Institute of Credit Management

Legal Proceedings and Insolvency

Question Paper, Answers and Examiner's Comments

Level 5 Diploma **June 2014**

Institute of Credit Management
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Legal Proceedings and Insolvency questions, answers and examiners' comments

LEVEL 5 DIPLOMA IN CREDIT MANAGEMENT

JUNE 2014

Instructions to candidates

Answer **COMPULSORY** questions 1 and 2 and any **THREE** other questions

All questions carry equal marks. Time allowed: 3 hours

You are reminded that, where appropriate, your answers should contain references to statutes and to case law.

COMPULSORY SECTION
Answer **both** questions in this section

There is overall concern about the quality of answers for this paper given this is a Level 5 Diploma level unit.

The best advice we, as the examining team, can give to candidates is to answer the question that is being asked to score higher marks and do not waste time writing about what has not been asked.

Remember show which question and question section you are answering to aid the examining team to distinguish between the answers for each question.

COMPULSORY SECTION

Answer **both** questions in this section

1. Enrique Sanchez thought he was doing his friend Martin a good deed when he helped him out financially, by lending him £23,000 on assurances that the money would be re-paid within a couple of months. Eighteen months later on, Martin has disappeared and despite having a County Court judgment in his favour, Enrique has been unable to enforce it and is now really annoyed about this loss.

   After deliberation, he completes the necessary forms, makes an appointment and goes to court to petition for his own bankruptcy along with the fee, just as he did 3 years ago. Enrique has assets in the form of a house, a car, a motor home and a quad bike. Apart from the house Enrique has not declared these on the court forms. He has sold the quad bike to his brother for £1. He owes significant amounts on his credit cards, but he has kept up with his mortgage payments.

   TASK

   With specific reference to criminal offences under the Insolvency Act, relate the above scenario to bankruptcy investigations and bankruptcy restriction orders.

   (20 marks)

Question aims
To test the candidate's knowledge in relation to:
- Bankruptcy Investigation
- Bankruptcy Restriction Orders and Undertakings
- Grounds for making a BRO
- Criminal offences under the Insolvency Act
- Procedure after the bankruptcy order
- Investigation of the bankrupt

Suggested answer

Bankruptcy investigation
- Need to commence a BRO within 12 months, new focus on investigation of the bankrupt

- Official Receivers, not enough resource to investigate all cases therefore usual process is for the OR to complete a (written) questionnaire with the bankrupt and to rely on comments from creditors.

Note credit managers can have an important role to play in this area by identifying "honest" or "culpable" bankrupts.

Penalties and restrictions on a bankrupt include the following:
- Cannot act in any professional capacity even though may be qualified to do so

- Cannot act as a director of a company or be involved in the management of it

- Disposal of property (including the payment of money) by the bankrupt after issue of the petition is void, unless made with the consent of the court

- Anyone who received money or property from the debtor in good faith, for value and without notice of the petition is protected

- Bankruptcy petitions' are no longer advertised.

BRO & undertakings

- Harsher restrictions on culpable bankrupts following The Enterprise Act 2002

- Encompass debtors who have been fraudulent, have concealed assets or failed to keep proper accounting records etc.

- Another key factor is the conduct during the bankruptcy.

Restrictions on bankrupts disappear upon discharge or annulment, usually after 12 months

However for culpable bankrupts the Secretary of State can extend the restrictions from two to fifteen years

Grounds for making a BRO

Schedule 4A Insolvency Act 1986 (inserted by the Enterprise Act 2002) – specific grounds

The court will also take into account the conduct of the bankrupt during the period of bankruptcy and if the bankrupt has been undischarged bankrupt in the preceding six years

Specific grounds

- Failing to keep accounting records in the two years prior to the application

- Failure to produce records on demand

- Entering into a transaction at an undervalue

- Giving a preference

- Making an excessive pension contribution

- Failure to supply goods/services that give rise to a claim in the bankruptcy

- Trading whilst insolvent

- Incurring a debt that was know/ought to be known no prospect of repaying

- Failure to account for loss of property

- Gambling or unreasonable extravagance between petition and the BO

- Neglect of business affairs

- Fraud.

In relation to the above question Enrique has sold at an undervalue and has 'hidden' some of his assets he was also an undischarged bankrupt in the preceding six years.

