INSOLVENCY AND RESTRUCTURING FORUM

1 August 2007

A long and winding road: putting companies into liquidation

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1. Introduction

A winding up order does not immediately mark the end of the corporate existence of a company. It is the start of a process whereby the company ceases carrying on business for any purpose other than the winding up. In a winding up (or a liquidation) the assets of the company are collected in, its debts and liabilities are ascertained, and the assets of the company are applied to pay the debts and liabilities. In the event that there are any surplus assets after the costs and expenses of the winding up have been paid, those assets will be distributed among the members of the company. The process may ultimately lead to the deregistration of the company, at which time it ceases to exist.

There are two types of winding up:

- the compulsory winding up of companies by the Court, generally at the instigation of unpaid creditors (although applications may also be brought by contributories); and
- the voluntary winding up of companies. If the company is unable to pay its debts, this will be a creditors' voluntary winding up, and if the company is able to pay its debts, it will be a members' voluntary winding up. Voluntary windings up are an extra judicial procedure and generally take place without any application being made to the Court.

This paper focuses on the compulsory winding up of companies by the Court.

2. Effect of a winding up order

The effect of a winding up order on a company are as follows:

- The company retains its powers, but it only exists for the purpose of being wound up.
- Dispositions of the company's property that have taken place since the commencement of the winding up by the Court (which is generally the date on which the Court orders that a company be wound up (s513A)) are invalidated unless the dispositions are "exempt dispositions" or unless the Court validates them (s468).
- No civil proceedings can be commenced or continued against the company, except by leave of the court (s471B). Creditors lose the right to bring proceedings against the

company at will and receive a right to prove their claims with the liquidator, from whose decision to reject a claim there is an appeal to the court.

- S471B does not affect a secured creditor's right to realise or otherwise deal with their security (s471C)).
- S474 and s483(1) authorise the liquidator to "take control" of the company's property. However, although the liquidator administers the company for the benefit of the creditors, the company remains the legal and beneficial owner of the assets - the liquidator is not an owner of them and the creditors have no proprietary interest in them.

The directors of the company lose their powers (s471A(1)) but not their office (s471A(3)). Directors retain residual powers which are not inconsistent with the purpose of the appointment of the liquidator. That includes the right to appeal, in the name of the company, against the winding up application.

3. Winding up on the grounds of insolvency

3.1 Who can apply?

S 459A *Corporations Act* (2001) gives the Court the power to order that an insolvent company be wound up in insolvency. S 459P(1) sets out the various entities entitled to make such an application, and they include:

- the company itself;
- a creditor; and
- a liquidator of the company.

Under s 459P (2), the following entities may also apply, but only with the leave of the court:

- a creditor who is a creditor only because of a contingent or prospective debt;
- a contributory;
- a director; or
- ASIC.

3.2 Grant of leave

As mentioned above, s 459P (2) provides that certain creditors can only apply for a company to be wound up in insolvency with the leave of the Court. Two recent cases demonstrate different approaches that the Court has taken in respect of applicants who do not seek leave as required:

(a) A 2006 decision in the Supreme Court of New South Wales by Justice White emphasises the importance of establishing whether or not the prospective plaintiff does in fact have standing to apply for a winding up order, or whether they are required to seek leave of the Court. In *Australian Beverage Distributors Pty Ltd v Evans & Tate Premium Wines Pty Ltd*[1], Australian Beverage Distributors (***ABD***)

[1] (2006) 58 ACSR 22

filed an application for Evans & Tate (***E&T***) and its parent company to be wound up in insolvency. There had been extensive litigation between the two companies and while some of the debts had not been quantified, Justice White concluded that it was more likely than not that ABD was a net debtor of E&T. E&T's parent company had a prospective debt to ABD under a series of convertible notes and a contingent liability under a deed of cross-guarantee.

Justice White dismissed the winding up applications as an abuse of process. In terms of the winding up application against E&T's parent, ABD only had a contingent claim. It was required to seek leave of the court to commence winding up proceedings, but had not done so. Justice White held that commencing the application in those circumstances constituted a 'serious abuse of the process of the court'. In addition, it was held that the winding up proceedings had been brought for an improper purpose, namely to deter E&T from proceeding with an application to restrain ABD from enforcing a costs order it had obtained.

