



Statutory demands – cost effective debt recovery for contractors?

Alex Walmsley, associate solicitor in our construction law team, looks at statutory demands and how they might provide a solution for recovering debts for construction firms and subcontractors.

In the fast-paced world of construction, disputes over unpaid invoices can cause significant delays to cash flow and place a significant financial strain on contractors and subcontractors down the contractual chain. In the current economic climate this problem is becoming increasingly common.

The usual excuse for non-payment is lack of cash flow, and there is often no substantive dispute that the sums claimed are rightfully due. Legislation has rightfully outlawed 'pay when paid' provisions in construction contracts to remove any legal legitimacy for such excuses, however that does not stop parties failing to make payment on these grounds.

Adjudication is often touted as a relatively quick and cheap solution to resolve disputes in construction contracts, particularly for recovering payments where the payer has failed to issue the requisite payment or pay less notice, with such adjudications commonly being quipped as "Smash and grab".

While it remains true that adjudications are a quicker and simpler form of dispute resolution when compared to the time and costs involved in court proceedings, the costs position in adjudication can make it an unattractive option if the amounts in dispute are low. This is because in adjudication:

1. You are liable for your own legal costs
2. You cannot recover legal costs from the other party (unless the contract expressly provides for this)
3. You may be ordered to pay the adjudicator's fees which are often substantial

Adjudications are relatively time efficient, typically taking four to six weeks. However, if no payment is made, steps must be taken to enforce the decision in the courts which can take up to three months to resolve at further cost.

However, in certain circumstances where the debt is unlikely to be disputed, service of a statutory demand is a useful alternative to adjudication.

What is a Statutory Demand?

A statutory demand is a formal request for payment of a debt and is a precursor to bankruptcy or winding up proceedings. It acts as a warning to the debtor that, if the debt is not paid within a specified timeframe (21 days) the debtor company is liable to face further legal action in the form of the service of a bankruptcy or winding up petition.

For construction professionals, this can be an efficient way to address unpaid invoices, especially when the debt is clear and undisputed as the risk of formal insolvency proceedings often prompts payment. Although insolvency proceedings can be discontinued as soon as the winding up petition is advertised in the London Gazette, then this may have draconian consequences for the debtor company. For example, banks often freeze the bank accounts of companies facing formal insolvency proceedings and it can be difficult for the debtor company to obtain credit.

A statutory demand can be issued for any debt of over £750 owed by a company. The threshold for an individual is considerably higher, at £5,000.

The process of issuing a statutory demand involves several steps. Firstly, the debt must be undisputed and all attempts at negotiation must have failed. The statutory demand must contain the



information prescribed by statute and must be properly served. Payment is due within 21 days, failing which the creditor can continue to pursue formal insolvency proceedings.

Disputed debts in construction contracts

A statutory demand should not be issued if the debt is genuinely disputed on substantial (i.e. real not frivolous) grounds, or the debtor has a genuine counterclaim against the creditor that reduces the debt to below the statutory threshold. If a demand is issued in this scenario, the creditor risks the courts viewing this as an abuse of process, which could result in a substantial costs penalty being ordered against the creditor.

When considering what is a disputed debt in a construction contract, case law is unclear on this point. The simple fact that the debtor has not issued a valid pay less notice does not in itself render the debt undisputed.

In the case of *COD Hyde Limited v Space Change Management Limited* [2016] EWHC 820 (Ch), 2016 WL 01445460, the debtor company, being the employer in the construction contract, challenged the validity of a winding up petition on the basis of the entirety of the debt being disputed on substantial grounds and that there was a counterclaim against the contractor which exceeded the sum claimed. The contractor creditor argued that, given no pay less notice had been issued, there could be no genuine dispute on substantial grounds.

A statutory demand was issued in the sum of £680,629.27, based on three interim applications. Of those three interim applications issued, two were responded to with payment notices for lesser amounts than the sums claimed by the contractor, although both were issued out of time, which under the terms of the JCT contract meant that the sums claimed within the respective applications became the notified sums due for payment, subject to any pay less notices served. No pay less notices were served for any of the three applications.

The contractor company subsequently served notices of suspension and termination following the failure by the employer to make payment. A statutory demand was issued for the total sums due in the three payment applications, following which a winding up petition was presented. The debtor then issued an injunction to restrain the insolvency proceedings.

It was held by Mr Justice Warren that the contract provided for sufficient mechanisms to allow any sums claimed in an interim application to be challenged (by way of a payment notice and pay less notice) and that the contract provided a commercial balance of interests for both employer and contractor.

It was therefore held that the existence of a vague dispute to the sums claimed in the application for payment was not a genuine dispute that could take precedent over the failure to adhere to the contractual deadlines for challenging an application. Further, the alleged counterclaim could not evidence that this would offset the sums due pursuant to the statutory demand to take the sum below the £750 threshold. The winding up petition was therefore upheld and the injunction refused.

Conclusion

The fatal consequences of failure to pay a demanded sum and the 21-day deadline for payment make statutory demands a cost-effective alternative to adjudication, which can often garner positive results when chasing debts up the contractual chain when the debt is clear and cannot be disputed.

The question of whether a debt is disputed will turn on the individual facts of each case. The existence of (or lack of) a pay less notice not being determinative of this point. Contractors should seek legal advice as to whether a statutory demand is an appropriate means to recover unpaid debts due under their construction contracts.

For more information on statutory demands, or any other construction dispute, contact Alex Walmsley on 01772 258321.