In several cases, this question was not answered correctly, moreover candidates described bankruptcy in general rather than Bankruptcy Restriction Orders and Investigation as required in the question. Also candidates mentioned liquidators rather than Official Receivers which was incorrect.

However it was good to see candidates who did refer answers directly to the question gain good marks.

2. You are Legal Collections Assistant at Aerospace Repairs Limited and your manager is currently on holiday. The Finance Director has approached you for some information relating to a potential bad debt and wants to understand the process should it become necessary to 'go to court' for recovery in particular he doesn't understand 'Tracks'.

   He explains that you have a customer, EAB Systems Limited, which now owes in excess of £22,500 for repair work carried out on an aircraft door, the quality inspection supervisor signed off the repair and is adamant that it has been carried out to the required specification however the customer is refusing to pay the bill.

   TASK

   Discuss in a memo to the Finance Director

   a) Why and how are cases allocated to particular Tracks by the court? (14 marks)

   b) Critically evaluate in relation to this scenario and determine the likely track allocation. (6 marks)

   (20 marks)

Question aims

To test the candidate's knowledge in relation to:

- History of case tracking and why it was introduced
- List the three tracks and outline the criteria applicable to each

Suggested answer

Set out as a memo

a) Introduced by Lord Woolf in what are referred to as the Woolf Reforms 1996 following his report 'Access to Justice'

   Brought about to address the delays in and the costs of the legal system

   Rules brought in to eliminate some of the delays and introduce a 'management structure' where defended cases come under the control of the court and judges.

   To avoid delays by reducing the volume of actions and then once an action is brought to ensure it is progressed through the court system as fast as possible. To achieve these objectives legal action should be brought only as a last resort when all other practical steps have been taken in order to negotiate settlement have been exhausted.

   How tracking operates

   Once case defended the case management comes into play and the case will be allocated to the appropriate track, the claim and the defence will be referred to the judge for him to consider the dispute and take control of the case and what needs to be done to progress it as fast as possible.

   Tracking process

   If the case is defended in the court in which action was commenced?
   Sends the allocation questionnaire to each party with a date by which it must be returned to court

If the defendant is an individual, transfers the case to the defendant's court. If the defendant is a limited company then the action will remain in the court in which the claim was issued.

There are penalties facing a party who fails to return the allocation questionnaire within the time limits

Three Tracks

Small Claims Track

- Will hear claims up to £10,000
- Defended actions dealt with by informal arbitration
- Court issues directions setting out the steps and the timescale they must be taken
- Failure to comply may result in claim being struck out
- Basic rules
- Informal hearing, arbitrator may adopt any method of preceding that is deemed fair and gives each party a fair and equal opportunity to have his case presented
- No expert evidence may be called by either party without the express permission of the court although the arbitrator may consult an expert
- Legal costs cannot be recovered
- Arbitrator may decide to deal with the matter without a hearing and will notify the parties accordingly and give each party written notice of the judgement and the reasons for it.

Fast Track

- Will hear claims between £10,000 and £25,000
- Cases prepared according to strict timetabling so that the claim is heard and determined within 30 weeks of issue
- Court may give written directions
- Court may fix dates for preliminary hearings to give directions
- Court will ensure the matter is progressing within the timetable
- Rules that apply
- No case is allowed to last for more than one day
- No verbal expert evidence without the express leave of the court
- Where the court does allow expert witness then no cross-examination allowed

- Parties encouraged to agree expert reports, witness statements and other documents where possible in order to reduce the length of hearings

- Court allocates fixed dates for hearings.

Multi Track

- Will hear claims over £15,000

- More complex cases

- Allocated to a named judge

- Judge has overall management of the case and deals with the final hearing

- Case conferences held in which parties and lawyers attend before the judge on a fixed date and time to consider the progress of the case and for the judge to give directions on future steps to bring the matter to the final hearing.

- It should be noted that the court has the discretion (particularly with straight forward business v business matters) to list cases in excess of £10,000 in the Small Claims Track where appropriate.

b) Basic concepts of the three track system are to **encourage settlement** wherever possible. If not possible then to case management process is intended to deal with matter as **quickly** as possible within the **timescales** defined by the judge and the courts.

Once defended the case is **taken over by the court** for them to process as quickly as possible making the **assumption** that everything has been done by the parties to avoid court action and therefore have been left with no alternative.

