The best of times

FOR PRACTITIONERS SEEKING TO RETAIN THEIR CLIENTS AND ENJOY THE BEST OF TIMES, THERE ARE FUNDAMENTAL MATTERS THAT SHOULD BE FIRMLY UNDERSTOOD BEFORE TURNING TO DEPLOY A STATUTORY DEMAND ON THE INSTRUCTION OF AN EAGER CLIENT.

BY SCOTT K MORRIS

In 1859 Charles Dickens could easily have been writing about the fortune that creditors often anticipate when choosing to serve a statutory demand compared with the reality that occasionally meets them shortly thereafter – "It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness . . ."[1] More recently, a wise old owl expressed a perception to me of the use of statutory demands: "they can be great way to lose a client".

A brief note

Statutory demands can be served by a creditor on a debtor company where the debtor owes at least the statutory minimum of $2000.[2]

If the creditor has not obtained a judgment in respect of the debt claimed, the statutory demand must be accompanied by an affidavit deposing to the fact that the debt is owed and that there is no genuine dispute in respect of the debt.[3] An error in the preparation of these documents may give rise to grounds for the statutory demand to be set aside.

Once service has been properly effected,[4] the company has 21 days to respond to the statutory demand. It can do so by:

- paying the debt owed to the creditor
- securing or compounding the amount of the debt to the creditor's reasonable satisfaction[5]
- issuing (and serving) an application in the Supreme Court or Federal Court seeking to have the statutory demand set aside on grounds that:
  - there is a genuine dispute as to the existence or amount of the debt

SNAPSHOT

- Statutory demands are non-curial devices that are often attractive to solicitors and their clients seeking to recover money from a corporate debtor.
- The threshold for setting aside a statutory demand on the basis of a genuine dispute is low. It is similar to the test applied when assessing an application for summary judgment.
- The service of a statutory demand introduces high stakes, it may result in a substantial cost order against the creditor or it may ultimately result in the winding up of the debtor company.

- the debtor has an offsetting claim[6]
- there is a defect in the demand that will cause substantial injustice or some other reason why the demand should be set aside.[7]

Failure to respond (by taking one of the steps above) within the 21 days available will give rise to a statutory presumption that the company is insolvent[8] and the creditor may rely on that presumption to commence winding up proceedings.

It is necessary at this point to note that the sole purpose of the statutory demand process is to provide a means whereby the insolvency of a company may be established for the purpose of an application to wind up that company.

Accordingly, where there may be a genuine dispute as to the debt and a judgment has not been obtained before serving a statutory demand (or if there is an offsetting claim), there is a real risk that the demand may be set aside by the court.

A note for creditors

If the debtor applies to the court and is successful in having the demand set aside, the creditor may expect an order requiring it to pay the debtor's legal costs of the court proceeding. These costs are likely to be substantial and will often exceed $20,000. For this reason, the decision to serve the statutory demand should not be taken lightly.

For creditor's considering the service of a statutory demand (and who have not obtained a judgment) the following points are noted:

