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Surge in number of companies taking legal action over mounting debts

The number of businesses taking legal action to recover debts from customers and clients rose by nearly a quarter in 2008.

There were 73,000 County Court Judgments against companies in the UK last year – a rise of 23% over the previous year. The total value of the judgments rose by 26% to £408m compared with £324m in 2007.

The research was carried out by the Credit Management Research Centre (CMRC) at Leeds University and shows that companies are less willing to see debts mount up before they take action to protect their business.

The need for such action is all the more urgent as the CMRC is now predicting that about 40,000 companies will be declared insolvent this year – that's 35% more than last year. Professor Nick Wilson, who heads the CMRC, said: "In 2007 we correctly predicted a 20% increase in insolvencies for 2008. It appeared then that insolvencies would peak in December 2009 and then start to fall. Our revised forecast shows a persistently high failure rate into 2010."

Further CMRC research shows that about one in four

insolvencies are caused by late payments. With struggling companies taking longer and longer to pay their bills it is hardly surprising that more and more creditors are taking legal action.

No one wants to be dragged under by late payments so it is important to respond as soon as problems arise. Early action also reduces the risk of losing out if a customer who owes you money becomes insolvent before they pay you. If this happens, you may receive little or none of the money owed and find you are facing insolvency yourself.

The other danger of holding back is that your invoices may go to the back of the queue while the struggling firm settles with other creditors who are quicker in taking action. This should not happen but it does and is perhaps inevitable.

Faced with not having enough money to pay everyone, many firms will often pay whoever is putting them most under pressure. It can be a case where politely holding back and giving people time can backfire and put your business at risk.

It looks as though the situation is going to get worse before it gets better so when faced with late payments it is vital to get legal advice as soon as possible so the necessary action can be taken in good time.



Creditors to learn more about firms in pre-pack administration

Creditors are now entitled to be given more information when a failing company is involved in a "pre-pack" administration – a practice which is becoming more widespread.

Under the pre-pack system, a buyer is lined up before the company actually goes into administration. Pre-packs tend to be used when swift action is needed because of particular commercial pressures.

New regulations came into force on the 1st of January obliging administrators to reveal to creditors the name of the

buyer and the price paid for the failing company. The new rules, the Statement of Insolvency Practice (SIP) number 16, also require administrators to explain the background to their appointment and why they decided that a pre-pack would be in the best interests of creditors. They must also reveal information about the relationship between the buyer and former directors or shareholders.

Graham Horne, Deputy Chief Executive of the Insolvency Service said: "The Insolvency Service welcomes the greater transparency that the new rules relating to "pre-pack" administrations will provide. Creditors will have better access to information about the new owners of a troubled business providing them with greater clarity about the administration process.

"We will be working closely with the bodies that regulate administrators to ensure that SIP 16 is put into practice. We will also be looking to use our enforcement powers to clamp down on any directors who misuse the

administration process to disadvantage creditors or seek to gain benefit for themselves."

Directors of insolvent companies can be banned from holding a directorship for up to 15 years if their conduct in the period leading up to the insolvency is deemed to be unfit.



Where next



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Personal insolvencies expected to reach record levels

The number of personal insolvencies is likely to reach record levels this year, according to the professional services firm KPMG.

It says we're likely to see 150,000 people declaring themselves bankrupt, entering into Individual Voluntary Arrangements (IVAs) or using other insolvency mechanisms. KPMG's research showed that creditors had to forego at least £1.1bn in bad debts because of people entering into IVAs in 2008. The level of individual debt ranged from about £20,000 to more than £100,000. The average debtor owed £47,800 but only proposed to repay 38% - that's £18,200 per debtor.

Mark Sands, the Director of Personal Insolvency at KPMG, said: "Most IVAs deal with personal loans, credit card balances and other forms of unsecured debts. Most of this money was borrowed to meet 'current' expenditure including lifestyle items such as holidays, or to meet monthly shortfalls in the household budget, rather than to acquire assets or to fund a business.

"By the time people realise the extent of their problems, their total debts will have been swelled by interest, charges and even further borrowing to fund the minimum repayments. This



high average level of debt clearly indicates that too many people have borrowings that they have no realistic hope of repaying."

The rise in personal insolvencies is clearly worrying but firms should think carefully before agreeing to Individual Voluntary Arrangements as they can break down after only a few payments. Be wary too of debt management companies which may try to persuade you to accept less than you are owed.

It is better to seek legal advice before entering into any arrangements to ensure you choose the option that gives you the best chance of getting as much of your money back as possible.

OFT begins extensive examination of 'irresponsible lending'

The Office of Fair Trading (OFT) has decided to examine a wide range of issues such as marketing and selling techniques as it prepares to produce guidelines to prevent irresponsible lending.

It follows a public consultation which showed that most industry stakeholders favoured a broad scope review of the sector and how it operates. There were 58 responses to the consultation document from organisations such as the Financial Services Authority, the Citizens Advice Bureau and several independent businesses. The OFT will now examine numerous issues including "advertising and marketing, selling techniques, product design, use of appropriate credit scoring techniques, and handling of defaults or arrears as well as behaviour and practices around a borrower's ability to repay credit".



The main objective of the process is to produce clear and concise guidelines on practices which the OFT believes to be irresponsible and unacceptable. It says it will continue to work with stakeholders and plans to publish some draft guidelines for consultation in the spring and then produce the finished document in the summer.

The guidelines are being drawn up because new measures introduced in the Consumer Credit Act 2006, which came into effect in April last year, mean the OFT now has to consider the possibility of irresponsible lending before granting a consumer credit licence.

There are currently 120,000 consumer credit licence holders in the UK. The OFT can refuse or revoke a licence if it decides that a trader is not behaving responsibly.

More and more firms are seeking alternative forms of finance

There has been a marked rise in the number of firms seeking alternative forms of finance in the wake of the credit crunch, according to the LC Factoring Advisory Service.

It says enquiries about asset based finance and factoring rose by 30% last year with both small and medium sized enterprises (SMEs) and larger businesses with turnovers of more

than £20m showing interest. The rise coincides with the increasing reluctance of banks to lend money, even to businesses with good track records.

Les Gordon, Director at the LC Factoring Advisory Service, said: "The liquidity problem affecting many of the banks has meant that alternative forms of funding, such as asset based finance and factoring, have become

more popular than traditional lending for many SMEs, and also interestingly, larger businesses that are new to the invoice discounting market.

"This increase in demand is being met with enthusiasm from most asset based lenders (ABLs). We've managed to convert more than three times as many enquiries into deals versus last year."