

Briefing Note: Debt Collection – Alternative Procedures

Introduction

This Briefing Note considers the two most common alternative options available to a creditor to recover a debt and highlights the advantages and disadvantages of each option. This guide should not be relied upon as legal advice and you should contact us for advice on your specific circumstances.

Update: On 26 June 2020, the Corporate Insolvency and Governance Act 2020 came into force, introducing temporary provisions affecting the use of statutory demands on companies and LLPs. In essence, the provisions prevent reliance on statutory demands against companies during the relevant period.

Starting on 1 March 2020 and originally set to end on 30 September, the relevant period has been extended twice, through the implementation of regulations, and is now due to end on 31 March 2021.

Creditors are therefore prohibited from relying on a statutory demand against a debtor company or LLP until 1 April 2021.

Importantly, the provision does not extend to individuals (i.e. sole traders and traditional partnerships) and therefore creditors can continue using statutory demands as a way of recovering debt.

Statutory Demand -v- Part 7 Claim

Statutory demands and ordinary court claims brought under Part 7 of the Civil Procedure Rules ('Part 7 claims') are the two principal weapons in a debt collector's armoury. However, it is not always obvious which one should be used in any given case. There are pros and cons to each.

As is so often the case in litigation, the right option will depend on the relevant facts (and in particular the nature of the debt and the efforts that have already been made to collect it).

Statutory Demands

- A statutory demand is a formal notice (in a form prescribed by legislation) demanding payment of a debt. The notice must contain certain basic information (including how the debt arose and how much of it is outstanding) and there are specific rules about serving it (i.e. formally bringing it to the debtor's attention).
- A statutory demand will not be appropriate in all cases, particularly if the debtor has indicated that he has or is likely to have a defence to your claim.
- Once the demand has been served the debtor has 21 days in which to pay the debt. The key consequence of failing to pay within this deadline is that the debtor will be deemed to be unable to pay its debts. This in turn will constitute grounds for a court ordering that the debtor is wound up (if it is a company) or made bankrupt (if he is an individual).

Advantages of Statutory Demands

The advantages of serving a statutory demand (with a view to recovering a debt) are:

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Summary:

A summary of the pros and cons of using bankruptcy or civil proceedings to recover debts.

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- Preparing and serving the demand can be done quickly. It should be noted, however, that the debtor will have 21 days in which to pay.
- It is inexpensive.
- You do not have to involve a court and do not have to pay a court fee.
- You do not have to follow the demand up if you do not want to (which should be contrasted with a court claim, which is harder to back out of once commenced). However, it should be noted that the debtor may apply to set aside the demand and if he does so and you no longer wish to follow it up, you would have to withdraw the demand and this is likely to lead to you having to pay the debtor's costs.
- It usually has a significant impact on the debtor. In particular, the debtor will know that the next step in the process (if it does not pay) is either a winding up or bankruptcy petition. The demand will particularly concern the debtor if it wants to save its business and/or its owners have invested in it or they have given personal guarantees. Often the service of a statutory demand will lead to the debtor paying or negotiating a payment plan.

Disadvantages of a Statutory Demand

- A statutory demand cannot be used in respect of a debt which is not for a specific and known sum. For example, it cannot be used where a debtor's breach of contract has caused losses which are yet to be quantified.
- The debt must be for at least £5,000 in respect of individual and £750 in respect of corporate debtors.
- There are quite specific rules governing how a statutory demand must be served. These are particularly onerous when the demand has to be served on an individual. Often the rules are not followed (simply because the creditor wants to obtain the benefit that service (even if done incorrectly) has on the debtor). It is important to note, however, that if the debtor does not pay, then the creditor will not be able to pursue the matter to the next stage if there has been defective service.
- It is very risky to serve a statutory demand on a debtor if you know that the debt is disputed on genuine grounds or if the debtor has been silent and there is a risk that the debt could be disputed on genuine grounds. This is not to say that you must accept any grounds as genuine; rather, it is inadvisable to serve a statutory demand where it is likely that the debtor will be able to persuade a judge that its reasons for not paying should be considered properly in court. If you proceed in any event, this may well lead to the debtor applying to court either for an injunction to restrain any further action on the statutory demand, or to set it aside. If they make such an application and succeed (which they will do if they can persuade a court that there is a dispute of substance), or if they make such an application and you withdraw the demand, then you will very likely be ordered to pay the costs of the application (and this is likely to be on an "indemnity basis" if you were aware of the grounds on which the debt is disputed or knew that the debt could be successfully challenged, and it is likely to be on the "standard basis" if the debtor was silent as to his position on the debt - see our briefing note 'Costs in Litigation'). This could lead to a situation where you do not recover your debt quickly and in fact you are required to pay the debtor money. The risk of paying the debtor's costs where an application is made to restrain further action/set aside the demand and the creditor withdraws it is greatly reduced in circumstances where the creditor has obtained a judgment against the debtor for the debt.
- If there is no response to the statutory demand, or the debtor simply cannot pay, then the follow-up action is a winding up or bankruptcy petition. This is significant, firstly because it is a more costly and time consuming procedure (even if still cheaper and quicker than an ordinary court claim) and, secondly, and most significantly, because winding up and bankruptcy are collective procedures for the benefit of all creditors. Usually the debtor's assets are realised by an independent insolvency practitioner and are then paid out in a specific order of priority. This normally means that unsecured

