FortyTwo Talks:
Statutory Demands and Winding Up Petitions

Paul Fuller & Lucas Nacif

Paul Fuller: Hello and a very warm welcome to *FortyTwo Talks*, the podcast which takes a deep dive in the legal world, led by the experienced members of 42BR Barristers.

I'm Paul Fuller, a member of the Business and Property team at 42BR.

Lucas Nacif: And my name is Lucas Nacif, also a member of the Business and Property team.

Paul Fuller: In todays episode, we're going to be looking at one of the most effective tools available to creditors owed money by companies.

That is statutory demands and winding up petitions.

Lucas Nacif: So, for many commercial solicitors, these procedures sit somewhere between debt recovery and insolvency law. When used appropriately, they can be a powerful means of applying pressure and protecting creditors' interests. However, when used improperly they can result in delay, wasted costs, adverse cost orders, and can jeopardise ultimate recovery.

Paul Fuller: We'll look at how the statutory regime works, why winding up petitions can be so effective, the circumstances in which the courts will intervene to protect against abuse, and some practical points for creditors and debtors.

Lucas Nacif: Everything starts with the Insolvency Act 1986.

Section 122 (1)(F) gives the court jurisdiction to wind up a company where the company is unable to pay its debts.

The question then becomes - how does a creditor prove that inability to pay?

Paul Fuller: And the answer to that question is found in Section 123 of the Act, that section contains a number of statutory tests for insolvency.

The best known section is Section 123 (1)(a) of the Act, which provides that a company's deemed unable to pay its debts where a creditor owed more than £750 serves a statutory demand at the company's registered office, and the company then fails for 21 days to pay, secure, or compound the debt to the creditor's reasonable satisfaction.

Lucas Nacif: That procedure is familiar territory, it's often the first formal step before presentation of a winding-up petition. However, practitioners sometimes assume that service of the statutory demand is a mandatory prerequisite to a petition - it is not.

Section 123 provides several ways of proving insolvency, including an unsatisfied judgment under Section 123 (1)(b), cash flow insolvency under (1)(e), and balance sheet insolvency under (2).

A creditor may proceed without first serving a statutory demand if the circumstances justify doing so.

Paul Fuller: And whilst it's not compulsory, statutory demands do remain extremely commonplace, and the principal reason for that is they provide a straightforward mechanism for establishing a presumption of insolvency if the debt remains unpaid as I said for 21 days.

Lucas Nacif: The current procedural requirements are found in rule 7.3 of the Insolvency England and Wales Rules 2016, which we'll refer as the Insolvency Rules going forward.

The demand must contain prescribed information, including details of the company, details of the creditor, the amount claimed, the basis of the debt, and an explanation of the consequences of non-compliance. It must also inform the company of its ability to seek injunctive relief if appropriate.

Paul Fuller: And from a practical perspective, owing to the consequences of failing to comply with a statutory demand, the demands frequently prompt an immediate response from, directors and their advisors.

Sometimes the debt is paid, other times repayment proposals are made, and sometimes, most importantly for the purposes of today's podcast, the company explains why the debt is disputed and that last category often determines whether insolvency proceedings should ensue at all.

Lucas Nacif: Now, if the debt remains outstanding a creditor may decide to present a winding up petition.

The procedural framework now largely derives from Part 7 of the Insolvency Rules and the practice direction on insolvency proceedings.

Paul Fuller: Before instigating winding up proceedings, a prudent creditor should consult insolvency searches to determine whether another petition is already pending against the company.

Paragraph 9.2 of the practice direction warns creditors against presenting a second petition where one is already on foot, except in exceptional circumstances.

Lucas Nacif: And Rule 7.5 prescribes the information that must be included in the petition, and Rule 7.6 requires verification by a statement of truth.

The petition is then presented to the appropriate court, and once sealed, served on the company in accordance with Rule 7.9 and Schedule 4 of the Insolvency Rules.

Paul Fuller: Service requirements are strict, and companies will often dispute petitions on the basis of alleged defective service, and that can often result in delay and wasted costs. Service is normally affected by handing the petition to a director or an officer or employee of the company or a person authorised to accept service.

If no appropriate person is present, then the petition may be left on or about the registered office in a way that's likely to come to the attention of someone attending there.

If service at the registered office is not practicable, alternative methods may be permitted including service at the company's last known principal place of business or on a director personally.

Service must take place at least seven business days before the first hearing of the petition, and a certificate of service must be filed at court.

The petition must generally be advertised as well in The London Gazette under Rule 7.10 of the 2016 Rules. The advertisement has to be published at least seven clear business days after the petition is served and at least seven clear business days before the first hearing and evidence of the advertisement also has to be lodged with the court at least five business days before the hearing.

And again, these are all rules which if they're not adhered to can at the very least result in delay as petitions are adjourned off for any errors to be rectified.

Lucas Nacif: And what's important to remind ourselves is that the consequences for the company once the petition's advertised can be significant.

