# Submission: Increasing the Statutory Demand ("SD") Threshold

## OUR QUALIFICATIONS

1. This submission is made by Roger Mendelson ("Mendelson") and Alison Lee ("Lee").

2. Mendelson is an Australian Legal Practitioner with over 46 years in practice and is the Principal of Mendelsons National Debt Collection Lawyers ("Mendelsons Lawyers"). Lee is also an Australian Legal Practitioner with 13 years' experience and is the Practice Manager of Mendelsons Lawyers.

3. In addition, Mendelson is founder and CEO of Prushka Fast Debt Recovery ("Prushka"), which is headquartered in Melbourne and is a national debt collection agency with a 45-year history. It is believed that Prushka is the largest debt collection agency in Australia in terms of client base, acting for in excess of 58,000 SME and healthcare clients as well as larger corporate clients.

4. In addition, Prushka is the ultimate owner of Zurich Capital and Finance Pty Ltd ACN 147 034 697 ("Zurich"). Zurich holds an Australian Credit Licence and is active in the debt purchase market and has purchased ledgers with a face value of approximately $350 million dollars from its commencement in this business 5 years ago.

## TYPICAL DEBTOR COMPANIES WHICH ARE SUBJECT TO SDs

5. We believe that Mendelsons Lawyers likely issues more SDs than any other law firm in Australia. This is because the preparing and service of SDs is often an important part of the process for determining the solvency of corporate debtors. Due to the volume of collection work undertaken by Prushka in the commercial debt collection sector, Mendelsons Lawyers receives large volumes of commercial debt collection and insolvency work.

6. The typical debtor company will have been subjected to extensive collection processes, both by the SME client of Prushka and then during Prushka's process. If there is a valid dispute, it is investigated, and no SD will be issued in that case. The only option in that case if all other processes fail, is to issue legal proceedings and obtain a judgment prior to issue of an SD.

7. Our belief is that a significant percentage of the SDs issued against debtor companies are against those which are technically and genuinely insolvent (i.e. unable to pay their debts as and when they fall due).

8. The reason for making this assumption is that extensive efforts would have been made to collect the debt including, invariably, offering an instalment arrangement. The underlying principle is that legal action and issuing of SDs is a last resort.

9. In our experience, the higher percentage of debtor companies tend to be smallish family run businesses, with few assets of value. Many have survived by deferring payment of creditors, including statutory obligations.

**ALTERNATIVE ENFORCEMENT OPTIONS**

10. There is a common perception that a viable legal enforcement path is issuing a Warrant of Execution, after obtaining a Judgment. This process, in every State, is of very limited value in that the results obtained invariably do not even satisfy the cost of obtaining the Judgment and cost of the Warrant of Execution.

11. If there are Directors Guarantees in place, the principle would be to make claims directly on the guarantors and if this fails to produce a result, sue the guarantors, as well as the company. This offers some a real chance of success. However, if there are no personal guarantees in place, the ultimate chance of success against a small debtor company is low.

**HOW MENDELSONS LAWYERS USES SDs**

12. As noted, SDs will only be issued at the point where the debtor company demonstrates some indicators of insolvency. This generally follows and becomes apparent when all other debt recovery techniques have been tried and have failed. Usually, this will involve offering the debtor company the opportunity to pay a reduced lump sum or pay by instalments.

13. If there is a genuine dispute over the debt, an SD will not be issued. If there is an allegation of a dispute, it will be investigated, information will be sought from the debtor company and this will be discussed with the creditor client.

**HOW EFFECTIVE ARE SDs?**

14. From SDs issued by Mendelsons Lawyers, the approximate outcomes are as follows:
    - Paid in full 5%
    - Settled to the satisfaction of the client 25%
    - File closed – not viable to proceed further 65%
    - Proceed to issue of a Creditor's Petition, which will ultimately lead to either settlement or a Liquidation Order 5%

**IMPACT OF THE MARCH 25, 2020 COVID RESTRICTIONS**

15. The interim changes, which temporarily increased the threshold from $2,000.00 to $20,000.00 and the response period required by the debtor company from 21 days to 6 months, lead to the issuing of SDs becoming ineffective and Mendelsons Lawyers essentially ceased doing so.

16. It is only after the rules were reversed, from December 31, that the process was recommenced.

**IMPACT OF THE "DEBTOR IN POSSESSION MODEL"**

17. Whilst the intentions of this amendment to the insolvency legislation is to enable struggling businesses to restructure, our expectation is that it will have minimal impact. The reasons are beyond the scope of this submission.

**ABUSE OF SDs**

18. We believe that abuse of the SD process is minimal.

19. The reason is that if a pre-judgment SD is issued, the creditor or director of the creditor company must swear an affidavit to the effect, in part, that the debt is due and is undisputed or that there is no valid dispute to it.

20. If the deponent swears a false affidavit, this amounts to perjury, which is a serious criminal offence. In addition, most SDs are issued by law firms and it would amount to a professional misconduct if the lawyer who signs off on the file allows it to proceed, without making due enquiries as to whether or not there is a genuine dispute.

**BENEFITS OF THE SD PROCESS**

21. The process is quick in that the pre-judgment SDs can be issued without firstly obtaining a judgment. Thus, it can be prepared and served within a matter of days and there are no disbursements incurred at that stage.

22. It is effective because it exerts pressure on the debtor company to respond to it. If it fails to respond within 21 days from the date of service, it is presumed at law to be insolvent and from that time onwards, the directors may become personally liable for losses incurred by creditors.

23. Because of the pressure it brings to bear on the debtor company, it allows for meaningful negotiations to be carried out if the debtor company is neither technically nor actually insolvent.

24. The benefits outlined above are all to the benefit of creditors, which, in our experience, are largely SMEs which rely on their debts being paid to enable them to carry on in business.

**INSOLVENT TRADING**

25. In our view, because of the cost involved in proceeding to a Creditor's Petition which would lead to liquidation, most creditors, including those we act for, decide not to proceed to that stage. Thus, there must be a significant number of companies which have been subject to an SD, have not satisfied it, but thereafter continue to trade. This is akin to something we would term as – "informal phoenixing". This is different from deliberate phoenixing activity but from the point of view of the creditor, it amounts to the same outcome.

**THE FOUR QUESTIONS**

1. We believe that the threshold should be increased to $4,000.00.

2. The amount should be $4,000.00 because this is in line with increases in CPI since the original $2,000.00 threshold was introduced.

3. There is no reason why the threshold could not be increased within 30 days.

4. The impact of increasing the threshold to $4,000.00 would be minimal, as few SDs are issued for below $4,000.00 anyway. Any increase beyond $4,000.00 would restrict the rights of SME creditors to collect debt owing to them.

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