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creditors will be lucky to receive a small proportion of their debt (there is no set proportion - it depends on what assets the debtor has, what they are sold for and what debtors take priority - but very often in a liquidation it is less than 10 pence in the pound), and the money will take many months to arrive.

- In certain circumstances it may be advisable to move immediately to serve a winding up or bankruptcy petition. This carries more risk than serving a statutory demand and should be done only in exceptional circumstances and specialist advice should be taken.

Part 7 Claims

A Part 7 claim is an ordinary court claim in which the creditor seeks an order from the court which requires the debtor to pay the outstanding debt (see our briefing note 'Guide to Litigation in the County Court'). Depending on the amount and nature of the debt, the claim can either be brought in the County Court or the High Court (whether in a district registry or the main court in London).

Advantages of a Part 7 Claim

- The fact that the debtor might dispute the debt is no bar to proceeding with a claim. Indeed, court proceedings of this nature are the very forum for resolving such disputes.
- The prospect of the debtor having to spend time and money defending the proceedings will act as an incentive to pay the debt or to put forward a compromise proposal.
- Similarly, the prospect of a judgment debt affecting the debtor's credit rating will act as an incentive to pay or settle.
- The debtor's existence as a trading entity is not immediately threatened by this form of recovery action and indeed it will allow the debtor to continue trading in order to generate money to pay the debt.
- A judgment or order requiring the debtor to pay the debt opens up a number of different enforcement options. Further, the debt will be as between you and the debtor alone - it will not of itself lead to a collective winding up or realisation of the debtor's assets for the benefit of all.
- It is much easier to obtain an order for costs against the debtor in a Part 7 claim and more likely that the costs will be recoverable (although it remains the case that quite often costs prove irrecoverable, whether in whole or in part).

Disadvantages of a Part 7 Claim

- It can be slow, in particular if the claim is defended. A typical defended debt claim will take between 3 and 12 months to reach trial. Strong claims (to which there is no serious defence) can be resolved more quickly by the creditor applying for summary judgment or the striking out of the defence.
- The procedure is more expensive. Firstly, there are (sometimes quite significant) court fees to pay. Secondly, the rules governing such claims require thorough preparation of the case before it is commenced. Thirdly, the level of paperwork and detail required are significantly greater. Fourthly, the procedure anticipates the swapping of statements of case and evidence in preparation for a trial (although, of course, very often the claims are either settled or resolved much earlier).
- The procedure is not confidential - once issued the claim will ordinarily be open for all to see (through the court's records). Of course, in the majority of cases there is no particular interest in the case and the relevant documents simply remain on the court file without being accessed by third parties.

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- The initial aim of a Part 7 claim is to obtain a judgment against the debtor and an order for costs. Critically, however, these may amount to no more than paper judgments, in particular if the debtor has no money or seeks to evade the enforcement of the judgment.

Other Considerations

Beyond this analysis, you should bear in mind the following:-

Invariably, the courts (whether in the context of a Part 7 claim or a winding up or bankruptcy petition) will expect you to have gone to reasonable lengths to try and secure payment of the debt without recourse to legal proceedings. Indeed, the rules governing claims in England and Wales now require the parties to follow a 'Pre-Action Protocol or Practice Direction'. In the context of debt claims, a 14 day formal letter of demand should be sent as a minimum. The courts also strongly encourage settlement negotiations.

Consideration should also be given to the impact of pursuing either procedure on your trading relationship with the debtor.

The Debt Respite Scheme (Breathing Space Moratorium and Mental Health Crisis Moratorium) (England and Wales) Regulations 2020

From 4 May 2021, The Debt Respite Scheme (Breathing Space Moratorium and Mental Health Crisis Moratorium) (England and Wales) Regulation 2020 ('the Regulations') takes effect.

The purpose of the Regulations is to provide protection to individuals in problem debt from their creditors. A qualifying debt under the Regulations is widely defined and, except for a named few, all personal debts and liabilities can qualify for protection. Please refer to briefing note <https://www.gabyhardwicke.co.uk/briefing-notes/debt-respite-scheme> for further details and how this may affect you.

If you would like to know more about this topic or our legal services, please contact Jeremy Laws on 01323 435 955 jeremy.laws@gabyhardwicke.co.uk

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