

Short notes on:

## **WHAT TO DO WHEN THE LIQUIDATOR COMES KNOCKING**

### ***Introduction***

If you are approached by a liquidator wishing to claim back money paid to you by a provisionally liquidated business, what are your options?

At the time of making the payment in this instance, the businesses liabilities exceeded its assets and the payment made to you was made with either the intention to prefer you over its other creditors, or it has had the effect of preferring you above the other creditors. This payment is thus an undue preference, alternatively, a voidable preference, with the effect of you having to repay the money. On what basis are you required to repay money which has been paid to you?

Section 29(1) of the Insolvency Act (“the Act”) provides an answer to this question. The Act is rooted in fairness and wants to ensure that each and every creditor of the liquidated business is in a position to share equally and proportionately in the proceeds of the liquidation. Section 29(1) can be broken down into two parts. The first part provides the liquidator with the necessary power to claw back the amount paid, while the second part provides you with a defense to the first part.

### ***Part One of Section 29(1):***

This section provides that all amounts the business has paid to creditors in the six months preceding insolvency proceedings can be clawed back by the appointed liquidator. Once clawed back, the liquidator will pay the clawed back amount into the insolvent estate for the benefit of the entire body of creditors.

The rationale behind this is to prevent a situation where a business, knowing that liquidation proceedings are looming, uses the remaining funds to pay preferred creditors over others. This section thus aims to protect the entire pool of creditors, by insisting on fairness and preventing a party from picking and choosing which creditors it would like to pay and thereafter liquidate itself leaving the remaining creditors with whatever scraps are left.

### ***Part Two of Section 29(1)***

In order for you to make use of the defense in this section, you will be required to show that:

1. The payment made by the business during the six-month claw back period is consistent with how payments were made prior to the period;

2. The payment in question is payment of a debt incurred by the business in the ordinary course of its business or financial affairs;
3. The payment was not made with the intention of preferring one creditor over the other.

While these requirements may appear to be straight forward, this is often not the case, and has resulted in the courts applying a test to determine whether the payment was made in the ordinary course of business or not. The objective test looks at an honest and solvent businessman and requires you to ask the question as to whether the solvent and honest businessman would have in the ordinary course of business acted in a similar manner or would the businessman have thought the transaction to be extraordinary.

### **Conclusion**

Section 29(1) of the Act both gives and takes, in that it provides the liquidator with the power to act retrospectively and claw back payments made which shouldn't have been made, while affording those who have received payments in the ordinary course of business a defense in the event the liquidator comes knocking. It is therefore advised that you ensure honest, reliable payments that echo the fairness ingrained in the Act.

For all your insolvency, liquidation and business law concerns, contact an Attorney at SchoemanLaw Inc today.

