

Beware of Demand Letters

An immediate concern for any company is a threat to present a winding up petition made in an email or letter – regardless of the size of debt, whether the debt is disputed or the company has a counterclaim.

The consequences of ignoring such a threat can have an immediate and adverse impact on a business. Failure to respond can be used as evidence that the company is unable to pay and that can be used as evidence to support presentation of a winding up petition.

The risk for companies is that a letter can often be overlooked or not taken seriously, and it may also give very limited time to respond.

A creditor only needs to leave enough time following demand for the company to make a bank transfer before it can present a petition. This could be as little as 24 hours, but typically such letters give a company two to three days to pay.

A demand letter does not have to be in any particular form or include any specific words.

It is often only a couple of paragraphs long, is usually sent by a lawyer (but does not have to be) and will usually reference the “Insolvency Act” or contain wording to the effect that “failure to pay will result in a winding up petition being presented”.

It is key to spot these types of demands in order to take action (see options below) before a petition is presented.

Statutory Demands

Instead of a demand letter, a creditor can serve a company with a statutory demand, giving 21 days to pay. This is usually, and should be, personally served at the company’s registered office address but might be sent by post. Although this gives a company more time to deal with payment or dispute the debt, it is important to deal with a statutory demand in a timely manner to avoid a petition being presented.

How Do You Respond to a Demand for Payment?

As noted, a petition can be presented on very little notice, but it can have an immediate impact on a company’s business, particularly because notice that a winding up petition has been presented is public knowledge almost immediately (see below).

It is important that a threat of a petition is, therefore, taken seriously and that you discuss the options available with your advisers so that steps can be taken to protect the business.

Level of Debt

A winding up petition can be presented for debts of £750 or more. Therefore, even where the outstanding debt is small, given the consequences below, it is important to address a threat of a petition even when the debt value is low.



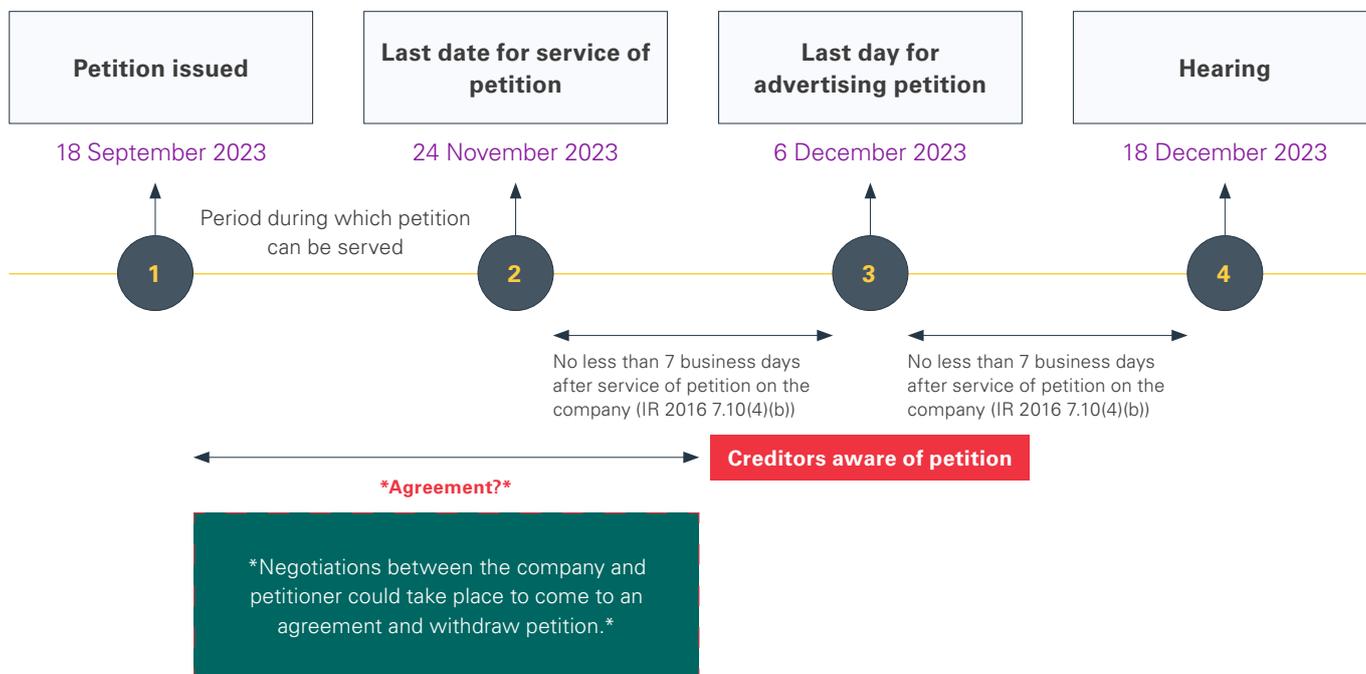
Awareness of a Winding Up Petition

Historically

Ordinarily, knowledge that a winding up petition has been presented would only be public knowledge once the petition was advertised. This could be several months after service of the petition on the company, but it gave the company and the creditor time to agree payment of the petition debt (if possible) or dispute it.

This also meant that the company's other creditors and the company's bank were unlikely to know that a petition has been presented until it was advertised – there were searches that creditors could do to find out about a petition, but these were limited.