- Damages and other forms of unliquidated claims are not capable of supporting a statutory demand. Other claims not capable of supporting a statutory demand include contingent or prospective liabilities, unquantified/untaxed orders for the payment of legal costs in a proceeding and distributions under a trust (as these are a claim in equity).
- When hearing an application seeking to set aside a statutory demand, the court is required (in genuine dispute cases)[9] to consider whether there is a "genuine dispute" in relation to the existence or amount of the debt claimed by the creditor. This is a low threshold. Dodds-Streeton J in *Powerhouse Australasia Pty Ltd v Virac Pty Ltd* [2006] VSC 508 observed at [40]:
  "The Court, in the context of the present application, need only find that the company has a genuine off-setting claim, or a genuine dispute about the existence or amount of the debt. That does not impose a particularly high standard, as is commonly recognised. The grounds for alleging a dispute or an off-setting claim must be not spurious, hypothetical, illusory or misconceived, but must be real, as the Full Court stated in *Spencer Constructions Pty Ltd v G & M Aldridge Pty Ltd* (1997) 76 FCR 452. The approach is analogous to that adopted in an application for summary judgment".
- Before instructing a solicitor to serve a statutory demand, it can be useful for the creditor[10] to speak with the debtor by telephone and ask the debtor when payment for the debt is likely to be received. Where there is an ongoing trading relationship, debtors will often be inclined to make a promise to pay the debt on a certain date in the future and in doing so, they (perhaps arguably) make a concession to the effect that the debt is due and payable. A contemporaneous file note of the debtor's promise to pay can be useful evidence whether at the hearing of the application to set aside the demand or (if the demand is set aside or withdrawn) in the course of a final hearing.
- Debtors will often (but not always) ask for the statutory demand to be withdrawn if they consider there are reasonable grounds for the statutory demand to be set aside. In circumstances where the demand is withdrawn without a resolution of the dispute (or without an agreement in respect of the costs incurred by the debtor in responding to the statutory demand), the timing of the withdrawal has important implications. If the withdrawal occurs after the debtor has issued and served its application to set aside the demand, then the debtor may expect to receive an order that the creditor pay its costs of making the application. Conversely, if the demand is withdrawn and the debtor then proceeds to make its application to the court, the court has no jurisdiction to hear the application (so the application will be dismissed with costs to be awarded in favour of the creditor).
- A commercial agreement that requires the parties to participate in alternative dispute resolution before issuing proceedings is unlikely to be sufficient to have the statutory demand set aside because the statutory demand itself is not a court process.
- Creditors should be aware that a payment from a debtor on account of an unsecured debt may become the subject of an unfair preference claim if the debtor is placed into liquidation. This issue should be kept in mind, particularly when negotiating any resolution of the debt and payment terms.

A note for debtors

Where a debtor receives a statutory demand, it will be presumed insolvent at the expiry of 21 days unless it has taken one of the necessary steps.

For debtors seeking to set aside a statutory demand:

- Where the merits justify the debtor making an application to the court, the debtor's solicitor should write to the creditor articulating the arguments in favour of the debtor and asking the creditor to withdraw the demand. This process should be engaged promptly so that there is sufficient time to make an application if the negotiations fail.
- A statutory demand can be withdrawn either orally or in writing. If the statutory demand is withdrawn orally, practitioners should ensure that this fact is promptly confirmed in writing to avoid a dispute over this issue at a later time.
- The 21-day period cannot be extended by the court or by agreement between the parties. However, if the 21st day is a Saturday, Sunday or public holiday, the application may be issued and served on the next working day.[11] The court vacation is not a public holiday.
- The application must be supported by an affidavit. The affidavit must disclose facts showing there is a genuine dispute. A mere assertion that there is a genuine dispute or a mere denial of a debt is insufficient as an affidavit in support. Further, supplementary affidavits (prepared after the 21-day period) cannot be used to raise new grounds of objection that were not addressed in the supporting affidavit filed and served with the application.
- With respect to statutory demands that are supported by judgment debts that are the subject of appeal, Randall AsJ made the following observation in *Body Corporate Repairers Pty Ltd v Oakley Thompson & Co Pty Ltd* [2017] VSC 435:
  "As a general proposition, when a statutory demand is based on a judgment debt, the fact that the judgment is under an appeal when the s459G application is heard cannot constitute a genuine dispute".
- Randall AsJ also referred to *Quarter Enterprises Pty Ltd v Allardyce Lumber Co Ltd* [2011] NSWSC 1031 to draw on the following summary provided by Justice White:
  "Where it is shown that there are arguable grounds of appeal, the court's discretion may be enlivened under s459J(1)(b) to set aside the demand on the grounds that there is some other reason why the demand should be set aside . . . it is consistent with the purposes of Pt 5.4 for a court to set aside a statutory demand based upon a judgment debt if satisfied that there are arguable grounds of appeal. Typically in such cases the demand is set aside on condition that the debt claimed is secured by payment into court or by other means".
- For practitioners acting for debtors (taxpayers) who have received a statutory demand from the Deputy Commissioner of Taxation, it is important to understand the existence and effect of the prima facie[12] and conclusive evidence provisions[13] contained in *Taxation Administration Act 1953*. See also, *DCT v Broadbeach Properties Pty Ltd* (2008) 237 CLR 473 and the Part IVC objections process. In the usual course, it is difficult to conceive of a circumstance in which an application should be made seeking to set aside a demand served by the Deputy Commissioner of Taxation. Rather, efforts should be made to engage with the Australian Tax Office and to progress through the Part IVC regime if the merits of the dispute warrant it.
- It is worthwhile to reinforce and develop the point that within the 21-day period, the debtor must:
  - issue their application to set aside the demand with an appropriate affidavit in support;
  - serve[14] the application together with the affidavit and any annexures on the debtor. At the time of service, the application must contain:
  - the proceeding number
  - the return date for the hearing
  - the seal of the court.
- If all these steps are not taken within the 21-day period, the application will be dismissed with a cost order being made against the debtor (*Opensoft Australia Pty Ltd v Miller Street Pty Ltd* [2011] FCA 653) and the debtor will be presumed to be insolvent.
- Having regard to the fact that some time is needed to take instructions, prepare the application and affidavit, then file and serve them, it is prudent to ensure that this process begins early in the 21- day period. This will also allow time for the documents to be filed with the Supreme Court or Federal Court registries (which both operate electronic filing systems in Victoria) with ample time for them to be processed with the necessary court file number, return date and court seal ready for service.
- Courtesy in dealings with court registry staff will assist in obtaining efficient service, but ample time must be allowed.
- This is a complex area of the law where mistakes can be costly for the client. For practitioners briefing counsel, the brief should be delivered no later than the 14th day[15] after service of the statutory demand to allow time for further instructions to be taken and for the above steps to be taken.
- When serving the application and affidavit, careful consideration must be given to ensure that the documents are properly served. An example of this issue arose in *Jin Xin Investment & Trade (Australia) Pty Ltd v ISC Property Pty Ltd* [2006] NSWSC 7 where Barrett J found that the debtor's application and affidavit were not left at the address disclosed for service in the statutory demand (Suite 103, Level 1 . . .) when the documents were deposited in the letterbox