For example, banks may freeze facilities, trade creditors may review credit arrangements, customers, suppliers, commercial counterparties may become concerned of the company's financial position, and of course, other creditors may decide to support the petition.

Paul Fuller: Now, the authorities have long recognised that these consequences that Lucas has just touched upon exert considerable commercial pressure on companies.

And to this end, much of the case law concerning disputed debts is founded on the court's recognition that a petition, a winding up petition, is not to be used as a mechanism to place pressure on a company to make payment where liability itself is genuinely disputed.

Put another way, the insolvency forum is designed to provide a class relief in the interests of all of the creditors of the company. It's not to be used as a debt collection tool.

Lucas Nacif: And were restated by Mr Justice Norris in *Angel Group Limited v British Gas Trading Ltd 2012 EWHC 2702* from the Chancery Division - the central tenet is that a creditor's petition may only properly be brought by a creditor, if creditor status is disputed on substantial grounds, the court will generally refuse to permit the insolvency jurisdiction to be used to determine that dispute.

Paul Fuller: And the policy grounds for that position are obvious. Because presentation advertisement of a petition can have such serious commercial consequences, there's a risk that a company might feel compelled to pay simply to avoid those consequences regardless of the underlying merits of the dispute, and the authorities therefore treat misuse of the insolvency process as an abuse of process.

Lucas Nacif: So, the question is - what is a genuine and substantial dispute?

Not every defence will do. The dispute as the terminology suggests, must be genuine, advanced in good faith, and have a real prospect of success.

It's important to note that the threshold is not particularly demanding. In the Court of Appeal case of *Tellington Lakes Ltd v South Kesteven District Council 2012 EWCA Civ 443*, the court confirmed that the threshold may be satisfied even where the defense could fairly be described as shadowy.

Paul Fuller: Typical examples might include a genuine contractual dispute, a credible allegation that goods or services were defective, a substantial cross claim or set off, or a legitimate argument regarding the amounts due.

What the court won't tolerate is the manufacture of artificial disputes simply to avoid a petition, and several authorities have recognised that the court remains alert to debtors who seek to create the appearance of a dispute where one doesn't actually exist.

Lucas Nacif: And the crucial question is - if a company becomes aware that a petition is threatened, what can it do?

One of the most important protections is found in Rule 7.24 of the Insolvency Rules.

Under Rule 7.24(1), a company may seek an injunction restraining presentation of a petition, and under Rule 7.24(2), a company may seek an injunction restraining notification or advertisement of the petition that has already been presented.

Paul Fuller: Applications of this nature require and are far more likely to succeed if they are supported, of course, by detailed evidence. So, the supported witness statement should ordinarily explain the dispute, set out the communications between the parties, identify the prejudice likely to arise if the petition proceeds, and demonstrate why presentation of the advertisement would amount to an abuse of process.

Meeting the allegations head-on with clear evidence as to why there is a genuine and substantial dispute really is paramount.

Lucas Nacif: The Court of Appeal in *Re A Company (No. 007923 of 1994)* emphasised that the applicant must produce prima facie evidence showing that the proposed proceedings should not be permitted to continue.

Even where a petition has already been presented, the company retains important procedural rights. Rule 7.16 enables a company to oppose the petition by filing and serving evidence setting out the grounds of opposition, generally speaking that evidence should be filed at least five business days before the hearing.

Paul Fuller: Depending on the circumstances, the court may dismiss the petition, adjourn the hearing, permit further evidence to be filed, allow time for payment, if satisfied as to insolvency in compliance with the procedural requirements, make a winding up order.

Lucas Nacif: And so, what are the key takeaways?

For creditors, statutory demands and winding up petitions remain highly effective tools, used properly they provide a mechanism for establishing insolvency and commencing a collective insolvency process under the Insolvency Act 1986.

Paul Fuller: For debtor companies, the important message is to act quickly. A statutory demand should never be ignored, and where a debt is genuinely disputed, advice should be sought immediately.

The procedural protections contained within Rules 7.24 and 7.16 can be critically important, but they're most effective when invoked promptly.

Lucas Nacif: And perhaps the overarching lesson from the authorities is that insolvency proceedings are intended to address insolvency. They're not intended to resolve ordinary commercial disputes.

That principle remains at the heart of cases we discussed such as *Mann* v *Goldstein*, *Angel Group*, *Tellington Lakes*, *Re A Company*, and continues to shape the approach of the court today.

Paul Fuller: So that just about wraps us up here. Thank you for tuning in to *FortyTwo Talks*, we hope you've enjoyed this podcast.

If you'd like advice on statutory demands, winding up petitions, injunctions, or insolvency litigation generally, please do get in touch with us here at 42BR Barristers.

Lucas Nacif: And to listen to other episodes, follow us on Spotify, Apple Podcasts, or wherever else you get your podcasts.

Paul Fuller: The next episode in this series will be coming out in a week or so discussing ‘Bankruptcy 101’, which will see Lucas return with our colleague, James Hoile.

Lucas Nacif: Thank you and goodbye.

Paul Fuller: Goodbye.