Typical Example Timeline Historically



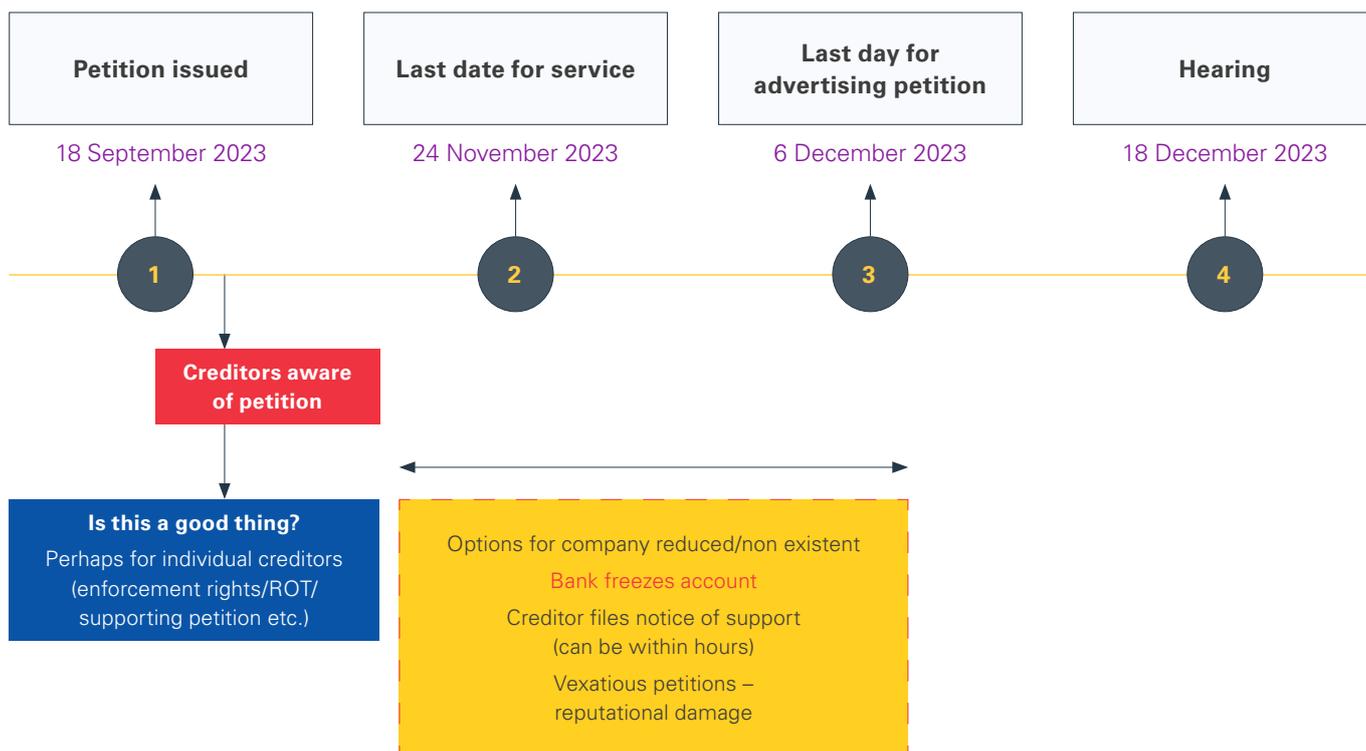
Now

With developments in how insolvency searches are undertaken, knowledge that a petition has been presented is now in the public domain almost immediately (and potentially even before the petition has been formally served on the company by the creditor).

This can have the following adverse effects on a company:

Creditors	<p>Creditors can easily find out about the existence of the petition and support it.</p> <p>This means that if you come to an agreement with the petitioning creditor about payment of the petition debt, the petition cannot be withdrawn without the court's permission.</p> <p>Also, if a supporting creditor wishes to take over conduct of the petition, then it can ask the court to be substituted as petitioning creditor and it can continue with efforts to wind up the company.</p>
Bank	<p>The company's bank is likely to find out about the winding up petition and freeze the company's bank account.</p> <p>This has an impact on cash flow and may halt business operations.</p> <p>If the bank freezes the company's account, the company's ability to agree and make payment to the petitioning creditor is also affected.</p>
Business operations	<p>Knowledge that a petition has been presented is likely to mean that:</p> <ul style="list-style-type: none"> • Suppliers stop supplying • Customers will be nervous about dealing with the company
Reputation	<p>The company's reputation may be damaged even if the petition is vexatious and should not have been presented and is then withdrawn.</p>
Options	<p>Options for dealing with the petition debt, such as repayment, or re-financing are limited/ non-existent.</p>

Typical Example Timeline Now



Options

The following steps can be taken to avoid the adverse impact of a winding up petition:

1. A Petition Should Not Be Presented if the Debt is Disputed, or the Company Has a Counterclaim

It is important to engage your advisers to assist with a response to the creditor threatening a petition. They can advise whether you have sufficient grounds to oppose a winding up petition and, if you do, ensure that the dispute/counterclaim is properly supported, and the right information is sent to the creditor. They can also advise on whether and when step two is appropriate.

2. If the Debt is Disputed or There Is a Counterclaim the Company Can Apply to Court for an Injunction to Prevent the Creditor From Presenting the Winding Up Petition

Obtaining an injunction can be expensive, but it might be worth incurring the cost (even if the level of the debt is small) given that, once presented, it might be difficult for the petition to be withdrawn if other creditors then support it.

3. Pay the Debt

Even if the debt is disputed, in some circumstances, it may be better to reach an agreement with the creditor. This will depend on the dispute, the terms of any counterclaim and the size of the petition debt.

4. Negotiate

If the debt is not disputed, but the company needs time to pay, then it can seek to agree a repayment plan, or agree time to source funds with the creditor. Your advisers can also assist with this. That can be particularly helpful when there is a limited window for you to reach agreement between demand and presentation of a petition.

Key Contacts



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