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Abstract
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Companies Act 1981, debts, company closures

Comments and Notes

RECENT DEVELOPMENTS ON WINDING UP FOR INABILITY TO PAY DEBTS

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The *Companies Act* 1981[1] (the Act) provides that a Court can only order the winding up of a company[2] where application is made by a party defined within s363(1) of the Act on one or more of the eleven grounds described in s364(1) of the Act. One of these, s364(1)(e), allows a creditor, including a contingent or prospective creditor,[3] to make application for the winding up of a company if the company is unable to pay its debts.[4]

To simplify evidentiary difficulties the Act deems a company to be unable to pay its debts[5] if any of the following occur:

1. a creditor, who is presently owed more than $1,000.00, serves on the company a demand for payment in writing, signed by or on behalf of the creditor, and the company fails to pay the sum due, or to secure or compound the sum, to the reasonable satisfaction of the creditor for 3 weeks after service of the demand;
2. execution or other process issued on a judgment, decree or order of any Court in favour of a creditor is returned unsatisfied in whole or in part; or
3. the Court, after taking into account any contingent and prospective liabilities of the company, is satisfied that the company is unable to pay its debts.

Despite this apparently simple mechanism and the relatively stable wording of the statute (or its equivalent) both in Australia and England, the interpretation of these provisions has been the subject of extensive litigation for more than 100 years. Neither the Courts nor the commentators have been able to agree upon an interpretation of the law which can be applied in a predictable manner. Contrary approaches have been adopted on both minor and substantial issues, even by judges of the same standing within the same jurisdiction.[6]

1 The provisions of the Commonwealth statute have been adopted by each of the States and Territories in complimentary legislation known as Companies (name of State or Territory) Code.
2 Defined in s5.
3 s363(1)(b).
4 s364(1)(e) is s360(1) in the new *Commonwealth Corporations Act* 1990.
5 364(2)
6 For example compare Young J in *Tecma Pty Ltd v Solah Blue Metal Pty Ltd* (1988) 6 ACLC 1080; with Cohen J in *CVC Investments Pty Ltd v P & T Aviation Pty Ltd* (1989) 7 ACLC 1218.

Effect of Incorrect Sum in Statutory Demand

It is not uncommon for a company to dispute a notice of demand on the basis that the sum claimed is different to the amount actually owed. Recent decisions in New South Wales[7] and Queensland[8] support the proposition that a statutory demand[9] is invalid where the sum claimed is not identical with the sum due. Each of the other jurisdictions, Victoria,[10] Western Australia,[11] South Australia,[12] Tasmania[13] and the Northern Territory,[14] have accepted the view expressed by Kaye J in 1975 in *Re Convere Pty Ltd*[15]: 'overstatement per se is not sufficient to destroy the validity of the statutory notice or to create a bona fide dispute as to the existence of the debt provided the amount not in dispute would entitle the petitioner to a winding up order'.[16]

The latter view is consistent with the policy of the section and would not prejudice the company in respect of the disputed amount. Amendments to the Act may need to be enacted to achieve consistency in interpretation of 'uniform' legislation[17] and satisfy the demands of modern commerce for predictability in the law.

Judicial Discretion and the Threshold Question

The exercise of the courts' judicial discretion will inevitably lead to some variation in the decision making process. Use of the discretion is an important variable in two of the most common proceedings in this area: an application for an injunction to restrain a petition for winding up and an application to stay or dismiss a petition already filed.

Recent cases highlight the difficulty the courts have in defining the parameters of their discretion and its application, for the purposes of ss 363, 364 and 367, to the threshold question of standing. This difficulty has led to inconsistency in the interpretation of the relevance of the company's solvency when seeking injunctive relief.