Given the value of the debt this matter would be allocated to the **Multi Track.**

Some candidates failed to expand on the tracks, mentioning them but not giving further details which again meant that fewer marks could be awarded.

Please remember to follow the format requested for the question, i.e. this question asked candidates to set out answers as a memo.

3. Elaine Chutney and Andrea Cheese went into partnership together running a small village pub which they named Chutney & Cheese. They specialised in micro brew real ales, quality wine, speciality coffee, homemade chutney and exquisite cheese with freshly made rustic bread. Business thrived as people travelled for miles to sample the products on offer and it was also well supported by the locals. They were lucky enough to pick up the pub, being run down, at a bargain price and didn't need any brewery backing to finance it. It was therefore a free house being owned outright by the partnership.

   It was like a dream come true for Elaine and Andrea until they fell out. No matter what friends tried to do there was no reconciling the relationship between the two until eventually it was affecting the business, customers stopped coming in, they were no longer trading at a profit and suppliers were putting them on stop.

   TASK

   a) Demonstrate your law-based understanding of Business Partnerships in the context of this scenario. (6 marks)

   b) Discuss how the Insolvent Partnership Order 1994 could be used in this situation. (14 marks)

   (20 marks)

Question aims

To test the candidate's knowledge in relation to Partnership Insolvency:

- Definition of a Partnership
- The Insolvent Partnership Order 1994 (SI 1994/2421)

Suggested answer

a) Partnerships are governed by The Partnership Act 1890.

   Partnership 'is the relationship that subsists between persons carrying on a business in common with a view to a profit s1 Partnership Act 1890.

   Partnerships generally sit between sole traders and limited company status, usually found among small businesses however large partnerships do exist in professional service industries such as accountants, solicitors, architects and doctors.

   Key legal aspect of a partnership is that the partners are jointly and severally liable for the debts of the partnership.

   Any liability incurred by one of the partners in the course of the business is binding on all partners.

   For creditors joint and several liability means they have recourse against each of the partners individually and against the partnership.

b) Following The Insolvent Partnership Order 1994 (SI 1994/2421) that came into force in December 1994 the law of insolvency in relation to partnerships was brought in line with that for individuals and companies. The principle of joint and several liability remains however it widens the scope to rescue partnerships.

Voluntary Arrangements enable partnerships to avoid liquidation and can run concurrently with the individual partners' voluntary arrangements. By application to the court the administrator can agree to administer the insolvency of the partnership and the individual partners together.

The partners of an insolvent partnership may propose a PVA (Partnership Voluntary Arrangement) where the partnership is not already in administration or being wound up otherwise the proposal may only be made by the administrator / liquidator.

Administration, ordered by the court for

- Survival of the whole or part of the partnership's undertaking as a going concern

- The approval of a PVA

- A more advantageous realisation of the partnership property than would be effected in a winding up.

The effect of an administration order is to give breathing space to debtors against legal action by creditors.

Winding Up as an unregistered company, in which case both creditors' and members' (partners) petitions may be presented to wind up the partnership as an unregistered company. However, in none of those cases would an automatic petition be presented against the individual partners.

Summary administration the court is able to issue summary administration certificates to one or more partner or to all the partners presenting joint bankruptcy petitions if appropriate. The maximum debt level of £20K is calculated by reference to the aggregate indebtedness of the partnership and the individual partners' separate debts.

Joint and separate estates

The trustee / liquidator of the joint estate can prove for dividend purposes in the separate estates of the individual partners where the partnership assets are insufficient to extinguish the partnership debts fully. Balances of preferential creditors from joint estate are not, however, treated as preferential in the separate estates and instead rank with unsecured creditors.

In relation to the above scenario an application for an administration order to give breathing space against legal action by creditors would be appropriate The reputation of the pub has been ruined and it is therefore doubtful that the business could be sold as a going concern,. The property is owned by the partnership. Therefore a suggested answer would be to advise Elaine and Andrea to market the property whilst winding up the partnership, this should enable them to settle their outstanding debts and walk away from the partnership without facing personal bankruptcy.

This question was not attempted by this cohort.

4. Kimberly and Michael decided to retire from the catering business they'd run for many years and set up a cattery at the delightful cottage they had been renovating. Kimick Cattery was never short of business due to recommendations of old customers.