The winding up proceeding against E&T itself was also held to constitute an abuse of process in circumstances where E&T was challenging the enforcement of the debt in question in separate proceedings.

(b) By contrast, a 2004 decision demonstrates that in certain situations, the Court may be prepared to grant leave after the event. In *Masri Apartments Pty Ltd (in liquidation) & Aus Constructions Pty Ltd (in liquidation) v Perpetual Nominees Ltd*,[2] the New South Wales Court of Appeal considered the circumstances in which the court will grant leave to a prospective creditor. The court also considered whether leave could be granted retrospectively.

In *Masri Apartments*, Perpetual was a secured creditor of a prospective liability. It therefore needed the court's leave before it could apply for the winding-up order to be made, but it had not originally sought such leave. Justice Beazley held that the Court did have power to grant leave retrospectively. As to whether the court should grant leave, Justice Beazley said that the court may not grant leave to an entity falling within s459P (2) unless it is 'satisfied that there is a *prima facie* case that the company is insolvent'. In this case, the appellants were insolvent, were not trading and had no viable prospect of obtaining alternative finance so as to resume trading. There was no discretionary basis upon which the court ought to have refused leave to Perpetual to make application for the winding up of each appellant. Leave was accordingly granted to Perpetual *nunc pro tunc* to apply to wind up each of the appellants on the ground of insolvency.

ASIC v Neolido Holdings Pty Ltd[3] provides an insight into the circumstances the court will take into account in determining whether or not to grant leave to ASIC to apply for an order that a company be wound up in insolvency. In that case, ASIC had applied for leave to apply for an order that certain companies that had incurred substantial debts be wound up. At first instance, they were granted leave, but on the condition that ASIC pay all the costs of the liquidator involved in the

[2] [2004] NSWCA 471

[3] [2006] QCA 266

winding up. ASIC appealed that decision. The Court of Appeal held that leave to apply to wind up a company should only be granted to ASIC where ASIC can demonstrate that there exists a strong prima facie case of insolvency. It went on to hold that considerations relating to future control of the liquidation (including the costs and expenses of the liquidation) are not relevant to the discretion to grant or withhold leave to ASIC to apply for a winding up order. Accordingly, the condition requiring ASIC to pay the liquidator's costs should not have been imposed.

3.3 Presumption of insolvency

In certain applications for companies to be wound up in insolvency, rather than the creditor having to prove solvency, there will be a presumption that the company is insolvent. Under s 459C(2), the court will presume that the company is insolvent in circumstances including the following:

- a failure by the company to comply with a statutory demand;
- execution or other process on a judgment in favour of a creditor being returned wholly or partly unsatisfied; and
- the appointment of a receiver to property of the company under a floating charge.

In the absence of such a presumption, the creditor would themselves have to persuade the court that the company was insolvent.

3.4 Time for hearing the application

Applications for winding up in insolvency that are not determined within six months after they have been made will be dismissed unless the court has granted an extension of the period on application within the original six months or within any extended period that has already been granted (s459R).

4. Winding up on grounds other than insolvency

S 461 sets out the other grounds on which the court may order that a company be wound up. They include:

- the company by special resolution resolves that it be wound up by the Court;
- the directors have acted in affairs of the company in their own interests rather than in the interests of the company as a whole;
- the affairs of the company are being conducted in a manner that is oppressive or unfairly prejudicial to or unfairly discriminatory against a member or members or in a manner that is contrary to the interests of the members as a whole;
- ASIC has stated in a report prepared under Division 1 of Part 3 of the ASIC Act that, in its opinion, the company cannot pay its debts and should be wound up or that it is in the interests of the public, the members or the creditors that it be wound up; or
- if the court considers that it is just and equitable that it be wound up;

S 462 provides that the company, a creditor (including a contingent or prospective creditor), a contributory, the liquidator of the company, ASIC or APRA may apply to court for an order that the court be wound up on these grounds.

