

Enforcing Contractual Obligations – What To Do If Business Debts Are Unpaid: A Quick Guide

by Joseph Lewin

As a result of the Coronavirus pandemic and the related lock-downs, many businesses will find that counterparties owe them fixed obligations, for example debt payments, but say that they are unable to fulfill these obligations due to the effect of the pandemic on their underlying asset or enterprise.

This article focuses on the options that may be available to companies to enforce these obligations. While the unprecedented crisis has caused shocks to the global economy, we understand that our clients need to protect themselves where their business is reliant on fixed obligations being performed.

Dorsey has created the following briefing, setting out the basic steps that businesses finding themselves caught in such a position can take.

1. Discuss with the Counterparty

Negotiation with the counterparty should always be the starting point. If there is scope for flexibility, it can often be the best option to try to reach a compromise rather than engage in more formal enforcement options (which may damage otherwise good business relationships).

If such negotiation is possible and the counterparty is willing to listen, it is important to keep the terms of the agreement under review and make sure that you do not waive any rights or accidentally agree to vary the agreements.

Be sure that any newly negotiated terms are properly recorded in writing and incorporated into the agreement.

It is also important to keep in mind that such discussions may in the future be required to be disclosed in legal proceedings. If businesses are concerned to protect such discussions, advice should be sought early from a lawyer. Legal advice sought and given is highly likely to be protected by the rules on privilege.

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2. Review the Agreement

If discussion fails or is not possible, then the next step is to carefully consider the contractual terms governing the fixed obligations.

Take time to check exactly what the counterparty's obligations are, and whether their reduced performance or temporary non-performance constitutes a breach of the agreement.

In particular, look out for the following types of clauses:

1. A Force Majeure clause, which may excuse the counterparty from being required to carry out its contractual obligations due to specified events, such as a pandemic;
2. A Material Adverse Change or Change of Law clause, allowing parties in certain circumstances, for example restrictions and measures brought in by the government, to suspend performance; and
3. Termination provisions; how quickly can the counterparty terminate the contract? And what are the requirements for effective termination? If the counterparty is able to terminate quickly, it may not provide sufficient time for your company to find suitable alternatives from a replacement counterparty.

The importance of reviewing the agreement is to assess the fixed obligations owed, the certainty of these obligations, and whether your counterpart has any contractual means to reduce or halt its performance of such obligations.

3. Enforcement

If the counterparty is failing to perform its obligations, the starting point under English law is that parties should perform the contract as agreed even if by fulfilling their obligations it becomes unprofitable or performance becomes difficult. This is subject to an assumption that the contract is not frustrated and that there is no contractual exception.

Therefore, if in a business to business contract performance is stopped, or does not pass specified minimum requirements, that is a breach of contract and the usual remedies for breach of contract will become available.

We have set out below three of the most common methods used to make a company perform its fixed obligations, in particular in recovering monies outstanding.

A. Litigation

Before a claim is sought you should ensure that reasonable notice has been given for the debt in question to be paid, including at least writing to the company setting out the particulars of the debt or serving a statutory demand (discussed below). If there is a genuine dispute over whether the debt is owed, it is also important to consider forms of alternative dispute resolution available, such as mediation.

If a claim is brought, damages are the primary remedy for breach of contract. To commence proceedings, you will need to issue a claim form and particulars of claim to

the Court and serve these documents on your counterpart. Debt claims can be brought in accordance with CPR Part 7 or Part 8. Part 8 proceedings are only appropriate where there is unlikely to be a substantial dispute of fact, however Part 7 proceedings may also be used where the debt is undisputed, or any defence to a claim has no real prospect of success, to obtain summary judgment. Summary judgment will determine the proceedings early and thus minimise time and cost.

Note however that even if you obtain judgment, the judgment will still need to be enforced.

Should a judgment be made in your favour, there are various means to enforce a money judgment. For example, your company could seek to:

1. obtain a writ of control, whereby a bailiff can take control of goods belonging to a debtor (such as plant and machinery) in order that those goods may be sold to satisfy the judgment debt.
2. obtain a charging order, whereby a charge is imposed over a debtor's beneficial interest in certain qualifying assets, most commonly shares.
3. obtain a third party debt order whereby sums owed by a third party to the debtor can be seized for payment of the judgment debt. Third party debt orders are most commonly used to freeze funds standing in the bank account of a judgment debtor and require the bank to pay such funds to the judgment creditor up to the amount of the judgment. They can be a very effective means by which to enforce a judgment.

B. Statutory demand

A statutory demand is a written demand for payment of a debt. If a debtor fails to comply with a statutory demand for a debt within three weeks of being served, then the debtor is at risk of having winding-up proceedings issued against it. It is therefore often extremely useful to put pressure on a company to pay its debt and is most effective where the debt is undisputed.

A further benefit of a statutory demand is it does not need to involve the courts from the outset and is therefore a relatively quick and inexpensive process and one which will get the debtor's attention due to the risk of winding-up proceedings. However, if the intention is to keep an ongoing relationship with the counterpart, it can be seen as an aggressive step and it may still lead to court proceedings. Therefore, as stated above, initial steps should attempt to involve negotiation.

C. Winding up proceedings

The statutory demand referred to above, if unpaid for more than three weeks, can subsequently be used to support a winding petition on the grounds that your counterpart is unable to pay its debts.

It is not necessary for a statutory demand to be served before presenting a winding-up petition to the Court (other evidence can be relied upon to establish a company is unable to pay its debts), however as discussed above it will provide useful leverage in

attempting to get a debt paid before a winding petition is needed.

The advantage of winding up proceedings, either the threat or commencement of it, is that it can assist in the debt being recovered promptly. If your counterparty does not pay the debt, the basic procedure is also relatively quick (though the counterparty has means to frustrate or delay proceedings if the debt is disputed). If the counterparty is wound-up, a liquidator will take control of the company's assets and, if available, will seek to distribute to its creditors (though this can take months, or even years).

Winding up proceedings should not be used if a debt is not clear-cut and there is a genuine disagreement over whether the debt is due. If the Court is not satisfied the debt exists, and the petition is dismissed, you would be required to pay a level of the counterparty's costs.

As always, if you would like to discuss any of the topics covered in this checklist, please call us.

This article is intended for general information purposes only and should not be construed as legal advice or legal opinions on any specific facts or circumstances. Members of Dorsey & Whitney are here to help and we will be pleased to provide further information regarding the matters discussed in this article. We have also created a Coronavirus Resource Center containing other briefings and information related to the current crisis: www.dorsey.com/coronavirus.