In the New South Wales decision of *Ron Pritchard Pty Ltd v Horwitz Grahame Pty Ltd*,[18] Smart J, when hearing an application for the dismissal of a winding up summons, said:

> Where it appears that there is a genuine dispute on substantial grounds that the petitioner or plaintiff is an actual, contingent or prospective creditor and that position will probably continue up to and including the final hearing of the petition . . . such a petitioner . . . lacks the standing necessary to present a

7 *Processed Sand Pty Ltd v Thiess Contractors Pty Ltd* (1983) 1 NSWLR 384.
8 *General Welding and Construction Co (Qld) Pty Ltd v International Rigging (Aust) Pty Ltd* (1983) 2 Qd R 568.
9 s364(2)(a).
10 *Re Convere Pty Ltd* (1976) VR 345 and *Re Faba Pty Ltd* (1989) 7 ACLC 19.
11 *Mine Exc Pty Ltd v Henderson Drilling Services Pty Ltd (in Liq)* (1990) 8 ACLC 51.
12 *Re Gem Exports Pty Ltd* (1984) 36 SASR 571.
13 *Re pardoo Nominees Pty Ltd* (1987) 5 ACLC 496.
14 *Arafura Finance Corporation Pty Ltd v Kooba Pty Ltd* (1987) 6 ACLC 194.
15 (1976) VR 345.
16 Ibid at p350.
17 See 1 above.
18 (1988) 6 ACLC 258.

> petition or issue a summons for the winding up of the company . . . I hold that (the petitioner) lacks the necessary standing and that that position will not change. In these circumstances it is not necessary for the company to establish its solvency. I have considerable doubt whether the modern practice does require a company seeking injunctive relief of process to provide its solvency.[19]

His Honour adopted the view of Ungoed-Thomas J in the leading case of *Mann v Goldstein*[20] that a creditor whose debt is genuinely disputed on substantial grounds lacks locus standi.

Abuse of Process

Smart J in *Ron Pritchard Pty Ltd* also agreed with the views of McLelland J as to abuse of process in *L & D Audio Acoustics Pty Ltd v Pioneer Electronics Australia Pty Ltd.*[21] McLelland J there stated:

> Proceedings by a person as creditor for the winding up of a company on the ground that it is unable to pay its debts will ordinarily be held to be an abuse of process:
>
> 1 if the winding up proceedings are bound to fail . . . ;
>
> 2. if the application is made for some improper purpose . . . ; or
>
> 3. if issues will arise in the winding up proceedings of a kind inappropriate for the determination in such proceedings, . . . [22]

Smart J acknowledged the distinction adopted by McPherson J in *National Mutual Life Association of Australasia Ltd v Oasis Developments Pty Ltd*[23] between the effect of a disputed debt made the subject of a statutory demand and a debt where no demand is made and insolvency is established by other evidence. The decision in *Community Development Pty Ltd v Engwinda Constructions Co*[24] was distinguished on its facts and the finding that the defendant was a contingent creditor because there was an existing obligation under a building contract to pay whatever amount might be fixed on an arbitration award.

Contrary Views on Standing and Solvency

In *Tecma Pty Ltd v Solah Blue Metal Pty Ltd*,[25] a New South Wales judgment handed down by Young J eight months after *Ron Pritchard*,[26] a different approach was taken to the problem of how to deal with a disputed debt which was the subject of a statutory notice. Young J found that, independent of the demand procedure, the evidence produced by the petitioner was sufficient to show on the facts that the defendant was insolvent. He prefaced his findings with the observation that the evidence as to insolvency was relatively sparse, but what there was tended to point in one direction: 'Once this conclusion (that the company is insolvent)

19 Ibid at p265.
20 (1968) 1 WLR 1091
21 (1982) 1 ACLC 536.
22 (1982) 1 ACLC 536, 538.
23 (1983) 1 ACLC 1263.
24 (1969) 120 CLR 455.
25 (1988) 6 ACLC 1080.
26 Ibid.

is reached it is really not necessary to go into the matter of disputed debts'.[27]

His Honour cites O'Donovan's third edition of *McPherson on Company Liquidation*[28] and McPherson J in the *National Mutual Case*[29] as authority for his view. He does not distinguish between petitions based on statutory demand and proving insolvency by other means; nor does he consider the threshold questions of locus standi and abuse of process. Despite his finding on general solvency, Young J proceeds to consider the affidavit evidence before him as to the genuineness of the dispute. Limited reference was made by Young J to only a few of the many authorities in this area. It is difficult to ascertain his purpose in pursuing the question whether a bona fide dispute on substantial grounds existed after expressing his opinion on the effect of insolvency.