'Just and equitable' ground

Some examples of recent cases in which the court has the 'just and equitable' ground applies are as follows:

(c) in *Phelan v Ambridge Corp Pty Ltd*[4], one of the company's directors was bankrupt and receivers and managers had been appointed to the other corporate director. Brereton J held that in these circumstances a 'constitutional and administrative vacuum' existed and the just and equitable ground was likely to be available in those circumstances;

(d) in *Armstrong v Minbani Aboriginal Corporations*[5], the court ordered that Minbani Aboriginal Corporations be wound up on the just and equitable ground as the winding up was in the public interest in circumstances where the corporation had failed to acquit government funds properly, the activities of the corporation were limited and could not be sustained without ongoing financial contribution, it owed money to the government and it was likely that it owed money to employees;

(e) in *Macquarie Bank Ltd v TM Investments Pty Ltd*[6], Justice Barrett held that the just and equitable ground covers situations where there has been serious fraud, misconduct or oppression regarding the affairs of the company. The defendants in this case were wound up on the basis that their mismanagement and misconduct in the operations of the company had produced such a serious lack of confidence in the directors that the business could not be ongoing;

(f) in *Labraga v Pomfret*[7] the Court held that it was appropriate that the company be wound up on just and equitable grounds because the level of mistrust and the lack of cooperation existing between the directors meant that the company could no longer continue;

(g) in *Deputy Commissioner of Taxation v Casualife Furniture International Pty Ltd; Deputy Commissioner of Taxation v Kencord Manufacturing Pty Ltd*,[8] Justice Hansen ordered that the two respondent companies be wound up on the just and equitable ground that it was likely, based on a long pattern of predecessor companies, that they would accrue substantial tax liabilities that would be left unsatisfied; and

(h) In *ASIC v International Unity Insurance Pty Ltd*,[9] an insurance company was wound up under the just and equitable ground where it was no longer trading, had failed to meet its obligations to meet policy claims, had improperly divested itself of assets, had entered into sham transactions for the purpose of disguising those divestments, and had entered into transactions that might have had the effect of putting its assets beyond the reach of creditors. Justice Lander also noted that a

[4] (2005) 55 ACSR 136

[5] [2006] FCA 803

[6] [2005] NSWSC 608

[7] [2005] NSWSC 973

[8] [2004] VSC 157

[9] [2004] FCA 1059

winding-up order could be made if the applicant could establish that there had been breaches of the provisions of the Corporations Act, including, but not limited to, breaches of directors' duties, inadequacy of accounts and inadequacy of record-keeping, or if there was a need to ensure investor protection.

5. Appointment of a provisional liquidator

In *Re Carapark Industries Pty Limited (in liquidation)*[10] Justice Street characterised the purpose of a provisional liquidation as follows:

> The task of the provisional liquidator is to attempt to maintain the status quo until a final decision can be made, after a full hearing, whether the company should be wound up.

Section 472(2) of the Corporations Act (***CA***) provides the statutory basis for the appointment of a provisional liquidator. It provides that:

> The Court may appoint an official liquidator provisionally at any time after the filing of a winding up application and before the making of a winding up order or, if there is an appeal against a winding up order, before a decision is made.

A court will consider the following factors in deciding whether or not to appoint a provisional liquidator:

1. whether the assets will be dissipated in the interim period between the filing of the application to wind up and the winding up order being made;
2. whether the applicant has established a prima facie case for the winding up of the company; and
3. whether the applicant has established a prima facie case that he or she has the necessary standing to bring the application to wind up.[11]

Any application to appoint a provisional liquidator would need to be made shortly after the time of filing the application for winding up. Any application would need to be accompanied by an affidavit setting out the grounds on which the provisional liquidator should be appointed. A court would be reluctant to hear an application ex parte given the consequences the appointment of a provisional liquidator for a company.