Mrs Tabbie, a well known customer of many years approached Kimick to look after her cat whilst she travelled on a trip of a lifetime. The rates were agreed in advance £5,025.00, Chaz arrived with his favourite toy and cushion and off Mrs Tabbie went on her trip.

Four months later Mrs Tabbie arrived home and came to collect Chaz. She was full of talk about her holiday but said she was really looking forward to being home with her dear Chaz. After two months and an unanswered phone call the bill had still not been paid. Kimick Cattery decided to send a letter before action. This provoked no payment or response from Mrs Tabbie so a claim form was completed and sent to the court with the relevant fee.

TASK

a) Discuss the term 'service of proceedings' (8 marks)

b) Advise Mrs Tabbie what her options are on receipt of the claim form from the court (8 marks)

c) Do you consider Kimick made the correct decision to commence action at this time taking into account pre-action protcols? (4 marks)

(20 marks)

Question aims

To test the candidate's knowledge in relation to Service of Proceedings

- Time for service
- Documents to accompany the claim
- The defendant's options on receipt of the claim

Suggested answer

a) **County Court** – court will serve.
High Court – the solicitor who issues proceedings will usually undertake service.

Service is by first class (ordinary) post.
Considered to be effected on the second day after posting.
Personal service is effected on the day it is handed to the defendant.
Where the claim is left at the defendants address or put through the letter box it is effected on the day after delivery/insertion.

Service for a limited company can be to the registered office but may be effected by delivery to any address of the company that has a direct connection with the claim.

Gone away or not known returned items to the court are deemed as 'not served' and the court will give written notification to the claimant.

The issue of the claim commences the action. Until and unless the claim is served the creditor can take no further step in the action.

Time for service – within four months of the date of issue. It is void if it remains unserved after four months. Time for service may be extended by the court, claimants apply by letter for leave to extend the period for service but the application has to be made before the four months have expired and disclose a reasonable prospect of service in the near future.

b) Once the claim is issued the court will produce a 'response pack'. This provides the defendant with explanatory notes with regards the options available to them and provides a set of forms to be completed with his chosen option.

Defendant's options

On receipt of the claim i.e. when the claim has been served, the defendant has the following options:

- Ignore the claim – do nothing
- Pay the amount due (including fees, interest and any scale costs)
- Allege that the debt has been paid
- Make an offer to pay
- Admit part of the debt and dispute the balance
- Defend (dispute) the claim
- Counterclaim – make a claim against the claimant.

The response pack contains four different forms (N9 A, B, C, D) along with a form for acknowledgement of service.

Defendant has 14 days from the date of service to exercise one of the above options.

If the defendant wishes to defend the claim but needs longer to prepare a defence then he can complete an acknowledgement of service form indicating his intention to defend. This will extend the period for response, with the defence, to 28 days from the date of service.

The acknowledgement of service must be returned within 14 days of the date of service.

If there is no response in 14 days of service the claimant may apply for judgement in default.

c) Suggested response, no – not enough done to try and ensure that there was no query or reason (is she still at the same address, phone not answered, is it the correct number) for the bill not to have been paid. Therefore not complied with pre-action protocols.

Some candidates answered this question well for both parts a) and b).

Where candidates attempted part c) there was a definite divide between those who answered correctly and were able to provide an explanation and those who considered one unanswered phone call to be sufficient pre-action protocol, which is incorrect.

5. Tickle Your Tastebuds silver service restaurant is owed and run by Meg Brown. Along with the general public Meg hosts many corporate dinners especially when a company wants to impress its customer. Meg realised several years ago that these corporate customers preferred to settle their account by her sending an invoice to their firm and has been happy to do this. 99% of the bills are settled within a few days. One customer in particular has let their payments slip and the 'tab' is now getting quite high. For a couple of months now Meg has been meaning to contact her friend Amy, who is a credit controller, for help. However, she has left it too long and has now received a letter from the company advising that a nominee has been appointed in relation to the proposal of a CVA. The letter advises he will be in touch about a creditors' meeting.

TASK

a) Meg has asked you to explain the CVA proposal, nominees' role and creditors' meeting. (18 marks)

b) How does this affect payment of her bill? (2 marks)

(20 marks)

Question aims

To test the candidate's knowledge in relation to:

- CVA proposal
- Nominee's role
- Creditors meeting

Suggested answer

a) The directors of the company have realised that they are in trouble and have submitted to the nominee.