The New South Wales Court of Appeal[30] did not clarify the question of standing nor the ambit of the judicial discretion in this area when given the opportunity in *Australian Mid-Eastern Club Ltd v Elbakht.*[31]

The divergent lines of authority on the question of whether or not solvency is an issue when a company seeks an injunction to restrain the filing and prosecution of a winding up application were considered by Master McLachlan in *F H Transport Pty Ltd v Ampol Petroleum (Queensland) Pty Ltd.*[32] In this case the petition for winding up was preceeded by the service of a statutory demand. The debt in dispute was to be litigated within one week of Master McLachlan's judgment. After having considered *Mann v Goldstein*[33] and other authorities supportive of the proposition contained therein[34] the Master referred to the decision of McPherson J in *General Welding and Construction Co (Qld) Pty Ltd v International Rigging (Aust) Pty Ltd* [35] which followed the *Community Development*[36] case and considered himself bound to follow the Queensland Supreme Court.

The Trading Reputation of an Insolvent Company

In *General Welding*[37] McPherson J asserted:

> An insolvent company has no trading reputation or commercial credit capable of amounting to an interest which the law either will or ought to protect by interposition of an injunction.[38]

27 Ibid at p1083.
28 O'Donovan, 'McPherson's Law of Company Liquidation' (LBC 3rd edn 1987). For further reading see: Corkery (1982) Adel L Rev 61; Ford, 'Principles of Company Law' (Butterworths 5th edn 1990) pp 756-761.
29 Ibid.
30 Kirby P Rogers AJA.
31 (1988) 6 ACLC 958.
32 (1989) 7 ACLC 262.
33 Ibid.
34 *Stonegate Securities Ltd v Gregory* (1980) 1 All E R 241.
35 (1983) 2 Qd R 568.
36 Ibid.
37 Ibid.
38 Ibid at p570.

It is submitted that this view, as an all encompassing proposition, is neither correct in fact nor law by current commercial standards. It is self-evident that a company can be technically insolvent as determined by the deeming provisions of the Act but still retain assets in excess of liabilities; have good will and maintain a commercial trading reputation. It is unlikely the opinion of the disputed creditor would be generally known. The usual reason a company seeks injunctive relief to prevent the filing of a winding up petition is to avoid the harm that can flow from the public advertisement of the proceedings. It would only be in rare circumstances that a company which was insolvent would be able to successfully challenge the standing of all its creditors who claimed non payment of monies due. Another creditor with standing can replace a disputed creditor on an application as the Courts have held that winding up proceedings are akin to a class action for the benefit of all creditors having claims on the company.[39]

The permutations and combinations of raising funds are virtually unlimited and frequently there is a blurring between debt and equity. It may not be just and equitable that a company with complex financial engineering is deemed insolvent when it is unable to pay its debts as they fall due if its realisable assets exceed liabilities. It is in this scenario that the judicial discretion could be most equitably exercised.

Statutory Insolvency

The judicial interpretation of statutory insolvency was considered by Barwick CJ in *Sandell v Porter.*[40] He said conclusions of insolvency 'generally speaking ought not to be drawn simply from evidence of a temporary lack of liquidity'.[41] He continued later: 'it is the debtor's inability, utilising such cash resources as he has or can command through the use of his assets, to meet his debts as they fall due which indicates insolvency'.[42]

In *Bank of Australasia v Hall*[43] Isaacs J said:

