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Claw-back provisions in bankruptcy

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A person can be made bankrupt if they owe more than \$5000 and have no means or assets to pay. Once a person has been made a bankrupt, a trustee in bankruptcy is appointed to manage their financial affairs. The main aim of the trustee is to collect all of the bankrupt's assets (as allowed by law) and to sell them and distribute them amongst creditors.

However, sometimes a person who has been made bankrupt has disposed of their assets just before bankruptcy. In some circumstances, the trustee is permitted to recover those pre-bankruptcy assets from those people who have received them. That is known as a "claw-back" in bankruptcy.

"Claw-backs can only be made for certain periods of time, and in certain circumstances."

Unfortunately, a claw-back sometimes includes people who have done business with the bankrupt just before the bankruptcy and have been paid for that work. The logic behind claw-back provisions is that a person who was paid a day before the bankruptcy should not have an unfair full payment when a person who was to be paid the day after the bankruptcy may only receive a portion of their entitlement.

However, there are some complex rules about that under the *Bankruptcy Act* (the Act").

Claw-backs can only be made for certain periods of time, and in certain circumstances.

Transactions made within five years before the bankruptcy and which were made for less than market value can be clawed back. For instance, if a property is purchased in the name of a spouse but all mortgage payments are made by the bankrupt, as long as that did not occur more than five years before the bankruptcy, the trustee can claim the property (subject to any claim by the spouse).

The ability of the trustee to claw-back assets also depends on whether the bankrupt was in fact solvent in the period that the transaction occurred, and whether the person transferring the asset did so in good faith.

Separately, the trustee can also attack and claw back the transfer of assets by a bankrupt which were undertaken with the intention to defeat creditors. A claw-back in such circumstances has no time limit.

The trustee can also attack preferential payments. Such payments are payments made to creditors which result in them receiving a preference over the remaining unsecured creditors at a time when the bankrupt was already insolvent but not yet bankrupt. The time limit for such a claw-back is six months prior to the commencement of the bankruptcy.

There are some defences which creditors who have received a pre-bankruptcy payment in those six months can raise.

For example, if they can show that they received the payment in good faith and had no reason to know or suspect that the other party was insolvent at the time, then that is a meaningful defence. One potential issue with such a defence is that often the trustee can point to a chain of correspondence or "instalment payments" which show that a creditor should, reasonably, have expected that insolvency was a distinct possibility.

The claw-back request and the circumstances of the transactions will require close examination and you should immediately seek legal assistance if you have received money from a person who has now become bankrupt and their trustee requires that you repay some, or all, of the money which you have received.

Further to that, there are methods of avoiding a claw-back altogether. One example is to secure your right to payment ahead of other creditors via registration of your rights against land or assets owned by the parties with whom you are dealing. Such "secured-creditor" status gives you rights ahead of other unsecured creditors and makes it more likely, if not certain, that you will recover that which you are owed in full.

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