A document setting out the terms of the proposed voluntary arrangement.

A statement of the company's affairs.

The proposal must include the appointment of a nominee to act in the CVA either as trustee or for supervising the implementation of the proposal

The nominee must be qualified to act as an IP. He is required to submit to the court within 28 days of being given notice of the proposal under section 2 Insolvency Act the following:

- that the proposed CVA has a reasonable chance of being approved and implemented
- that the company has sufficient funds available to continue to trade during the moratorium period
- if in his opinion meeting of the company and its creditors should be summoned to consider the proposal
- if meetings are to be called the date and time he proposes for them.

Summary of proposal contents

- Rationale
- Assets & liabilities
- Duration
- Distribution
- Fees
- Security
- The name & address of the IP
- Continuation of business?
- Administration matters.

By looking at the above Meg will be able to see how this is going to affect her relationship with the company and what part she is expected to play, for example to continue to allow the company to use her restaurant whilst they try to trade through this patch, how much it is intended she will receive in the pound against the outstanding account. Once Meg has considered the contents of the letter she should complete the response and return it to the nominee.

Company and Creditors Meetings

Where the company is not in liquidation/administration both creditors and members meetings should be held not less than 14 and not more than 28 days from the date on which the nominees report was filed at court.

Both meetings should be held on the same day and at the same location but the creditors meeting should take place first so that the company can consider the outcome of the creditors meeting, for example they may reject the proposal.

The Convenor (person who calls the meetings) chairs both.

Resolution to approve or modify the proposal deemed passed with votes in excess of 75% in value of creditors present.

Members meeting pass resolutions on a simple majority i.e. 51% (unless articles of association say otherwise).

Modifications that are passed at the creditors meeting must also be passed at the members meeting.

If resolutions are not passed the convenor may adjourn for a max of 14 days.

If agreement not reached on the terms of the proposal within the 14 day period it is treated as rejected.

The chairman is under a duty to file a report with the court in relation to the outcome of the meetings within four days of the meetings.

Meetings should be held on a business day i.e. Mon – Fri but not a bank holiday

- They should start between 10am and 4pm
- They should be held at a place convenient to the creditors.

You should advise Meg on the importance of attending the creditors meeting if one is called.

b) Had Meg chased the outstanding account as soon as it became due she may have been paid either as a one off payment or by agreeing to accept so much a week to reduce the amount owed.

Her debt may therefore have been cleared in full and then she would not have been notified of the CVA or the amount outstanding may have been reduced in which case she would only have to prove for the balance in the CVA.

Question 5 was a popular question with candidates scoring high marks. However, some candidates did not answer the question set and therefore fewer marks could be awarded.

6. You are credit controller at The Garden Centre Ltd and have recently commenced action against one of your customers Pink Is Us Ltd for a relatively small debt of £823. You have been trying to collect this debt for months but just not getting anywhere. Your letters and phone calls have provoked no payment whatsoever and not even an acknowledgement that the debt is logged on the system.

   You have come into work today and there is a defence pack waiting on your desk along with a memo from your manager asking you to consider how best to approach this with a view to getting settlement but also to keep the customer if at all possible.

   TASK

   In a memo to your manager demonstrate your understanding of the Small Claims Mediation Service by explaining why you would take this approach here.

   (20 marks)

Question aims

To test the candidate's knowledge in relation to:

- Mediation
- Allocation of Tracks

Suggested answer

Understanding
Synthesis

Set out as a memo

Mediation is a well-established process for resolving disagreements in which an impartial third party (the mediator) helps the people in dispute to find a mutually acceptable resolution.

It is based on the **following principles**

- Reaching a settlement situation by collaborative problem solving which is acceptable to all
- Emphasis on rebuilding relationships rather than apportioning blame
- A belief that by acknowledging feelings as well as facts allows parties to let go of their anger/upset and move forward.

The structure and common-sense approach of mediation

- Opportunity to step back and consider how they could sort out the situation
- Participants can come up with their own practical solutions to benefit both parties
- Allows the rebuilding of relationships.

Mediation is often cost effective and quicker than going to court. It's a flexible process that can be used to settle disputes in a range of situations. A preventative tool to stop problems escalating and getting worse. If no agreement reached the court process will be reactivated.