> If... the debtor's position is such that he has property either in the form of assets in possession or of debts, which if realised would produce sufficient money to pay all his indebtedness, and if that property is in such a position as to title and otherwise that it could be realised in time to meet the indebtedness as the claims mature, with money thus belonging to the debtor, he cannot be said to be unable to pay his debts as they become due from his own moneys.[44]

In *Re Tweeds Garages Ltd*[45] Plowman J quoted, with approval, *Buckley on the Companies Acts* on the issue of commercial insolvency:

> That is the company being unable to meet current demands upon it. In such a case it is useless to say that if its assets are realised there will be ample to pay 20 shillings in the pound: this is not the test. A company may be at the

39 *Re Anglesea Island Coal and Coke Ltd* (1861) 4 LT 684.
40 (1966) 115 CLR 666.
41 p670.
42 p670.
43 (1907) 4 CLR 1514.
44 Ibid at p1514.
45 (1962) ch 406.

> same time insolvent and wealthy. It may have wealth locked in investments not presently realisable; but although this be so, yet if it have not assets available to meet its current liabilities, it is commercially insolvent and may be wound up.[46]

The complexity and sophistication of financing today raises serious questions as to whether the definitions of insolvency established in a different era are applicable for modern times. This issue would be less important if a consistent approach was adopted by the Courts to standing and the parameters of their discretion.

Mann v Goldstein Reinforced

The questions of standing and judicial discretion were fully canvassed by Cohen J in *CVC Investments Pty Ltd v P & T Aviation Pty Ltd; Amann Aviation Pty Ltd v Pacific Aviation Pty Ltd; Pacific Aviation Pty Ltd v Amman Aviation Pty Ltd.*[47] CVC and Amann were associated companies. P & T and Pacific served statutory notices on CVC and Amann and each company obtained an injunction restraining the commencement of proceedings for winding up. In separate Federal Court proceedings there was evidence pointing to the insolvency of Amann. P & T sought a discharge of the injunction preventing it from bringing winding up proceedings (and Pacific made application to wind up Amann). Amann sought injunctions restraining its winding up. P & T and Pacific conceded that there was a bona fide dispute on substantial grounds as to the debts owed but claimed that because Amann was insolvent they had standing to wind it up. Cohen J dismissed the proceedings by P & T and Pacific and held that a creditor is required to establish a debt to have any standing in bringing a winding up application and their petition was an abuse of process on the principles enunciated by McLelland J in *L & D Audia Acoustics.*[48] His honour further held that even if there is a ground for winding up in existence it does not give the disputed creditor greater standing. The solvency of the debtor company may be relevant in the consideration of the Courts discretion where the extent, and not the existence, of the debt is found to be in dispute:

> There is no apparent distinction between the principles to be applied in dismissing a petition or summons to wind up on the ground that there is a bona fide dispute on substantial grounds and in the granting of an injunction to prevent such a petition or summons being filed or to prevent the advertising of the hearing. In both cases, if it's established that the petitioner or plaintiff has or would have no standing to obtain a winding up order then there is no justification for proceedings being commenced or continued. If the company is insolvent then it is a matter for a creditor, established as such, or one of the persons designated under s363 of the Code, to bring the matter to the Court. It is necessary for the Court to make a careful scrutiny of the evidence in order to establish the genuineness of the alleged dispute and the substance of the defence or cross claim. If there is a likelihood that the debt may be owing even in part then the question of the solvency of the company may become relevant in the consideration of the Courts discretion.[49]

46 'Buckley on the Companies Acts', 13th edn 1957, p60.
47 (1989) 7 ACLC 1218.
48 Ibid.
49 Ibid at p1224.

Cohen J distinguished *Community Development*[50] on the basis that it was a contingent debt. His Honour referred, with approval to the comments by Ungoed-Thomas J[51] on the often quoted statement of Jessel M R in *Niger Merchants Co v Capper:*[52]

> When a company is solvent the right course is to bring an action for the debt: where a company is insolvent, no doubt it is reasonable to wind up the company even where the debt is disputed.

