

# Review

## Commercial Disputes



## New Year blues

### THE PERENNIAL PROBLEM OF UNPAID DEBTS – YOUR RECOVERY OPTIONS

Unpaid debts are perennial. They show no respect for seasonal changes or the advent of a New Year, but as businesses look forward to the year ahead, many will still have to bear the burden of those debts from the old year, which they simply cannot shake off. In certain circumstances, it may be that the issue of formal court proceedings does not represent the most cost-effective or appropriate manner in which to secure payment or, at the very least, establish that the debt simply cannot be recovered. In the case of an “undisputed debt”, it may be that some form of insolvency process can be employed as an alternative to litigation. Stephen Cole, Senior Associate, in our Commercial Disputes Team looks at the various options available to recover those unpaid sums.

#### Court Proceedings

In the vast majority of cases, irrespective of the type of debt to be recovered, before any formal court proceedings can be commenced, it is necessary to write to the debtor setting out the detail of the claim, providing all relevant documentation and allowing them a reasonable time to respond. Absent payment or a response that requires further attention, the next step would be to issue court proceedings (either County or High Court depending upon the value of the claim) for recovery of the sums outstanding. This will incur an issue fee of between £30-£1530 depending upon the value of the claim.

Once issued, it may be that the claim can be disposed of relatively quickly by means of what is known as “summary judgment”. Alternatively, it may be necessary to proceed to a full trial before a judgment can be obtained. To succeed at the summary judgment stage, you must show to the court’s satisfaction that the debtor has ‘no reasonable prospect of defending the claim’. This is a quick and effective solution for getting rid of a claim, but if this is not an option available to you or if you fail, the next steps to get a case to trial can be time consuming and costly. Bear in mind though that obtaining judgment (be it by way of summary judgment or at trial) is only the first step and absent voluntary payment by the debtor, following judgment it will be necessary to enforce that judgment against the debtor’s assets. Failing that, to commence some form of insolvency process.

If litigation is successful, the court will usually award costs in the successful party’s favour (i.e. the loser pays the winner’s legal costs) although the costs figure awarded is unlikely fully to cover the sums the successful party would be liable to pay to their own solicitors (typical recovery awarded from the other side is 60-70%). Any costs order takes effect in the same manner as a judgment and therefore similar considerations as to enforcement, absent voluntary payment, apply.

#### Insolvency Proceedings/Process

The insolvency process is not designed to be used as a means of “debt recovery”. That said, it is often seen as a useful commercial tool for achieving an early resolution of what could otherwise be a protracted and expensive claim.

The first, key consideration as to whether a form of insolvency process is appropriate, will be whether or not the debt is disputed. It is not enough for a debtor to raise a spurious dispute about the debt simply to defeat any insolvency process. Any dispute must be raised on genuine grounds. The threshold for establishing genuine grounds for a disputed debt is not particularly high (certainly a lower threshold than needs to be overcome in a summary judgment application) as the insolvency courts are not interested in considering and resolving detailed disputes. That said, the insolvency court will nonetheless need to satisfy itself that the dispute(s) raised are genuine and are not simply designed to avoid payment and/or insolvency proceedings being commenced or continued. The types of things that the court will take into account are the time at which a dispute is raised (the later it

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is raised the less likely it is to be viewed as genuine) and any clear admissions as to some or all of the debt being outstanding.

For insolvency purposes, it is only necessary to persuade the court that a sum in excess of £750 is due and owing and therefore even in circumstances where part of a debt is genuinely disputed, unless the undisputed element is paid, it may still be appropriate to proceed down the insolvency route. The process differs slightly depending upon whether you are proceeding against a corporate debtor or an individual.

### **Corporate Debtor**

With a corporate debtor, there are two options:

- (i) to serve a statutory demand followed by a winding up petition or
- (ii) immediately issue a winding-up petition.

A statutory demand is a means by which you can establish the company's inability to pay for the purposes of the Insolvency Act 1986. This then entitles you to proceed with a winding-up petition. Once the statutory demand has been served (it must be served personally at the company's registered office) a winding-up petition cannot be issued for a period of at least 21 days. It is hoped that payment can either be secured or a deal can be done within that 21 day period to avoid the costs of issuing a winding-up petition.

Unlike for personal insolvency there is no procedure for applying to set aside the statutory demand. A company which receives a statutory demand may look to apply for an injunction to restrain presentation of a winding-up petition which, if successful, could lead to a costs order being made against the party serving that demand.

Once the 21 day period has expired, the creditor is at liberty to issue a winding-up petition at court. Once issued, the petition may either be opposed at its final hearing or the debtor may apply for an injunction to restrain advertisement of the petition. The issuing of a winding-up petition is a draconian measure and if a company's bankers find out that a petition has been issued they are likely to freeze the company's bank accounts which will cause it obvious difficulties in continuing to trade.

Having issued a winding-up petition, it is still open to the parties to negotiate a settlement. Please bear in mind though that winding-up orders take effect from the date of the winding-up petition rather than from the date upon which the order is made. Technically, a disposition of the company's property after the issue of the winding-up petition is void unless the Court orders otherwise (Section 127(1) of the Insolvency Act 1986). This means that were another creditor to take over carriage of the winding-up petition once the petitioning creditor's debt has been satisfied, it would be open to the liquidator of the company to seek to claw back any sums of money paid to the petitioning creditor. Clearly, from a commercial perspective, should an offer of payment be made post-issue of the winding-up petition it probably makes sense to accept the same, but to have in mind that there is a real risk it may be clawed back.

The statutory demand and winding-up petition must be served by way of personal service. The winding-up petition incurs a court fee (currently £560 inclusive of the Official Receiver's deposit).

### **Personal Insolvency**

Unlike corporate insolvency, when pursuing an individual to bankruptcy, it is necessary to serve a statutory demand (as a pre-cursor to a bankruptcy petition). Again, the statutory demand must be served personally on the debtor.



Once served, the debtor has 18 days in which to make an application to the court to set aside the statutory demand (this will usually be on the basis that the debt is genuinely disputed and similar considerations to those set out above will apply). Absent an application to set aside the statutory demand, the creditor is at liberty to present a bankruptcy petition 21 days after service of the statutory demand. Like a winding-up petition, a bankruptcy petition must be served personally upon the debtor.

The bankruptcy petition will be listed for hearing before the court and could be contested at that hearing rather than by way of a set aside application on the statutory demand. The bankruptcy petition incurs a court fee (currently £520 inclusive of the Official Receiver's deposit).

### **Effect of Winding-Up Order/Bankruptcy Order**

If the company is wound-up or the individual is made bankrupt, this does not guarantee the creditor will receive payment either in full or in part. The creditor will be required to "prove" for the sums outstanding to it as part of the winding-up/bankruptcy and, depending upon the level of other creditors and the available assets, this will ultimately determine what, if anything, is recovered by way of 'dividend' payments. In both cases, the legal costs of applying for the winding-up/bankruptcy order can be proved for together with the underlying debt.

In any insolvency situation secured creditors (e.g. a fixed charge holder) and preferential creditors (e.g. HM Customs and Revenue) together with the insolvency practitioners' fees and expenses will all be paid before any balance is divided amongst unsecured creditors.

### **FURTHER INFORMATION**

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