

Can't Pay – Won't Pay

Leonard Wallace, Advocate



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Inability to pay Debts in Corporate Insolvency? Best Tactics for Recovery

The threat of a winding-up petition is undoubtedly a powerful tool in any creditor's armoury.

Section 122(1)(f) of the Insolvency Act 1986 provides that a company may be wound up if it is unable to pay its debts.

The definition of inability to pay debts is found in Section 123(1) and includes:

(a) if a creditor...to whom the company is indebted in a sum exceeding £750 then due has served on the company, by leaving it at the company's registered office, a written demand (in the prescribed form) requiring the company to pay the sum so due and the company has for 3 weeks thereafter neglected to pay the sum or to secure or compound for it to the reasonable satisfaction of the creditor, or...

(c) if, in Scotland, the induciae of a charge for payment on an extract decree, or an extract registered bond, or an extract registered protest, have expired without payment being made, or...

(e) if it is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due.

Section 123(2) also provides that a company is unable to pay its debts if it can be shown that its assets are less than its liabilities.

Ground (a) is the Statutory Demand procedure. The beauty of this procedure is that if there is anything approaching a *bona fide* dispute then it ought to be flushed out before significant expense has been incurred. The downside is that there is a three week period of notice.

Ground (e) has become a much more common ground in recent years. If there is reasonable apprehension that the assets of a company are being misappropriated by the directors then obvious time constraints may dictate this as the preferred route towards debt recovery through a winding-up petition. However, there are pitfalls for the unwary.

Points to Note

- The petitioning creditor must set out a *prima facie* case in the petition.

- It is not enough to simply show that there was an unexplained failure to pay following a demand for payment.
- The burden of satisfying the court that a company is unable to pay its debts as they fall due lies with the petitioning creditor.
- A winding-up petition is not a suitable remedy to resolve commercial disputes.
- When seeking a provisional liquidator *ex parte* there must be a full disclosure of all matters, whether favourable or unfavourable to the granting of a winding up order.

Running into Difficulty

Prima facie case

In the case of *Gillespie v Toondale Ltd* 2006 SC 304, Lady Cosgrove examined the test of a *prima facie* case when considering recall of inhibition. She found that an aspect of a *prima facie* case was that there was a “good arguable case” and that the test was a substantial hurdle for a pursuer to mount. It is not sufficient to advance a “colourable case”. Interestingly, Lady Cosgrove stated that “if there is an apparently substantial defence to the pursuer’s claim it is difficult to say, on the basis of the whole material before the court, that the claim amounts to a good arguable case.”

Unexplained failure to pay following a demand for payment

By petitioning under 123(1)(e) a petitioner is necessarily relying on the inference that a company is unable to pay its debts as the fall due. In the case of *Blue Star Security (Scotland) Ltd Petitioners* 1992 SLT (Sh Ct) 80, Sheriff Principal MacLeod was satisfied that an undisputed debt and an unexplained failure to pay was sufficient to deem a company unable to pay its debts as they fell due. However, in the case of *Purewal Enterprises Ltd Petitioner* 4th September 2008 unreported, Lord Glennie says this:

“Whether or not the necessary inference should be drawn will depend upon all circumstances. It does not follow from the *Blue Star* case that it will always, or even usually, be enough to show a demand for payment within a short time followed by a failure to pay. In some cases, such a demand and such a failure, when viewed in light of what has gone before, may indeed be indicative of an inability on the part of the company to pay its debts as they fall due. But it does not necessarily give rise to that inference; and it should not be assumed that s123(1)(e) can simply be used as a speedier and less formal version of the statutory demand process set out in s123(1)(a).”

Burden

It may seem an obvious point but the burden of satisfying the court that there are sufficient circumstances from which to draw the necessary inference lies with the petitioning creditor.

See Paragraph [14] in *Purewal*. It is therefore important when drafting a petition to have clear and concise averments of fact based on reliable testimony.

Commercial disputes

Lord Glennie expressed the view in *Purewal* that “A winding up petition is not the proper forum for the resolution of commercial disputes.” If the debt is disputed on *bona fide* grounds then the petition should be dismissed. *PEC Barr (Holdings) Limited* 23rd June 2009 unreported, Sheriff Holligan considered *Purewal* but apparently declined to follow it and granted first orders in a winding up petition. Sheriff Holligan found support for granting first orders notwithstanding the existence of a *bona fide* dispute, from the opinion of Lord Kincaig in *Foxhall & Gyle (Nurseries) Ltd Petitioners* 1978 SLT (Notes) 29. It is worth observing that counsel for the petitioner in *Purewal* accepted the proposition that where the debt was subject of a *bona fide* dispute the petition should be dismissed.

Provisional Liquidator

There is a general feeling within the profession that courts are much more reluctant to make an appointment of a provisional liquidator than they were five or six years ago. I am not at all sure that this feeling of a new reluctance is justified. From a practitioners stand-point requests for provisional liquidators has increased over the years.

Courts generally require to be persuaded not only that there is a *prima facie* case but that if the position is not secured by the appointment of a provisional liquidator then there is a real and substantial risk of the assets of the company being dissipated.

There is another important point about seeking the appointment of a provisional liquidator and that is that the case for the appointment must be pled with absolute candour. There must always be full and frank disclosure of all relevant and material facts when an *ex parte* application is made to the court (see *Bell v Inkersall Investments Ltd* 2006 SC 507). That means all fact that might affect the way in which the court views the application whether such matters are favourable to the application or not. In *Purewal* the petitioner was found wanting in this regard. Lord Glennie found that there had been a failure by the petitioner to disclose certain events which amounted to a “material and serious non-disclosure”. The petition in *Purewal* was ultimately dismissed but Lord Glennie stated that had he not dismissed the petitions he would in any event have recalled the appointment of a provisional liquidator.

Footnote

In a recent case, I was asked to draft a winding-up petition and seek the appointment of a provisional liquidator. There was lengthy correspondence from both sides over a period of a

year. The debt of around £13,000 was disputed on various spurious grounds including that invoices had been tendered months after the work had been done and that the debtor's ledger balance did not agree with the petitioner's own statement. There was enough from the correspondence to show that at least £12,000 was admitted. The grounds for the appointment of a provisional liquidator were thin if not unstateable, simply being that the correspondence showed that the company was "disingenuous" in its responses. As it happened a caveat was in place and the company asked for a few days to pay the sums sought and asked for first orders to be continued. The company paid up but they wanted their expenses. Only the issue of expenses was argued at a continued hearing and the petitioner lost on the basis that there had not been a *prima facie* case. Yes – there was an undisputed sum and there had been further prevarication following a "final demand" but that was not enough. The judge thought that the inference which could be drawn from the facts was "Won't pay" not "Can't pay".