PRE-LEGAL & LEGAL PROCEDURES FOR DEBT RECOVERY (SA)

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PRE-LEGAL DEMANDS

It has always been considered proper to send to overdue debtors notice warning of the issue of legal proceedings.

Under the current Court Rules, there is a requirement to send to debtors a pre-Action Claim as defined in the Rules. Those Rules would seem to apply only with larger claims and where it is likely that the debt will be disputed. On that basis, we suggest that demand be sent in matters where the debt has not been disputed and if it subsequently turns out that the debt is in fact disputed then the matter can be reviewed accordingly.

Although the failure to send to a demand to a debtor prior to the issue of proceedings does not invalidate the proceedings, if the debtor objects the creditor is at risk of not being allowed to claim the costs of the proceedings.

The demand may be made by the creditor or by the creditor's agent or solicitor. To comply with the Court Rules, the demand must simply state the existence of the debt and warn of the issue of legal proceedings in the event of non-payment.

As a free service to clients we are happy to ensure that a client's demands comply with the Court Rules. If you provide us with a copy of your demands we will check the same and advise you accordingly.

Many clients will send their own demands to debtors prior to instructing us. If you send out your own, it is important to let us know this (together with the date any demand was sent) so that we can adjust the compliance period in any demands that we send out to make sure that time is not wasted.

Demands can be sent to debtors by post, fax or email. To save time you may wish to consider sending final demands by fax or email. Verbal demands are not sufficient for the purposes of the Court Rules. You should ensure that a copy of the demand is retained for future reference (in case the service of a demand ever becomes an issue).

THE CLAIM

If the pre-legal contact with a debtor is not successful, consideration should then be given to commencing legal action. This generally involves the issue of a claim. The Court from which it is issued depends on the amount of the debt. The distinctions are as follows :-

(a) Where the debt is $100,000.00 or less a claim is issued from a Magistrates Court. Magistrates Court claims are divided into the Civil (Minor Claims) Division being debts of up to $ 12,000.00 (previously known as “Small Claims”) and the Civil (General Claims) Division being for debts above $12,000.00 and up to $100,000.00. This Court was previously known as the Local Court and came into being on 6 July 1992.

(b) Where the debt is more than $100,000.00 a claim is issued from the District Court.

A claim is in effect a notice of your claim. It is usually prepared by a solicitor (although prospective plaintiffs can issue their own) and processed electronically via the Court website.

Once the claim has been issued by the Court, it must be served upon the debtor. Service must be effected within 6 months of the date the claim is issued and can be effected by posting a copy to the debtor's address nominated on the document, by emailing it to a known email address or by a bailiff taking a copy to the debtor's place of residence or business (in the case of a person) or registered office (in the case of a company). These times can be extended in exceptional circumstances. Also where service by the “usual” means proves impossible, the Court will entertain applications for service to be effected by other means, as long as it is satisfied that the method of service proposed will in all likelihood bring the process to the attention of the debtor.

The claim claims from the debtor the amount of your debt and the fee charged by the Court for the issue of the summons. If the claim is issued by a solicitor for you, it should also claim the scale fee allowed by the Court for the issue of the claim. Under the Magistrates and District Court Acts the Court is entitled to set the scale of fees solicitors can charge for legal work under the Act. The significance of the "scale fee" is that this is a fee which can be claimed from the debtor in addition to the debt and Court issue fee. Fees above scale cannot be claimed from the debtor (in the absence of a contractual term to the contrary) and must be borne by you.

The claim once served upon the debtor basically gives the debtor two choices. The debtor is given 28 days to make the choice, before the creditor is able to proceed further (if the debtor does not take up either option). These choices are as follows :-

(a) The debtor can pay the amount claimed (including the Court fees and solicitor's fees). Alternatively, the debtor may make a proposal for payment, however, you are not obliged to accept the proposal if you do not wish to; or,

(b) The debtor can attempt to dispute your debt. This involves filing a document called a defence. This document sets out the grounds of dispute. If a defence is clearly a tactic to gain additional time to pay, an application for summary judgment can be made, particularly where the debtor has confirmed in writing the amount due or made offers of repayment.

If the debtor still chooses to ignore the collection process, you can then decide to take the process to the next stage, namely recovery proceedings.

RECOVERY PROCEEDINGS

If the debtor fails to respond to the claim (either by paying the amount due, making satisfactory arrangements for its payment or by disputing your claim), judgment may be entered in default. This is not in default of the debtor appearing in Court, but by reason of the debtor's failure to file defence documents (which if filed would indicate that your claim was disputed).

