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Statutory Demands – useful debt collection tool?

In these difficult economic times, minimising bad debts is critical for any business. Increasingly, businesses are opting to issue statutory demands in an attempt to recover debts, but is this an appropriate debt collection tool?

A statutory demand is a demand by a creditor in respect of a debt owing by a company, which is made pursuant to section 289 of the Companies Act 1993. If a company fails to comply with a statutory demand, it is presumed to be unable to pay its debts and the creditor can apply to the Court to put the debtor company into liquidation.

It is for this reason that the issue of a statutory demand is considered a very serious matter by the Courts. It requires the debtor company to act very quickly in order to avoid facing liquidation. If a company wishes to avoid that consequence, it must either persuade the issuer of the statutory demand to withdraw it, pay the debt or come to a compromise or, alternatively, apply to the Court for an order setting the demand aside. The timeframe for the filing of an application to set aside is very tight, namely it must be done within 10 working days of service of the demand, and there is no room for error as the Court has no power to extend the time within which an application to set aside a statutory demand may be filed.

In the case *Gateway Cargo Systems Ltd v Airborne Freight Ltd* 16/3/04 Master Faire, HC Auckland CIV-2003-404-7207, the following observations were made:

“There is developing a trend where debt collectors use statutory demands as the first step in a process to recover a debt. The statutory demand procedure is not intended as a debt collection device. Its purpose is to provide the evidential foundation to support an application to appoint a liquidator in respect of a company.... Statutory demands should only be issued in cases which are appropriate, that is, where there is a genuine basis for establishing the evidential foundation so that an application can ultimately be made to appoint a liquidator. It is quite improper for the procedure to be used as a debt collection device or as a device to embarrass a party in a situation where there is a contest as to liability for a given debt.”

Statutory demands should therefore be used where a creditor has genuine concerns about the ability of a debtor company to pay its debts rather than simply as a means to collect debt.

One of the key requirements before a demand can be issued is that the debt must be due and owing as at the date on which the statutory demand is served on the debtor. In other words, the creditor should be entitled to immediate payment of the debt. It is therefore not appropriate to issue a statutory demand in respect of a debt that is in dispute and doing so may amount to an abuse of process.

Some authorities have held that statutory demands should be issued by the creditor's solicitor rather than the creditor itself or a debt collection agency. Solicitors are subject to ethical obligations which require us to ensure that a debt is not disputed before a statutory demand is issued. In the case *Rembrandt Custodians Limited v Pro-Drill (Auck) Ltd* (13/6/03, Master Lang, HC Auckland M337-IM03), the Court held that it had no doubt that, if a solicitor had properly perused the correspondence that passed between the parties, he or she would have realised there was a dispute and advised the creditor in the strongest terms not to issue a statutory demand but rather to issue a claim in the District Court or Disputes Tribunal. As the solicitor had failed to do so, the Court held the use of the statutory demand procedure amounted to an abuse of process.

Notwithstanding that, there is no statutory provision which prevents creditor companies from issuing statutory demands and it is a common practice. If you elect to do so, there are additional procedural requirements to be aware of.

Firstly, a statutory demand must be in writing. Secondly, it must state that the debtor company is required to (a) pay the debt; (b) enter into a compromise under Part 14 of the Companies Act 1993, (c) otherwise compound with the creditor, or (d) give a charge over its property to secure payment of the debt.

Finally, the demand must be served on the debtor company. Obviously, it is important to make sure that you are serving the statutory demand on the right entity and at the right address. The demand may be served by leaving it at the company's registered office or address for service or by serving it personally on a director of the company.

If the above requirements are not met, you face the risk of the statutory demand being deemed invalid or the debtor applying to the Court to set aside the statutory demand, both of which can involve additional time and cost.

We recommend you seek legal advice if you are considering issuing a statutory demand and particularly if you have been served with a demand. At Govett Quilliam we are experienced in the entire statutory demand procedure, from the drafting and serving of the demand through to the issuing of liquidation proceedings and subsequent liquidation of the debtor company. Please do not hesitate to contact one of our friendly team if you require any assistance.

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