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NEWS

No set-off to unfair preference claims

The long-standing debate between liquidators and creditors about the ability to set-off debts owed by a company in liquidation against an unfair preference claim has been settled by a recent Federal Court decision.

KEY POINTS

- The defence of set-off cannot be used by a defendant in unfair preference proceedings.
 - However, where the creditor knows of the company's insolvency, it is still a defence if the benefit was received by the creditor in good faith and without reasonable grounds for suspecting the company was insolvent.
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WHAT IS AN UNFAIR PREFERENCE CLAIM?

An unfair preference claim arises when a creditor of a company has received payment for unsecured debts when the creditor knew, or ought to have known, the company was insolvent.

RECENT CASE

In this recent case, the creditor received \$190,000 in payments during the relevant period before the company was wound up. The liquidator issued proceedings claiming these payments were unfair preference payments and seeking to claw them back from the creditor.

The creditor argued it was owed approximately \$194,000 from the company and, therefore, the amounts should be offset against each other.

However, the Full Court of the Federal Court said the defence of set-off could not be used in unfair preference claims as the respective claims were not sufficiently connected or mutual. This is because the creditor's claim for payment of its outstanding debts is against the company, whereas the right to recover unfair preference payments rests solely with the liquidator of a company.

CONCLUSION

Whilst a set-off cannot be used against unfair preference claims if the creditor knows of the company's insolvency, it is still a defence if the benefit was received by the creditor in good faith and without reasonable grounds for suspecting the company was insolvent.

It is important to watch for red flags as to the solvency of counterparties, such as consistently missed payments, requests for extensions for payment, or debt collection action.

Reach out to our Litigation team if you need to understand more about the impact of this decision.

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