After judgment is entered, notice of the entry of judgment must be served upon the debtor. This is done by simply sending a letter to the debtor advising of the same and attaching a copy of the Court Record indicating the same.

The entry of judgment has three effects, namely:

- Firstly, a creditor can issue enforcement proceedings if the judgment debt remains unpaid after notice of the judgment is given.
- Secondly, interest accrues on the judgment debt from the date of judgment at the Court rate.
- Thirdly, a default is noted on the debtor's credit file which apparently remains there for 5 years from the date of judgment. That default inhibits a debtor's ability to obtain credit from other sources and can only be removed once the judgment debt is paid (along with other steps that need to be taken by the debtor).

A judgment entered in default may subsequently be set aside by the Court, providing the debtor applies for this (by filing an application and supporting affidavit/s) and shows a good reason why the claim/summons was not disputed in the first place and a plausible defence. The excuses offered can range from ignorance of legal procedures to lack of diligence on the part of a legal practitioner. One important factor to be taken into account here, is the length of time the debtor takes to bring the application after the proceedings first come to his attention. If the debtor waits several months and receives several follow-up processes before bringing the application, the Court will usually demand a very plausible explanation of the delay. On the second point, the debtor is not required to produce evidence of a defence only show an arguable and plausible basis for one. Attempts to dispute the application with answering affidavits do not generally have a great deal of success in the absence of an excellent case or something else to point to (for example, a written offer of repayment confirming the amount due).

The type and/or nature of recovery proceedings used if the claim does not prompt a response depends to a large extent on the type of debtor you have dealt with, the size of the debt and the debtor's financial circumstances (as far as they are known).

Discussion of recovery proceedings from here will be divided into two sections, namely those relating to people and those relating to companies.

The cost of each of these individual processes (insofar as the Magistrates' Court is concerned) is as set out in the relevant Court's cost scales. Again, the significance of the "scale fee" is that this is a fee which can be claimed from the debtor in addition to the debt and the Court issue fee. As previously mentioned, fees above scale cannot be claimed from the debtor (in the absence of a contractual term to the contrary).

PERSONS

Investigation Summons (IS)

An Investigation Summons is a summons issued at the request of a judgment creditor from a Court nearest to where the debtor resides. It is generally used with smaller debts and with debtors whose financial circumstances are unknown. The summons requires the debtor to attend before the Court to be examined on oath as to the debtor's means and ability to pay the amount due. The Court can ask the debtor to provide details of his income, expenditure, other financial liabilities and living expenses.

If the creditor has information about the financial affairs of the debtor which is different to that provided by the debtor himself, the creditor is entitled to present that evidence to the Court. The Court can then decide to order the debtor to pay the full amount owing or to pay the full amount by a certain date. The Court will generally make some form of instalment repayment order commensurate with the debtor's financial circumstances.

The Court also has the power on an Investigation Summons to require any other person who may be able to assist with the investigation to appear for examination or to produce documents relevant to the investigation. Accordingly, a judgment creditor can require persons otherwise unconnected with the proceedings to attend with copies of statements, invoices or other documents (for example, accountants or employers).

If a debtor fails to appear at the hearing, the Court can issue a Warrant of Arrest (see below).

Under the Court Rules, where the action is for less than $12,000.00 and was not incurred by the debtor in carrying on a business, an Investigation Summons must be issued as the initial recovery process.

Warrant of Arrest

A Warrant of Arrest is issued from the Court at the request of the creditor. It is used where a debtor fails to appear on an Investigation Summons or Examination Summons. The Court bailiff will execute the Warrant of Arrest by attending at the debtors residence or place of business and arresting him. The debtor is then brought before the Court for a repayment order to be made.

Examination Summons

If the debtor fails to comply with an order made on the hearing of an Investigation Summons the Court can issue an Examination Summons to have the debtor brought before it to explain his default. If the explanation at the hearing of the Examination Summons is satisfactory to the Court, orders as to payment can again be made by the Court. If the explanation is unsatisfactory, the Court may make an order for the debtor's imprisonment (see Warrant of Commitment, below).

Warrant of Commitment

If a debtor is brought before the Court on the hearing of an Examination Summons and the debtor's explanation for non-compliance with a previous repayment order is unsatisfactory, the Court may make an order for his imprisonment. This is an order relating to contempt of Court (for failing to comply with a Court order) and does not involve imprisonment for non-payment of a debt. If a debtor is imprisoned, the debt is not extinguished. However, where the order is for payment of the debt by instalments, the Court will not imprison a debtor unless two or more instalments are in arrears. The Court has the power to imprison a debtor for this contempt of Court for up to 40 days.

