

## Effective Debt Recovery

The economic downturn has resulted in an increase in unpaid invoices and bad debt with inevitable implications for cash flow. Many businesses are not sure of the best way to try and recover outstanding debts. This article sets out some of the options available.

### Preventing and limiting bad debts arising

- The easiest way to limit bad debt is to avoid them occurring the first place. It is important to have good terms and conditions that clearly set out payment obligations. In particular, you should consider:
  - Asking for deposits prior to the goods/services being provided;
  - Providing in your terms and conditions for payment of interest at a reasonable rate on overdue invoices;
  - Where goods are supplied a term that title to the goods supplied remains with you until full payment of sums due (a “retention of title” clause); and
  - Seeking some form of guarantee or other security in appropriate cases.
- You should put in place effective credit control with prompt action being taken to maximise the possibility of recovery of unpaid debts. You should consider putting in place an internal procedure to follow up late payers by phone or letter.
- Before taking further steps (and incurring costs), you should consider whether or not the debtor is good for the money. If they do not have the money to pay you, there may be little benefit in incurring further time and money pursuing them.

### Options for legal action

There are a number of ways through which a creditor can pursue a debtor. These options are outlined below:

#### A. Pre-action letter and Court action

- Prior to issuing proceedings, you must send the debtor a letter before action setting out the basis of your claim and allow the debtor a minimum of 14 days to provide a response. The Court rules encourage the parties to any potential claim to seek to resolve their dispute by negotiation, mediation or some other means. Specific rules

apply to the letter before action where the debtor is an individual.

- Depending on the value of the claim it will either take place in the High Court (for claims of more than £50,000) or the County Court.
- Claims of £5,000 or less are called small claims. They have a simplified procedure for litigants in person. As a general rule legal expenses are not recoverable but a successful litigant in person can recover their Court fees, the reasonable expenses of a party or witness including their travel and overnight expenses, their loss of earnings (limited to £90 per day, per person) and expert fees (limited to £200 per expert).
- Claims of over £5,000 have a more formal procedure. A proportion of your legal expenses may be recoverable as described below.
- If the debtor does not respond to your claim or if you can persuade the Court that there is no prospect of the defence succeeding you can ask the Court to enter judgment against the debtor at an early stage in the proceedings.
- If a defence is filed, the Court will provide directions for the future conduct of your claim through to trial and may encourage you to seek to resolve the claim through an appropriate form of alternative dispute resolution.
- If you proceed to trial and are successful then the Court may order the debtor to pay a proportion of your legal costs. You would normally expect to recover between 50 – 70% of your total costs. Conversely, if you are unsuccessful you may be required to pay a proportion of the defendant's costs, as well as your own.
- If you obtain judgment against the debtor and he still does not pay, there are a number of enforcement options available to you. Recovery will depend on the debtor having sufficient assets to pay both the judgment sum and any costs order. You should therefore seek to clarify this in advance of pursuing proceedings. The value of a judgment is based on your ability to enforce it.

## **B. Statutory Demand**

- A Statutory Demand can be served on an individual or a company if there is a debt which is due and undisputed of more than £750.
- A Statutory Demand is in a standard and prescribed form. It requires no reference to the Court before it is served on the debtor. The form sets out details of the amount owed and requires the debtor to pay that sum within 21 days.
- If an individual debtor disputes the amount claimed in the Statutory Demand they may make an application to Court to have the Statutory Demand set aside. A company debtor who disputes the sum claimed in a Statutory Demand must apply to the Court for an injunction to prevent a winding up petition being issued or proceeded with.
- If the debtor persuades the Court that there is a genuine dispute about the debt the Court is likely to order that you pay the debtor's costs of the application.

- Failure to comply with a Statutory Demand is evidence that the company / individual is unable to pay debts as they fall due. This entitles the creditor to present a bankruptcy petition (in the case of an individual debtor) or a winding up petition (in the case of a company debtor). This is an expensive process and there are a number of disbursements that you are required to pay.
- If you are successful your debt will be one of the unsecured debts of the bankrupt / liquidated company and will not be prioritised (although the costs you incur in obtaining the bankruptcy order / winding-up order will be). You will recover the same proportion of your debt as all other unsecured creditors in due course. It therefore may not be in your interests to be the petitioning creditor and incur the expenses referred to above.

### **C. Mediation**

- Mediation should be considered as an alternative (or in addition to) issuing proceedings in cases where the debt is disputed.
- Mediation is a process by which a third party is appointed to assist the parties to negotiate a settlement. A mediator is not a judge and does not make any decision about the merits of the case.
- Mediations are undertaken on a “without prejudice” and confidential basis in order to encourage full and frank discussions and will only provide a “binding” resolution if both parties reach agreement.
- Mediation may enable you to reach a swift resolution to the dispute; limit the costs you incur; and retain an element of goodwill with the debtor. Mediations can also provide the opportunity to explore more creative resolutions to a dispute than the Court can order.
- The Court has made it clear that, in some cases, if you pursue litigation but do not consider mediation then you may be penalised in costs, even if you are ultimately successful at trial.

If you would like any further advice on these matters, please contact:

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