How to avoid bad debtors

LEGAL MATTERS

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B asks what happens if she is paid a debt and the debtor company then goes into liquidation.

A liquidator's job is to obtain all available funds to share on an equal basis with all creditors after payment of any secured or preferred creditors.

If the liquidator considers that payment to a creditor has given them a preference over other creditors, the liquidator may file a notice within two years of the liquidation to have the payment set aside, and require the return of the funds that were paid to the creditor.

The rules specifically provide that to constitute a voidable preference claim, the transaction must meet all of the following:

- Payment must have been within two years before the beginning of the liquidation.
- It must be made by a company unable to pay its due debts.
- It must have enabled the creditor to receive more towards the satisfaction of a debt than they would have otherwise received in a liquidation.

Liquidators must issue court proceedings as long as the creditor objects in writing to the liquidator's notice within 20 working days.

Previously the liquidator could issue a notice and the creditor was required to start court action if it disagreed with the notice.

Generally difficulties with proof and cost mean liquidators will only worry about large payments within the last six months.

If you had due debts paid within six months of the liquidation, the onus is on you to prove you don't have to give it back.

Beyond six months the burden of proof is on the liquidator. The problem for creditors is how to avoid clawback when you know that your customer is in trouble.

It is hard to say you didn't know they were in trouble when you only got paid as a result of stopping credit or sending the debt for recovery action.

To prevent a clawback the creditor must be able to show that it:

- Acted in good faith.
- Could not reasonably have suspected that the company was or would become insolvent.
- Gave value for the property or altered its position in the reasonable belief that the transaction would not be set aside.

It appears that ignorance of the debtor's perilous position will provide a defence, but this flies in the face of good credit management.

My advice to businesses providing goods on credit is:

- Have terms of trade in writing and make sure all customers have a copy.
- Send out statements to all customers who owe you money each month.
- Look for a clean credit history and a demonstrated ability to pay.

It is worthwhile "screening" new customers to make sure they can pay.

Do not be a victim of those unreliable, late-paying customers who often shop around for an easy target in hard times.

Remember the old adage: "If it seems too good to be true, it probably is."

Undertake diligent and regular bookkeeping.

Customers who do not settle their account within the agreed payment terms must be closely monitored to avoid the debt becoming seriously overdue.

Don't delay. Make the time to call and ask for payment.

Just because the banks will not lend money to the debtor doesn't mean that you should start being your customers' bank. Remember that banks require interest as well as payment on time.

In tough economic times business will be competing for a limited amount of cash.

That means many clients who usually pay on time are likely to find it harder to continue doing so.

Your debtors could stretch out beyond the number of days you currently tolerate, putting extra pressure on your cash flows.

To combat that, your business must be particularly diligent about managing cash.

The quicker you act the more likely you are to get paid and the less likely the liquidator will be able to prove you knew the debtor was unable to pay its debts.

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