Ungoed-Thomas J[53] described this statement as being tentatively phrased in an apparently unreserved judgment, unreported at the time, in the early period of the developments of the jurisdiction and, as far as he was aware, stood alone.

Cohen J commented upon the opinion of McPherson J in the *National Mutual case:*[54]

> I do not understand McPherson J to be suggesting that where there is a bona fide dispute as to the whole of the debt then notwithstanding that the plaintiff or petitioner has not established himself as a creditor he is entitled to proceed to wind up the company relying only on insolvency and not having to establish his locus standi.[55]

Cohen J expressed strong views on the issue of the creditors ability to prove standing:

> The fact that there is a ground for winding up in existence does not give that claimant any greater standing. There are a number of grounds under s364 upon which the court may make an order for the winding up of a company. The most common one relied upon is that the company is unable to pay its debts. Nevertheless the Code gives only a limited number of persons a right to have the company wound up on that or any other ground. It is an abuse of process if a person in bringing proceedings assumes a standing which it does not have and seeks orders to which it is not entitled.[56]

Recent Western Australian Decisions

Perhaps reflecting the economic difficulties in Western Australia, there have been four recent cases in that State on the interpretation of the law in this area. In *Mine Exc Pty Ltd v Henderson Drilling Services Pty Ltd (In Liq),*[57] Ipp J refused to grant an interlocutory injunction to restrain an alleged creditor filing a winding up petition after serving a statutory notice. He doubted the genuineness of the debt dispute and found that it was the extent of the debt and not its existence that was the subject of the dispute. He viewed the Court's jurisdiction to grant (an injunction as not being conditional upon proof of the debtor companys solvency. This is contrary to the views taken by Lucas J in the *Community*

50 Ibid.
51 *Mann v Goldstein.* ibid.
52 (1877) 18 ChD 557.
53 Ibid at p772.
54 Ibid.
55 Ibid at p1222.
56 Ibid at p1223.
57 (1990) 8 ACLC 51.

Development case[58] and McPherson J in *General Welding.*[59] Ipp J provided some comfort to the views of Lucas J and McPherson J when he said that it would be unlikely that an insolvent company would be able to show irrepairable, or at least significant and substantial damage to justify an injunction.[60]

It is submitted that the statutory legal definitions are designed to fulfil their statutory purpose. These definitions should not be used for an extended purpose. We have seen that a company can have realisable assets in excess of liabilities and still be legally insolvent because it is not able to readily raise funds to meet debts as they fall due. The filing, in these circumstances, of a winding up petition and the resultant advertisements can have the effect of reducing the value the company has inter alia, in intellectual property, contractual rights and product goodwill and may also trigger defaults in other securities.

Ipp J introduced a new and confusing dimension into the debate on the relevance of solvency when he stated that 'the element of solvency is also a relevant factor in determining whether a debt is genuinely disputed. A Court would more readily conclude that the dispute is bona fide when it is shown that the plaintiff is manifestly solvent'.[61] The relationship between a company's solvency and the genuineness of a disputed debt is not immediately clear.

In another case[62] shortly after *Mine Exc* [63] Ipp J dismissed a petition by the State Government Insurance Commission of Western Australia (SGIC) to have Bond Corporation Holdings Limited wound up and ordered indemnity costs on the ground that the filing of the petition was a flagrant abuse of process. His Honour held that the debt claimed by SGIC was genuinely disputed on substantial grounds and this was known to SGIC.

Ipp J accepted the view of Cohen J in *CVC Investments*[64] that there is no material distinction to be drawn between restraining the presentation of a petition and dismissing a petition that has already been presented. He acknowledged the potential harm to a company in staying a petition because the filing of the petition is still capable of fixing the date of winding up[65] and creditors who continue to deal with the company are put at risk pursuant to s368(1) of the Act.

