe that you have received a preference, and they are requesting that you repay this amount to form part of the funds available in the liquidation.

3. WHAT MUST THE LIQUIDATOR PROVE TO SHOW I RECEIVED A PREFERENCE?

To establish that you received a preference, the liquidator needs to demonstrate several key elements:

- The transaction(s) caused you to receive more money than you would have obtained if you had not been paid and instead, claimed your debt during the company's liquidation process
- The company was insolvent either at the time of the transaction(s) or as a result of those transaction(s); and
- The transaction(s) occurred no more than six months before the company started the winding-up process. If the liquidation is a simplified liquidation, this period is reduced to three months.

4. WHAT DEFENCES ARE AVAILABLE TO A PREFERENCE CLAIM?

You may wish to seek your own legal advice about any available defences. The main defence to a preference claim requires you to prove:

- You received no benefit from the transaction, OR
- You received a benefit, but:
  a) You received it in good faith (which can mean not knowing you received payment ahead of other creditors)

b) You had no reasonable grounds for suspecting the company's insolvency or future insolvency due to the transaction, and

c) A reasonable person in your circumstances would not have had grounds for such suspicion.

5. WHAT INFORMATION SHOULD THE LIQUIDATOR PROVIDE ME WITH?

The liquidator should explain in the letter why they believe you have received a preference. They should provide:

1. Details of the transaction(s) resulting in the alleged preference.
2. The timeframe for the transaction(s) to qualify as a preference.
3. The date (or period) when the company is believed to have become insolvent.
4. Details of why they think you, or a reasonable person in your situation, would have suspected insolvency at the time of the transaction(s).
5. The likely estimated dividend in the liquidation in order to show how you received more due to the transaction(s) than if you had proved your debt during the winding-up.

6. WHAT IF I HAD AN ONGOING TRADING RELATIONSHIP WITH THE COMPANY?

If you had an ongoing trading relationship with the company, the preference amount may be calculated differently to give credit for ongoing supply made by you during the relevant period.

The letter from the liquidator should outline how the preference amount has been calculated in this situation.

7. WHAT CAN I CLAIM IN THE LIQUIDATION FOLLOWING A PREFERENCE CLAIM?

The law doesn't allow you to set off money owed to you by the company against a preference claim. That is, if you are owed a debt by the company at the date of liquidation, you cannot reduce the preference claim by the amount owing to you from the company.

You must repay the preference, and then you can claim the amount you're owed in the liquidation, plus the amount of the repaid preference.

9. WHAT SHOULD I DO NEXT?

1. Read the liquidator's letter and this information sheet.
2. If you need more information, request it from the liquidator.
3. If you believe you didn't receive a preference, or have a defence, write back to the liquidator explaining why.
4. If you think you might have received a preference, consider your options:
   a. Seek legal advice.
   b. Pay the preference back and claim the amount in the liquidation together with any debt owed to you by the company.
   C. You can defend the claim. If you do this and the liquidator thinks that they have a good claim, they may take you to court to try and obtain a court order for the recovery of the preference. It would be open to you to try to negotiate a commercial settlement with the liquidator.



For more information, go to **www.arita.com.au/creditors**.
Specific queries about the liquidation should be directed to the liquidator's office.