

Debt Recovery Processes Explained



Unfortunately within any business there will be occasions when the Creditor has to recover its debts. This is a brief guide to a number of the legal recovery options available to Creditors.

The primary question will be who owes the debt?

Depending on whether the Debtor is a corporation or an individual will determine the various enforcement options open to the Creditor. This paper addresses unsecured claims only. The procedures open to secured creditors (such as mortgagees and registered charge holders) are very different.

Creditor's Statutory Demands can only be used in relation to debts owed by companies, and not individuals.

If the Debtor is a corporation and there is no genuine dispute in relation to the debt the Creditor can issue and serve a Creditor's Statutory Demand then initiate liquidation proceedings.

If the corporation has a dispute in relation to the debt, then a Creditor's Statutory Demand cannot be served and the only option is to issue court proceedings against the Debtor.

1. Corporate Debtor and no dispute – Creditor's Statutory Demand

1.1 Prepare and serve Demand

A Creditor's Statutory Demand (CSD) is the first step in winding up proceedings, which means placing the Debtor into liquidation. The wording of a CSD is strictly controlled by the *Corporations Act*.

A CSD, and an affidavit in support, will need to be prepared and served on the Debtor company.

1.2 Debtor's response

Once the CSD and affidavit has been served on the Debtor, the Debtor has 21 days to either:

- pay the debt or secure the amount of the debt to your satisfaction; or
- apply to the court to set aside the Demand on either of the following grounds:
 - there is a genuine dispute in relation to the debt;
 - the Debtor has an offsetting claim; or
 - there is a formal defect in the

Demand that causes substantial injustice to the Debtor.

If the CSD is simply ignored, the Debtor is "deemed" to be insolvent 21 days after the CSD is properly served. That means a

Creditor does not have to otherwise prove the Debtor is insolvent in subsequent court proceedings to appoint a liquidator.

If the Debtor disputes the debt then it is usually prudent to withdraw the CSD and commence proceedings in the Local, District or Supreme Court to obtain a judgment in relation to the debt (see below).

Challenging a CSD is a relatively easy matter, as the Debtor only needs to satisfy the court that there is a dispute as the threshold for establishing such a dispute is that there is a "*plausible contention requiring investigation*". The Debtor does not have to prove it will be ultimately successful on the dispute.

If a dispute is raised and the CSD is not withdrawn then there is a cost consequence as the Debtor will be required to apply to the Supreme or Federal Court for orders to set aside the CSD.

1.3 Liquidation Application

If the Debtor does not pay the debt or take any steps outlined above to set aside the CSD within 21 days, then the Creditor can make an application to appoint a liquidator to the Debtor company.

Such an application may be made immediately upon the Debtor's failure to comply with the CSD, but in any event must be made within three months of that failure.



The steps involved in winding up a company, in summary are: filing a winding up application with the Supreme or Federal Court and serving it upon the company and ASIC; the application must be advertised; further affidavits are then prepared, filed and served; and the matter is then listed for hearing approximately six weeks after it is filed.

If the application to wind up the Debtor is unopposed, the costs and disbursements are likely to be approximately \$6,000, including filing fees and advertising costs.

1.4 Liquidator appointed

If an order is made to appoint a liquidator, the liquidator's role will be to take control of the Debtor company, liquidate its assets (if any) and distribute the proceeds, equally amongst creditors. Secured creditors (charge-holders, mortgagees etc) generally take priority over all other creditors.

The appointment of the liquidator will not result in further expense as the liquidator's fees are paid from any assets of the company in liquidation.

We have long-standing relationships with many insolvency practitioners, so we can recommend the right person for the job at the start of the matter.

1.5 Assets distributed

The assets must be distributed in a

specified order. It is only after payment in full of certain creditors, such as employees, that any distribution can then be made to unsecured creditors on a pro rata basis.

If the Debtor does not have any assets from which to pay a Creditor's debt, then it is not generally financially viable to spend further money pursuing recovery action against the company. However, a Creditor may want to "test the waters" by at least serving a CSD on the Debtor company, as there is no obligation to issue court proceedings once the 21 day period in a CSD has expired.

2. Corporate Debtor with a dispute, or Individual Debtor – court proceedings

2.1 Issue letter of demand

The first step in recovering a disputed debt is to issue a letter of demand. This is entirely different from a Creditor's Statutory Demand.

2.2 Commence court proceedings

If the debt remains unpaid, the next step is to commence court proceedings. Court proceedings are commenced by issuing a Statement of Claim in the appropriate court, for example:

- The Supreme Court has jurisdiction for money claims over \$750,000.
- The District Court has jurisdiction for money claims between \$60,000 and

\$750,000.

- The Local Court has jurisdiction to deal with claims up to \$60,000.

2.3 Serve those proceedings

Any proceedings that are issued are required to be properly served on the Debtor.

2.4 Apply for default judgment

If the Debtor does not file a defence within 28 days of service of the claim, a Creditor may apply for a default judgment. If a judgment is obtained then the Creditor is free to enforce that judgment in a number of ways including issuing a CSD and then winding up proceedings (see above) against a company, or bankruptcy proceedings against an individual.

2.5 Directions hearing

If a Debtor does file a defence within 28 days of service of the claim, the court registry will allocate a date for the first directions hearing.

What the court expects the parties at the first directions hearing will depend on the court in which proceedings have been filed. At the directions hearing orders are made and directions are given with a view to the just, quick and cheap disposal of proceedings.

Typical orders and directions may relate to:

- the filing of points of claim, points of defence or other similar documents;
- the filing of any cross-claims;
- the filing of a statement of agreed issues;
- the provision of essential particulars and "discovery" of documents; and
- the filing or service of any evidence, usually in the form of a sworn affidavit.

If the proceedings are in the Small Claims Division of the Local Court (for claims for less than \$10,000) then the matter will ultimately be listed for hearing before an assessor. At the hearing the assessor will consider written statements and documents filed with the court. The assessor will then make a decision which is binding on both parties without any need for witnesses to give evidence.

2.6 Costs

Generally, if a Creditor is successful in court proceedings, the court will usually order that the other party pay the Creditor's legal costs. Costs ordered by a court to be paid by one party to the other are called party-and-party costs.

Party-and-party costs cover the majority of the cost you will be charged by your lawyer, but there will be a balance you are not permitted to recoup (direct lawyer and client costs). In our experience party and party costs are between 60% and 75% of lawyer and client costs.



We will attempt to reach agreement with an opposing lawyer as to the amount of these party-and-party costs. Failing this we would prepare a bill of costs which would be assessed by the Registrar of the Supreme Court.

However it is important to note that a Creditor is still responsible for its own legal costs even though an order has been made that costs be paid by the other party. An order that another party pay your costs is only as good as the other party's capacity to pay; it will be

of little benefit if the other party has no funds or cannot be located.

2.7 Enforcing a Judgment

Other than liquidation or bankruptcy proceedings, there are other legal processes available to a Creditor to enforce a judgment against a Debtor, including the issue of:

- An Examination Summons: where the Debtor is questioned about his assets and liabilities by a Registrar of the court.
- A Writ of Execution against property (goods) of the Debtor: where the Sheriff's Office seizes goods belonging to the Debtor to sell at auction in order to satisfy the debt.
- A Garnishee Order: where an employer or bank of the debtor is required to pay certain amounts directly to the Creditor.

These processes are usually only effective against Debtors for small debts under \$10,000. The threat of liquidation or bankruptcy proceedings is usually more effective against larger Debtors.

DibbsBarker can assist Creditors with the recovery of their debts through any of these processes.

FOR MORE INFORMATION

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