Standing, Abuse of Process and Judicial Discretion

According to Ipp J, where it is found that a petitioner does not have standing, the Court has a discretion to restrain the filing of a petition or to dismiss the petition (as the case may be) on the one hand, or stay further proceedings on the other, although the usual order is to dismiss

58 Ibid.
59 Ibid.
60 Ibid at p53.
61 Ibid.
62 *Re Bond Corporation Holdings Ltd* (1990) 8 ACLC 153.
63 Ibid.
64 Ibid.
65 s451.

the petition. His Honour accepted that even in cases of true abuse of process the Court has a discretion to dismiss or stay a petition although the Court would rarely not dismiss the petition.

It is submitted that the judicial discretion can only be used when the creditor has standing. A discretion may exist to decide which evidence will be heard on the disputed debt to determine standing; and a discretion certainly exists once the creditor has standing even when the extent of the debt, and not its existence, are genuinely disputed on substantial grounds. Ipp J accepts that insolvency is irrelevant to standing but it may be relevant to abuse of process or to the exercise of a discretion to dismiss or stay a petition. He does not expand upon this distinction or explain its rationale.

In the Western Australian Supreme Court Master White has also recently delivered two judgments which give the Court broad discretions to either grant, dismiss or stay a petition for winding up. In *Re Synthetic Oils Pty Ltd*[66] he held that the Court retains the discretion to order the winding up of an insolvent company even where there is a bona fide dispute on substantial grounds as to the debt. He found as a matter of fact that there was no bona fide dispute and ordered the company be wound up. He did not expressly turn his mind to the threshold questions and overcame the dilemma of conflicting authorities by stating '. . . it is desirable that the discretion of the Court should be fettered by any hard and fast rule'.[67]

In *Re Worldwide Testing Services Pty Ltd,*[68] Master White was invited to dismiss a petition on the basis that the petitioner was not a creditor of the company, or, if he was, that his claim was genuinely disputed on substantial grounds. The company was insolvent as its business had been sold by a receiver. The petitioning creditor did not file an answering affidavit to the company's claim that the debt was disputed. Master White was unable to assess the merits of the case on the evidence before him and stayed the petition pending the resolution of the debt dispute between the parties. Consistent with his views expressed in the *Synthetic Oils* case[69] Master White held that his judicial discretion should not be fettered by hard and fast rules and he thought it was just and equitable to stay the petition in this case because, if the petition was dismissed the petitioner would be unable to recover anything as the debtor company was not trading and had not traded for some years and there were no other creditors to seek substitution. On the balance of convenience the debtor would suffer less than the petitioner. Perhaps, more importantly for consistency with one line of authorities, he had doubts as to the bona fides of the dispute and as to whether it was in fact a dispute about the extent of the debt, rather than its existence.

Conclusion

It is desirable that this frequently litigated area of law achieve a consistently predictable approach from the Courts but recent cases do not give confidence that this will occur in the near future. It is clear from the

66 (1990) 8 ACLC 95.
67 Ibid at p97.
68 (1990) 8 ACLC 99.
69 Ibid.

wording of ss 363, 364 and 367 of the Act that the powers given to the Court are discretionary but, it is submitted, judicial discretion cannot be exercised until the threshold questions are affirmatively answered.

It is submitted that the determination of whether a plaintiff/petitioner falls into one of the categories in s361(1) of the Act is not a matter within the Court's discretion. Nor does the court have a discretion to determine whether one of the grounds in s364 of the Act is established. The discretion lies in determining the disposition of the hearing once the matters have been judicially decided and discretions will exist as to the evidence to be heard to determine standing and whether the debt is bona fide disputed on substantial grounds.

There are clearly divergent views expressed by the authorities on this area of law and it is important for the continued confidence in commercial activity that the uncertainty generated by the differing criteria used by Courts is removed or substantially reduced. Allowing the Courts to develop the law using discretionary powers is a dangerous practice because it fuses the judicial and administrative function.

It is unfortunate that the legislature did not take the opportunity with the introduction of the *Corporations Act* to provide further statutory interpretation of the controversial provisions and give guidance to the Courts to develop a clear and consistent policy which would reduce the substantial litigation in this area and give confidence to the commercial community and its advisers.