Pre-allocation
Following receipt of a defence to a part 7 small claim the court sending to both parties a defence pack this contains

- Notice of defence

- Small claim allocation questionnaire (N149)

- Leaflet EX307 on the Small claims track.

The allocation questionnaire asks the parties if they want to use the free small claims mediation service.

Settling the case at mediation with save the cost of the hearing fee.

Allocation

- If the N149 allocation questionnaire is returned it will be sent with all the papers for allocation

- The district judge considers which mediation directions are most appropriate to the case. This is dependent on what parties have asked to use the mediation service i.e. one party, both parties or neither party

- Very few types of cases are inappropriate for mediation. (RTA, DVLA,CSA, HMRC, bank charges, water rates)

- If the case is suitable for mediation the judge will tick a box to indicate this and give standard directions orders.

A typical response as to why you would use mediation in this case is because the amount involved is small, there appears to have been no dialogue in connection with why the invoice is not logged on the system. The court looks more favourably where mediation has been suggested/attempted. You have been asked to preserve the customer relationship.

This was not a popular question and candidates did not answer in enough detail to be awarded high marks.

Candidates also did not follow the required format for the answer. Candidates should remember to read the question carefully and note format requirements.

7. Trevor Jones t/as Blown a Gasket has been servicing your car for several years. You always pay when you collect your car as do all the other customers of the garage. However, Trevor has asked for your advice as he has been contacted by the local taxi company to provide full service, MOT and breakdown service to their fleet of vehicles. They have specifically asked for 30 day credit terms rather than settling the account on collection of the car. This is all new to Trevor.

   TASK

   Trevor has asked you to draft a briefing note to him of what he needs to take into consideration before agreeing to take on this new contract as whilst he is keen to do the work he is also worried in case they don't settle their bills on time.

   Your briefing should include advice with the possibility of future litigation in mind, as well as advising Trevor of any time limitation within which proceedings must be commenced. (20 marks)

Question aims
To test the candidate's knowledge in relation to:
- CRIME - Collection, Resolution, Identity, Means, Evidence
- Payment and trading terms
- Time limits for suing
- Protocol approach

Suggested answer

Trevor must **set out his payment and trading terms** if he is to commence operation of credit accounts rather than cash on collection this is important as claims for recovery of commercial debt are claims under contract law.

Standard credit terms would include
- Date on which payment is due
- A right to interest on late payment
- Retention of title clause
- Proper law of the contract, in this case English law
- Disputes will be settled in England.

The customer must be **made aware of the terms before or at the time** the contract is made and accepts them. It cannot be assumed that the standard terms have been agreed just because you have made the customer aware of them.

Also important to remember if the customer agrees your terms but then issues you with their terms you must respond reiterating your terms. Otherwise it will come down to a 'battle of the forms' whereby generally speaking the last document wins.

Should it become necessary to sue the customer for recovery of the debt then there are certain criteria that should have been considered at the start of the contract.

It is important that you have the **true identity of the customer**, are they a limited company, partnership or sole trader? Do you have their correct trading name and address and also do you know their registered office address if it's a limited company?

Have you checked their credit rating to ensure **they are credit worthy**?

If the matter progresses to debt recovery then to add to the above we must also consider if all **genuine queries and disputes** have been resolved.

Is the customer worth suing – just because you obtain a judgement does not make the creditor have the funds to settle it.

Finally can we prove the claim?
Just because we have raised and delivered a bill to the customer it not enough.

If the claim was to be defended then the **burden of proof is on the claimant** and they must prove that

- There was an agreement between the parties that is legally enforceable
- The claimant has carried out their part of the agreement
- The defendant has failed to pay the sum due to the claimants, who have made requests for payment and adopted a 'protocol approach'.

Advise Trevor to keep copies of agreed terms, signed delivery notes or job sheets, copy invoices, statements, credit notes, any letters sent chasing payment and notes of any telephone conversations. **Proper documentary procedures must be maintained.**

Prospect of a successful claim very limited without this.

Trevor will also need to **adopt some system for chasing** and recording chasing of any overdue accounts.

Finally it is also worth mentioning to Trevor the Time limits for bringing an action Limitation Act 1980.

Time limit for suing on a debt usually **six years** from the date the debt fell due for payment.