Both the New South Wales Supreme Court Rules and the Federal Court Rules (as well as some other jurisdictions) give the respective courts power to require an undertaking as to damages from the applicant.[12] In *ASIC v ACN 102 556 098 Pty Limited*[13] Barrett J noted that while there is no inflexible rule that an applicant for a provisional liquidator's appointment should be required to give an undertaking as to damages, the applicant's failure to offer the undertaking may, in the ordinary case, tell against the making of the order. He went on to comment that if ASIC was applying for a winding up order in a representative capacity to enforce private rights rather than to perform a public duty, an undertaking as to damages might be required. However, where ASIC was

[10] [1967] NSWLR 337 at 341

[11] *Re Mackay Investments Pty Ltd* (1996) 14 ACLC 319 at 321

[12] Supreme Court Rules 1970 (NSW) Corporations Rules R6.1(4); Federal Court Rules R6.1(4)

[13] [2003] NSWSC 1253

performing a public duty and acting in its own right, an undertaking as to damages would not be required.

The following cases are given as examples where the court has appointed a provisional liquidator (these examples are examples only and do not mean that the Court would automatically appoint a provisional liquidator if any one or more of these points are established):

- when the affairs of the company may have been conducted casually without due regard being given to the legal requirements so as to cause the court to have no confidence that the affairs of the company are being carried on properly and for the benefit of shareholders;[14]
- where, in the public interest, there is a need for an examination of the state of accounts of a company which are in disarray;[15]
- where the company is trading at a loss and will incur further liabilities;[16]
- where there is a paralysis caused by an intra-company dispute;[17]
- where there is a need to stop either dissipation or seizure of assets;[18]
- for the purpose of ascertaining whether the company's business could be carried on effectively and to see whether an arrangement could be reached with creditors;[19]
- where there is a need to investigate the affairs of the company;[20]
- to enable the company to conclude current contracts;[21]
- to enable the company to enter into new contracts and execute the relevant documents;[22]
- to represent the company in legal proceedings;[23]
- where the winding up application is made on just and equitable grounds, there is a lack of opposition from shareholders to the winding up application, and minimal interference would be caused to the management of the company by the appointment of a provisional liquidator;[24] and

[14] *ASC v Solomon* (1996) 19 ACSR 73

[15] *Re Huntford Pty Ltd* (1993) 12 ACSR 274

[16] *Re Club Mediterranean Pty Ltd* (1975) 11 SASR 481

[17] *Re Club Mediterranean Pty Ltd (1975) 11 SASR 481*

[18] *Rural Industries Co-op Society Ltd v Porky Pigs Pty Ltd* (1988) 12 ACSR 794

[19] *Cope Allman (Marrickville) Pty Ltd v The Marrickville Businessmen's Club Ltd* (1983) 1 ACLC 1003

[20] *Tickle v Crest Insurance Co of Australia Ltd* (1984) 2 ACLC 493

[21] *Deputy Commissioner of Taxation v Ceiling Services Pty Ltd* (1983) 1 ACLC 1077

[22] *Re Central Earthmoving Pty Ltd* (1984) 2 ACLC 148

[23] *Davids (Vic) Pty Ltd v Miller Huthwaite Pty Ltd* (1985) 3 ACLC 747

[24] *David Alexander Grace* v *Deborah Sharon Grace &5 ors* [2007] NSWSC 6

- where the changing nature of the insurance industry, particularly the medical insurance industry, following the collapse of HIH and the events of 11 September 2001 made the appointment of a provisional liquidator "proper and desirable in the public interest".[25]

6. Statutory demands

Statutory demands are commonly used by creditors as a means of requiring a company to pay its debts. The consequences of a company failing either to pay the debt or apply to have a statutory demand set aside within 21 days of being served with the statutory demand is that the creditor may apply to the court for the company's winding up on the basis of its failure to comply and that company is presumed to be insolvent. Accordingly, a company that receives a statutory demand is presented with a powerful incentive to pay its debts - to avoid being wound up and put into liquidation.

For a creditor, the potential downside of issuing a statutory demand is that a company can apply to have a statutory demand set aside, and if it succeeds, will be entitled to recover its legal costs of that application.

