THE 'GOOD FAITH' DEFENCE TO RESIST UNFAIR PREFERENCE CLAIMS

The 'good faith' defence under section 588FG(2) of the *Corporations Act 2001* (Cth) (Act) has always been one of the most effective tools in a creditor's arsenal when responding to an unfair preference claim from a liquidator.

However, it is not uncommon for a liquidator's letter of demand to assert that the creditor will likely be precluded from relying on the good faith defence on the basis that:

1. payments were made outside of payment terms;
2. invoices have been repeatedly followed up by the creditor;
3. threats have been made to withhold supply or supply has actually been withheld; and
4. final demands containing threats to elevate to collection or legal action have been issued.

The decision of *Heavy Plant Leasing Pty Ltd (In Liquidation)*[1] (**Heavy Plant**) is a recent example of a creditor successfully defending an unfair preference claim in reliance on the good faith defence where all of the above factors were evident.

Facts

The facts of the dispute were as follows.

Christine Mancer carried on a business under the name of Bildavoid Concrete Voidforming Solutions (**Mancer**) and was a supplier of sealant used to support constructions in early stages.

In June 2012, Heavy Plant Leasing Pty Ltd (**Company**) and McConnell Dowell (**Head Contractor**) novated a subcontract to the Company for construction and earthworks on a major project in Roma.

In September 2012, the Company requested pricing and product information from Mancer.

Mancer issued various quotations and some invoices for goods supplied to the Company in September and October 2012. The quotes contained a term that provided that payments were to be made 30 days after the end of the month in which the purchaser was in receipt of the goods or the tax invoice, whichever was later.

On 30 October 2012, Mancer issued an invoice for $149,265.79 for goods to be supplied to the Company (**Invoice**). The goods were actually supplied over multiple deliveries between November 2012 and January 2013.

In late December 2012, Mancer sent various emails to the Company following up on payment of the Invoice.

---

[1] [2018] NSWSC 707

THE 'GOOD FAITH' DEFENCE TO RESIST UNFAIR PREFERENCE CLAIMS

On 2 January 2013, Mancer sent an email to the Company informing them that they have put a hold on production and delivery until payment of the account has been made.

In the following days, various emails were exchanged between the parties with Mancer requesting payment and threatening to provide the goods manufactured specifically for the Company to another customer to satisfy another order. The Company promised payment by 11 January 2013.

The Company subsequently contacted Mancer on 12 January 2013 to inform her that the account had been settled and requested release of the goods. This was untrue and no payment was received.

Mancer continued to follow up the Company for payment and on 31 January 2013, Mancer emailed the Company:

1. demanding payment by 7 February 2013; and
2. foreshadowing a default listing and legal action if no payment was received.

The following day on 1 February 2013, Mancer received payment in full in the amount of $152,609.79 (there were additional charges for freight and storage incurred due to some attempted deliveries that occurred).

On 14 March 2013, Neil Cussen and John Greig were appointed as voluntary administrators of the Company and subsequently as liquidators on 20 December 2013.

Issues

All of the elements to constitute an unfair preference were admitted by Mancer and the only issue to be determined was whether Mancer could rely on the good faith defence under section 588FG(2) of the Act.

The good faith defence requires the creditor to demonstrate that:

1. the creditor became a party to the transaction in good faith;

2. at the time of the payment:

   (a) the creditor had no reasonable grounds to suspect that the company was insolvent; and

   (b) a reasonable person in the creditor's circumstances would have no such grounds for suspecting insolvency; and

3. the creditor has provided valuable consideration under the transaction.

In order to satisfy the test in paragraph 2 above, the creditor must show an absence of grounds on which it or a reasonable person in its position ought to have suspected insolvency and regard must be had to:

1. the factors that were apparent to the creditor at the time of the payment; and
2. the impact that those factors had or should have had on the creditor.

The relevant suspicion must be one of actual or existing insolvency as opposed to impending or potential insolvency.

The liquidators admitted that the elements in paragraphs 1 and 3 had been satisfied and pointed to the following factors as grounds to allege that suspicion of insolvency arose.

1. Failure to pay promptly and within terms.
2. Dubious explanations given by the Company for the failure to pay.
3. The exertion of pressure to procure payment, in particular withholding delivery.
4. The final demand given on 31 January 2013.

Decision

Brereton J rejected the arguments advanced by the liquidators and awarded judgment in favour of Mancer.

His Honour restated a number of principles in respect of factors that may provide grounds for suspecting insolvency. His Honour noted the following in particular.

1. Recalcitrance or late payment is indicative of cash flow difficulties which may fall short of the permanent state of insolvency required under section 588FG of the Act.

2. Debts are not always paid on time even by solvent traders.

3. Resorting to ordinary collection procedures does not necessarily provide grounds for suspecting insolvency.

In respect of each of the grounds raised by the liquidators, Brereton J concluded as follows.

Ground 1 — late payment ([65] to [68])

The delay in payment was not a protracted one particularly in the context of the building and construction industry which is notorious for subcontractors to suffer cash flow difficulties due to delayed or non-payment by head contractors.

Ground 2 — excuses for non-payment ([69])

The failure to pay in accordance with a promise to pay by a recalcitrant debtor is not necessarily indicative of insolvency.

Grounds 3 and 4 — pressure exerted by Mancer and final demand ([70] to [74])

The action taken by Mancer were steps that would have been taken against a recalcitrant solvent creditor and did not go as far as following through with the threats as it resulted in full payment.

This can be distinguished from a situation where the debtor puts forward a partial payment or instalment plan, which is more indicative of insolvency.

Judgment was awarded in favour of Mancer and the liquidators and Company were order to pay Mancer's costs of the proceeding.

Lessons learnt

The decision in *Heavy Plant* is great win for creditors, particularly in a time when preference claims are becoming more prevalent and liquidators are taking an overly proactive approach in seeking to recover unfair preferences through formal court proceedings (with many actions for particularly small amounts that will likely see no return to creditors).

The factors outlined by Brereton J highlight that the strict observance of a creditor's internal credit policy may not give rise to a suspicion of insolvency as it would be applied equally to recalcitrant solvent customers.

Creditors are strongly encouraged to obtain legal advice upon receipt of an unfair preference demand letter from a liquidator to ensure they are appropriately advised of their legal position and potential defences available.

Acting early and proactively is the best way of dealing with an unfair preference demand and will always result in a better outcome than ignoring the demand in the hope that the liquidator will not progress any further.