Exceptions to the rule

- Agreements made under seal can be sued on for up to 12 years
- The six year period can be extended if the debtor makes a part payment or admission of the debt within the six year period. Then the six years runs from the date of the part payment or acknowledgment of the debt.

If Trevor has any doubts about the credit worthiness of the taxi company, he should try to obtain personal guarantees from the directors.

The suggestions above represent a range of acceptable responses; however candidates are expected to include the ones shown in bold to gain marks.

This was not a popular question and candidates did not answer in enough detail to be awarded high marks.

8. Get Fit Gymnasium Ltd had been struggling financially up until the Christmas period and unfortunately the expected January influx of new members did not help enough. They have not done a payment run now for three months and the survival of the business no longer looks an option. Yesterday they received a statutory demand for £1,500 to be paid within 21 days and do not know what it is or what it means. The purchase ledger clerk therefore contacted you for some help. You work in the Collections department at a local firm of solicitors and have become quite friendly with Mickie at the gym where you workout.

TASK

Send an email to Mickie, Purchase Ledger Clerk at Get Fit Gymnasium Ltd:

a) Explaining what a statutory demand is and the consequences of being served with one. (10 marks)

b) Defining and discussing Winding Up in relation to statutory demands. (10 marks)

(20 marks)

Question aims

To test the candidate's knowledge in relation to:

- Statutory demands
- Company Winding Up

Suggested answer

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Set out as an email

a) **Statutory Demand**

A statutory demand must be in one of the forms as prescribed by the Insolvency Rules 1986

- Form 6.1 – for a liquidated sum payable immediately
- Form 6.2 - for a liquidated sum payable immediately after a judgement order of court
- Form 6.3 – for a debt payable at a future date.

The statutory demand must contain the following

- The amount and nature of the debt
- The debtors name and address
- The name and address of the creditor
- The time limits applicable for response to the demand.

The creditor is under an obligation to take all reasonable steps to bring the demand to the debtor's attention. Although postal service is allowed, personal service is far better since it prevents the debtor from denying any knowledge of the demand at the subsequent hearing of the petition.

According to section 268 of the Insolvency Act a creditor may issue a winding up petition if

- He has served on the debtor a statutory demand requiring the debtor to pay the debt and

- Three weeks have passed since the demand without the debtor paying.

On receipt of a statutory demand the debtor has three options

- To pay the debt

- To offer some sort of security (i.e. a charge over debtors property)

- To make a proposal to discharge the debt, for example, to pay part of the debt in full and final settlement or to pay the debt over an extended period by instalments. This is known as 'compounding' the debt.

If the debtor wants to dispute the statutory demand he must apply to the court within 18 days of service of the petition to have it set aside.

b) **Winding Up**

The most likely ground on which creditors will seek an order for winding up of a company is that the company is unable to pay its debts – this is known as a compulsory winding up.

According to section 123 (1) of the Insolvency Act a company is considered unable to pay its debts if:

- A creditor with a debt exceeding £750 has served a statutory demand on the company requiring payment within three weeks and the company has failed to pay the debt or secure or compound for it to the reasonable satisfaction of the creditor

- Execution on a judgment against the company has been returned partly or wholly unsatisfied

- It is proved to the court that the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities

- It is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due (liquidity test)

- There has been an inordinate delay in the conduct of a voluntary liquidation.

There are two statutory tests for insolvency available

- The liquidity test

- The balance sheet approach.

Many creditors will opt for the statutory demand procedure as it is relatively inexpensive. If it produces payment or an arrangement for payment it avoids the substantial fees involved in issuing a winding-up petition.

Additionally if the creditor has gone through the statutory demand procedure it is difficult for the debtor company to defend proceedings by disputing its insolvency.

If it is in fact solvent or able to pay the debt it may only avoid a winding up order by paying both the debt and the costs of the petitioner.

A winding up order should only be considered when all other methods of enforcement have failed and the debt owed is reasonably substantial in proportion to the costs involved, in which case the creditor should seek a compulsory winding up order.

Whether the company is solvent or insolvent it's winding up will always lead to dissolution of the company and the termination of the company's legal existence. Winding up is never concerned with promoting the survival of the company.

This was a popular question, however, only a small number of candidates were able to gain high marks with their answers as they did not go into enough detail.

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