in the ground floor foyer of the building. Personal service on the creditor will avoid these arguments (as will service on a director of the creditor company (see s109X of the *Corporations Act 2001* (Cth)).

A word on communications

When communicating with one another, practitioners on both sides should ensure that they are clear as to whether they intend for their communications to be open communications or whether their communications are intended to be protected by the joint privilege of without prejudice. If a letter is to be an open communication, make a notation at the commencement of the letter, "This is an open letter". This will remove any ambiguity and allow the letter to be relied on in court. Alternatively, if the letter is seeking to resolve the dispute and it is intended to be a without prejudice communication, mark it accordingly. ■

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1. Charles Dickens, *A Tale of Two Cities*, first published as a single book by Chapman & Hall, London (1859).
2. *Corporations Act 2001* (Cth) s459E(2)(e) requires that the statutory demand be in the prescribed form, which can be found at Schedule 2 of the *Corporations Regulations 2001*, form 509H.
3. Note 2 above, s459E(3) does not require an accompanying affidavit where the statutory demand seeks only the payment of a judgment debt (*Body Corporate Repairers Pty Ltd v Oakley Thompson & Co Pty Ltd [2017] VSC 435*, per Randall, AsJ).
4. If the demand has not been properly served and does not come to the attention of the company within the 21-day period, the debtor company may be able to resist a winding up proceeding by seeking an interlocutory order that the statutory demand was not served and that no statutory presumption of insolvency arose.
5. Whether a debt is "satisfactorily secured or compounded" will depend on the facts of each case, but a debt will be compounded if the creditor accepts a payment arrangement of the amount claimed or a different sum on the basis that the original obligation to pay the debt is discharged.
6. It is not necessary that the offsetting claim arises from the same facts that give rise to the debt claimed by the creditor.
7. Note 2 above, ss 459H and 459J.
8. The statutory presumption arises by operation of s459C(2) of the *Corporations Act 2001* (Cth). The presumption cannot be relied on after three months from the date that it arises (ie, it expires).
9. As distinct from disputes regarding an offsetting claim (see Note 2 above, s459H).
10. In the context of their usual dealings with the debtor.
11. See *Acts Interpretation Act 1901*, s36(2).
12. For example, a Running Balance Account (RBA Statement) is prima facie evidence of the debts due (*Taxation Administration Act 1953*, s8AAZI). There are numerous other similar prima facie evidence provisions.
13. See for example s350-10 of Schedule 1 of the *Taxation Administration Act 1953* which, among other things, provides that a notice of assessment is conclusive evidence that the assessment was properly made and that the amounts and particulars of the assessment are correct (save and except for Part IVC proceedings).
14. Service does not need to be effected within business hours to be effective.
15. Preferably earlier, particularly in more complex matters.