The Warrant is executed by a Court bailiff, who generally gives the debtor the option of paying out the amount due before executing the Warrant. With smaller debts, this process can prove extremely useful and result in the payment of a considerable number of debts in the smaller range. The process can be a lengthy one however, as the Warrants may not be able to be executed for a month or more.

It is extremely rare for people to be imprisoned on such warrants.

Warrant of Sale

On the issue of a Warrant of Sale, a Court bailiff is directed to attend at the debtor's address (as nominated by the creditor or its solicitor) and seize and sell any real or personal property of sufficient value to recoup the debt and claimable costs. There are limitations on the type of property which the bailiff can seize. Clothing, household goods, tools of trade to a certain value and motor vehicles to a certain value cannot be seized. If an item is encumbered (i.e. subject to a Hire Purchase agreement, a Bill of Sale or a lease) the item cannot be taken to satisfy the Warrant. As a result, these Warrants are quite often returned "nil effects", which indicates that there was no property available to be seized by the bailiff.

The Court Bailiff also has the power to seize and sell the debtor's real property or land. Very few Warrants of sale for land ever proceed to complete finality (namely the sale of the debtor's property by auction) as debtors choose to pay out the amount due under the Warrant, prior to sale. The creditor is responsible for any costs incurred by, for example, the auctioneer, although these costs are recoverable from the judgment debtor.

Attachment of Debts

An order for an attachment of a debt (known as a garnishee order), is used where there are monies owing from a third person to a judgment debtor. An application is made to the Court for the monies held by the third party to be "attached". The Court makes a garnishee order nisi (that is, interim order), which must then be served on the debtor and third party. The third party is restrained from dealing with the monies to which the order relates until they have been heard in the proceedings.

If an order is made in the Court that the third party release the monies to the creditor, and the third party does not comply with that order, they commit a Contempt of Court, and become personally liable for payment to the creditor. The third party is entitled, if he intends to comply with the order, to claim a certain amount for his costs of compliance.

The major restriction in obtaining orders of this nature, is the knowledge of the financial situation of the debtor. Monies held in a bank account are generally not able to be attached, as the bank is not liable to pay those funds to the debtor until they present a withdrawal slip or a cheque.

Wages and/or salaries are not attachable unless the debtor consents to, for example, a certain amount being paid directly by his employer to the creditor. That consent can be filed at the Court, and is not able to be varied by the debtor without a further order of the Court.

Charging Orders

A creditor is able to apply to the Court to charge the property of a debtor with a judgment debt or part of a judgment debt. This enables a creditor to, for example, register a charge on a property owned by the debtor jointly or as a tenant in common, or to charge the assets of a company. The Court can require the charge to be registered on the property or on the books of the company and can prohibit or restrict any dealings with the property subject to the charge. Should the property or company assets be sold at any stage, the presence of a charge enables the creditor to be paid in priority to other unsecured creditors of the debtor or of the company.

COMPANIES

Summons to witness

If the debtor is a partnership or an incorporated association, the judgment may be

enforced against the partnership property, the common property of the association or against the property of any person who is liable for the debts of the partnership. Prior to the new rules of Court being implemented, the Court could only order a member of a partnership to pay if it appeared that that person was acting without the authority of the partnership. This is no longer the case.

A creditor who obtains a judgment against a company may also issue a Summons against one of the company's directors. This summons directs that person to attend before the Court and be examined as to the means and ability of the company to pay the debt. If the director fails to attend then an arrest order may result (the same as with a personal debtor). If the Court makes a repayment order, the repayment order is made against the company (not against the director personally).

Warrant of Sale

As with personal debtors, the option of issuing a warrant of sale against the goods of a company is also available. The same comments apply here.

Appointment of Receiver

Where the debtor is a company, the Court can, at the request of the judgment creditor, appoint a receiver to enforce a judgment. This will be possible even though no other proceedings for enforcement of the judgment have been taken. The Court would have to be convinced that appointing a receiver would be in the best interests of the creditor and debtor. Once the receiver is appointed, the receiver has the power to take charge of all property, income and business of the debtor and to direct payment towards satisfaction of the judgment debt.

Charging Orders

As with personal debtors, the option of seeking a charging order against the goods of a company is also available. The same comments apply here.

INSOLVENCY PROCEDURES

Insolvency procedures (insofar as they relate to persons and companies) whilst not strictly speaking recovery procedures, are often used as a means of obtaining payment. I will detail the various procedures and options available, dividing the two areas into those applicable to persons and companies.

Insolvency procedures are expensive, but relatively successful. In my experience around 70% of bankruptcy and/or winding up applications are paid out (including costs) before a final order is made.

