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LAWYERS

DISCUSSION PAPER

STATUTORY DEMANDS: A DEBT COLLECTION TOOL?

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1. INTRODUCTION

- 1.1. A Statutory Demand is a formal written request for payment of debts owed by a company, issued pursuant to Part 5.4 of the *Corporations Act 2001* (Cwlth) ('Act'). The core intention of the relevant legislation is to prevent companies from trading whilst insolvent, and thereby incurring further debts which will not be repaid.¹ It is an initial step in the winding up process.
- 1.2. However, there is a tendency by some entities to use Statutory Demands as a debt collection tool. This paper will explain briefly how Statutory Demands work, and then consider the circumstances in which it is appropriate to use them.

2. HOW DOES A STATUTORY DEMAND WORK?

- 2.1. Broadly speaking, Statutory Demands are relatively simply. Once a Statutory Demand has been served upon a company, the company must either:
 - (a) pay the debts which are the subject of the Statutory Demand;² or
 - (b) apply to have the Statutory Demand set aside.³
- 2.2. Failure to take either of those actions within twenty one (21) days of receiving the Statutory Demand results in a legislative presumption that the company is insolvent.⁴ The creditor who served the Statutory Demand may then make an application to the court that the company be wound up in insolvency i.e. placed into liquidation.⁵
- 2.3. The presumption of insolvency can be rebutted, but the onus lies solely upon the company and it is costly and can be difficult to achieve. Accordingly, a company that receives a Statutory Demand will usually follow one of the two paths set out in paragraph 2.1 above.

3. SETTING A STATUTORY DEMAND ASIDE

- 3.1. There are many different grounds upon which a Statutory Demand may be set aside, so creditors intending to make use of a Statutory Demand need to ensure that it is formulated

¹ *Scolaro's Concrete Construction Pty Ltd v Schiavello Commercial Interiors (Vic) Pty Ltd* (1996) 62 FCR 319 per Sheppard J.

² Section 459F of the Act.

³ Section 459G of the Act.

⁴ Section 459C of the Act.

⁵ Section 459P of the Act.



correctly. A detailed examination of the legal requirements and potential pitfalls of Statutory Demands are not within the scope of this paper, but they include:⁶

- (a) the amount of the debt(s) claimed is less than \$2,000.00 or for an unliquidated amount;
- (b) there is a genuine dispute between the creditor and the company about the existence or amount of the debt which is the subject of the Statutory Demand;
- (c) the Statutory Demand fails to comply with the prescribed form (509H) or to clearly, correctly and unambiguously identify, and demand payment of, the debt(s) within 21 days of service of the Statutory Demand;
- (d) there are deficiencies in the accompanying affidavit verifying the existence of the debt (if the debt is not a judgement debt);
- (e) the Statutory demand is not properly served upon the company;⁷
- (f) the company has a genuine off-setting claim against the creditor, which does not have to arise out of the same transaction or circumstances; and
- (g) there is some other defect in the Statutory Demand that will cause substantial injustice unless set aside.

3.2. It is worth noting that many companies who receive a Statutory Demand may apply to have it set aside on disingenuous grounds with the aim of delaying the presumption of insolvency (it does not arise until the Court finally determines the application to set aside) and obtaining a better bargaining position with the creditor.

3.3. For creditors who attempt to use Statutory Demands as a debt collection tool, the main issues are set out in paragraphs 3.1(b) and (f).

4. IS THERE A "GENUINE DISPUTE"?

4.1. The phrase "*genuine dispute*" is not defined by the legislation, so we must look to the common law for guidance as to its meaning. The following principles are generally accepted:

- (a) A genuine dispute connotes a plausible contention requiring investigation, and raises similar consideration as the "serious question to be tried" test;⁸ and/or
- (b) A genuine dispute requires that: the dispute be bona fide and truly exist in fact; the grounds for alleging the existence of a dispute are real and not spurious, hypothetical, illusory or misconceived.⁹

⁶ See sections 459E, 459H, and 459J of the Act.

⁷ See s. 109X of the Act.

⁸ *Eyota Pty Ltd v Hanave Pty Ltd* (1994) 12 ACLC 669; 12 ACSR 785 at 787, *Britten-Norman Pty Ltd v Analysis & Technology Australia Pty Ltd* (2013) 31 ACLC 13-061; [2013] NSWCA 344.



- 4.2. In layman's terms, there need only be a reasonable argument about the existence or amount of the debt alleged by the Statutory Demand. This is not a high threshold to meet.¹⁰ A similar test is applied to whether the company has a genuine off-setting claim against the creditor.
- 4.3. Therefore, if the company has some factual basis for disputing that it owes a creditor money, owes less than the sum claimed, or that the creditor owes the company an off-setting amount, then the Statutory Demand will be set aside.
- 4.4. The Courts frown upon the use of a Statutory Demand as a debt collection mechanism, they see it as an abuse of process in contravention of the intention of the legislation.¹¹ Therefore, if a Statutory Demand is set aside upon the hearing of the application, the Court will usually order the creditor to pay the companies legal costs of the application.¹² This can be expensive and is the major risk for creditors attempting to use the Statutory Demand process as a debt collection tool.
- 4.5. The safest way to avoid this risk is for the creditor to obtain a court judgement against the company for payment of the debt prior to issuing the Statutory Demand. However, it is well documented that the civil litigation process can be long and costly – in many instances a creditor may end up spending more in the attempt to recover a debt than the value of the debt itself. This is a prime reason why some creditors choose to use a Statutory Demand in situations where there may be a dispute about the debt owed.
- 4.6. Due to the substantial risks faced by creditors and companies, often the debts become the subject of negotiation and a deal will be struck for the payment of a proportion of the debt in exchange for the withdrawal of the Statutory Demand. However, if a creditor falls into a habit of relying on this outcome, he is likely to be abusing the Statutory Demand process, risks meeting a company who will not strike a deal and may be ordered to pay that company's legal costs.
- 4.7. The decision to use a Statutory Demand to recover a debt against a company without a judgement therefore requires careful consideration, as creditors must assess their willingness to accept the potential risk of an adverse costs order, against their belief that the debt claimed is legitimate and cannot be genuinely disputed.

For further information in relation to the issues discussed in this paper, or if you have received or would like to issue a Statutory Demand, please contact either Aaron Hindmarsh or Joe Brown.

The contents of this publication, current at the date of publication set out above, are for reference purposes only. They do not constitute legal advice and should not be relied upon as such. Specific legal advice about your specific circumstances should always be sought separately before taking any action based on this publication.

⁹ *Spencer Constructions Pty Ltd v G & M Aldridge Pty Ltd* (1997) 16 FCR 452.

¹⁰ *Saferack Pty Ltd v Marketing Heads Australia Pty Ltd* (2007) 214 FLR 393

¹¹ *Lifese Pty Ltd v Lee Crane Hire Pty Ltd* [2012] FCA 302

¹² Section 459N of the Act.