Getting Paid – and “Unpaid”

Liquidation and Bad Debtors

When someone owes you money, it can be hard work getting paid. Particularly if you become aware or even suspect that they may not have the money to pay you. It can be particularly gratifying to finally receive the cheque, bank it, and remove the debt from your list of concerns. All that hard work can be unraveled if your debtor then goes into Liquidation, within 2 years of making that payment to you.

A Liquidator has the power to consider all payments made by a company in the two years prior to Liquidation, and if at the time of the payment the company was not then able to pay all its due debts, decide that any payments were voidable transactions (Companies Act 1993, s.292).

In effect, if you have received more from the payment than you would receive via the Liquidation, that payment can be recovered by the Liquidator. As unsecured creditors often receive nothing in a Liquidation, all such payments are at risk.

If the Liquidator decides to challenge the payment, a notice is issued which identifies the payment and requires the recipient to raise any valid defences (s. 294).

Farrell and Ors v Fences and Kerbs Ltd and Ors

One of the defences often used has recently come before the Court of Appeal, in the case of Farrell and Ors v Fences and Kerbs Ltd and Ors [2013] NZCA 329.

It is a defence to a claim that a transaction is voidable if the recipient can prove (i) that the payment was received in good faith, and (ii) the recipient did not suspect and had no reasonable grounds to suspect the company could not pay its debts, and (iii) the recipient gave value for the payment or altered its position in reliance on the payment (s. 296(3)).

DISCLAIMER: This publication is necessarily brief and general in nature. You should seek professional advice before taking any further action in relation to matters dealt with in this publication.

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The issue for the Court of Appeal was what the relevant time is, for the giving of value for the payment. The argument is that a debt arises when value is given, and obviously the debt is discharged when payment is made. Value was clearly given for the payment.

But under the section, does some additional value have to be exchanged at the time when the debt is finally paid, in order for the section to apply?

The Court indicated that the prior giving of value is not sufficient. It must be a fresh provision of value, at the time of payment. "New value which is real and substantial must be given" (Judgment para 27).

Lawyers have traditionally argued that a forebearance to sue on the debt is such a further thing a value, in exchange for payment. The Court of Appeal warns that this will not always be the case. The problem will boil down to the value that attaches to any such forebearance to sue (not easy to qualify, and thus not sufficient in terms of the requirement quoted above).

If the prospects of suing successfully are high, then there may be sufficient value. If the company is already in a very poor position, the value may be minimal, and therefore the defence will not avail the recipient of the payment.

The Court of Appeal did not address the practical problem for the recipient. The defence has three limbs, and each limb must be available to enable the defence to attach. The first two limbs require good faith, and no knowledge of reason to suspect the company is insolvent.

In order to assess whether any payment of a debt will be safe from attack, the Court of Appeal is inviting the recipient to make the types of enquiry that will destroy those two limbs of the defence.

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In Conclusion

Not only is the outcome of the case very good news for Liquidators, but the practical outworking means that creditors seeking payment will never know whether the money is safely theirs, or whether a Liquidator may come knocking asking for it back. A Liquidator has 6 years to launch these types of claim, calculated from the date of Liquidation; (not date of payment) - which means the uncertainty can extend for up to 8 years from the date the payment was received.

I wonder whether it is prudent to make provision for this type of uncertainty in your financial accounts? Best talk to your accountant about it as we are lawyers and happily disclaim any knowledge of or ability to comment on tax and related issues. But the practical outcome of this decision may prove to be quite far reaching, and require some legislative intervention.

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