PERSONS

Under the provisions of the Bankruptcy Act 1966, a debtor owing more than $10,000.00 may be declared bankrupt by a creditor in certain situations. Section 40 of the Act sets out the various situations where a debtor commits an Act of

Bankruptcy. If an Act of Bankruptcy is committed, a creditor may petition a Federal Magistrates Court for an order declaring the debtor a bankrupt.

The most common method by which the Act of Bankruptcy is established is by serving upon the debtor a Bankruptcy Notice. A Bankruptcy Notice is issued after a judgment is obtained in either the Magistrates, District or Supreme Court, and requires the debtor to pay or make satisfactory arrangements for the payment of the judgment debt within 21 days, failing which an Act of Bankruptcy is committed.

The Bankruptcy Notice should not be treated as a debt collection procedure, rather a test of solvency. The debtor passes the test by paying the amount due or fails it by not making payment. The cost of the notice is considerable and because of this, a Bankruptcy Notice is generally only used when the debt is relatively large (from my experience $15,000.00 upwards).

Before bankruptcy proceedings are issued some research should be undertaken regarding the debtor, to ascertain whether or not there is any point in actually issuing the Bankruptcy Notice. These checks can include a simple Lands Titles Office search, to ascertain whether or not the debtor owns any real estate or a check with one of the credit reporting agencies for more detailed information (including other known action against the debtor). Obviously, if the debtor owns real estate or has something to lose (for example, a professional qualification) then the prospect of success with the Bankruptcy Notice is considerably better.

If the debtor fails to comply with the Bankruptcy Notice or otherwise), the creditor can issue a Creditors Petition which is basically a request to the Court to make an order declaring the debtor a bankrupt and appointing a trustee of the debtor's estate. The debtor can obviously avoid bankruptcy by paying the amount due to the creditor. The amount claimed should also include the costs incurred by the creditor in issuing the Bankruptcy Notice and Creditor's Petition.

A more unusual procedure is to issue a Creditor's Petition without the issue of a Bankruptcy Notice. Although this is rare, it is possible to do this especially where one has written confirmation from the debtor of insolvency (for example, a written offer to pay a debt by instalments as a result of inability to meet the debt in full).

COMPANIES

Under the Corporations Act 2001, a creditor of a company whose debt exceeds $4,000.00, may serve upon the company a notice under Section 459E requiring the company to pay (or make satisfactory arrangements for payment) of the debt within 21 days of service of the notice. The notice is again a test of solvency, rather than a debt collection procedure. The debtor passes the test by paying the amount due for payment or making a reasonable re-payment offer.

It is not necessary to have a judgment before one issues a Section 459 notice, but I consider it prudent to do so (unless the debt is not capable of being disputed or where a written repayment offer has been received). Without a judgment the creditor

always runs the risk that the debtor will dispute the creditor's right to bring the application on the basis that the creditor's debt is disputed. As long as the debtor can make out a prima facie case that the dispute is a bona fide one and based upon substantial grounds, then the application will be dismissed (with costs possibly awarded against the creditor). Unscrupulous and imaginative debtors have more than once "manufactured" a dispute to gain additional time. It should be noted that if the debtor does not attempt to set aside the 459E notice within the 21 day compliance period, the debtor is excluded from raising any dispute regarding the debt on a later hearing of a winding up application (except in special circumstances).

With a judgment to fall back on, the debtor must go to the Court in which the judgment was obtained and attempt to set the judgment aside (see above). Even if the debtor is successful in setting aside the judgment (in which case the winding up application will be dismissed unless some other creditor is substituted), the debtor will generally be ordered to pay the costs incurred by the creditor in bringing the application.

If the debtor fails to comply with the notice a winding up application may be issued from the Supreme Court or Federal Court. We currently issue all such applications out of the Federal Court.

Once the winding up application is issued, it must be served and advertised. This latter point can cause some problems for the creditor who has simply issued the application as a means of obtaining payment, as other creditors of the company may support the application (in the hope that they get paid also), which may cause the company to be wound up later by a substituted creditor.

The debtor can pay the amount due to the creditor prior to the winding up order being made. In such cases the creditor would normally demand that the debtor pay the costs incurred by it, which are generally agreed in accordance with the amount allowed under the Court scale (see above).

A creditor can also "support" a winding up application issued by another creditor. This is done by filing and serving appropriate documentation and is usually done where there is some prospect of the original creditor being "paid out". Supporting the application puts the debtor in the position of having to pay out the supporting creditor/s also, otherwise one of them may get substituted on the application and obtain a winding up order.

DISCLAIMER

The information set out above is only a general guide to the legal procedures available to creditors. The facts and/or circumstances of individual matters may warrant a different approach, so you should always seek advice accordingly.