Under s459E, a statutory demand is validly made if:

(a) it relates to a debt or debts, including certain taxation liabilities (set out in s459E(5)), which total at least $2000 and which are due and payable to the person who makes the demand (s459E(1) and s9);

(b) the demand:

  (i) is in writing;

  (ii) specifies the total amount of the debt(s);

  (iii) requires the company to pay the total amount of the debt(s) within 21 days after the demand is served on the company;

  (iv) is signed by or on behalf of the creditor;

  (v) is in the form prescribed by Form 509H in the Corporations Regulations Sch.2 (s459E(2)); and

(c) it is accompanied by a verifying affidavit in the event that the debt(s) are not judgement debts (s459E(3)).

A debt has been described as "*a liquidated sum in money presently due, owing and payable by one person, called the debtor, to another person called the creditor*." Significantly, claims for unliquidated damages are not debts.[26]

Whether or not a particular claim constitutes a 'debt' that can be claimed by way of a statutory demand is an issue that requires careful consideration prior to issuing a statutory demand. By way of example:

[25] *Re United Medical Protection Limited* [2002] NSWSC 413

[26] *First Line Distribution Pty Ltd* v *Paul Whiley & Ors* (1995) 13 ACLC 1,216; *Odyssey Re (Bermuda) Limited (Company No. 161930) v Reinsurance Australia Corporation Limited* [2001] NSWSC 266

- In *Odyssey Re (Bermuda) Limited (Company No. 161930) v Reinsurance Australia Corporation Limited*[27] it was held that claims against insurers and reinsurers are claims for unliquidated claims and therefore not debts unless or until there is a judgment, an arbitral award or binding settlement agreement.
- The New South Wales Court of Appeal in *Box Valley Pty Limited v Elizabeth Kidd and David John Kidd*[28] has confirmed that prospective future liabilities for unliquidated damages are not 'debts'. It was held in that case that a liability that was almost certain to arise under a futures contract in the near future was not ascertainable and was therefore not a 'debt' at the relevant time.

7. Winding up applications relying on failure to comply with statutory demand

If an application for a company to be wound up in insolvency relies on a failure by the company to comply with a statutory demand, then under s459Q the application:

(a) must set out the particulars of service of the demand on the company and the failure of the company to comply with it;

(b) must attach a copy of the demand (and any order by which it has been varied); and

(c) must attach a verifying affidavit in the event that the debt(s) are not judgement debts.

It is also necessary under rule 5.6 of the Supreme Court (Corporations) Rules 1999 (NSW) to publish a notice of the application in a newspaper circulating generally in the state at least three days after the originating process is served. The purpose of the three day period is to allow a company against which an originating process for winding up has been served to take steps prior to the advertising of the proceedings to protect itself from being damaged by adverse publicity relating to proceedings that have no merit (for example by seeking an injunction). In *Australian Beverage Distributors Pty Ltd v Evans & Tate Premium Wines Pty Ltd*[29] the petitioning company published a press release before the expiry of the prescribed three day period. Justice White held that constituted an abuse of process which was calculated to, and did, cause harm to the defendants.

8. Setting aside statutory demands

Under s459G a company may make an application to the court, within 21 days of receiving the demand, to set aside the statutory demand.

If the company does not make such an application, it cannot later contest, without leave of the court, an application for a winding up order, on any of the grounds that it could have relied on to set

[27] [2001] NSWSC 266

[28] (2006) 24 ACLC 471

[29] (2006) 58 ACSR 22

aside the statutory demand (s459S). The court will not grant this leave unless it is satisfied that ground is material to proving solvency (s459S(2)).

An application to set aside the statutory demand can only be made by filing an affidavit in support of the application with the Court and by serving a copy of the application and the supporting affidavit on the demanding creditor (s459G(3)).

The court may set aside the statutory demand if it is satisfied:

(a) that there is a genuine dispute about the existence or amount of the debt(s) demanded (s459H);

(b) that the company has an offsetting claim against the creditor (s459H);

(c) that because of a defect in the demand, a substantial injustice will be caused unless the demand is set aside (s459J(1)); or

(d) there is some other reason the demand should be set aside (s459J(2).

The application to set aside a statutory demand must be made within the 21 period, and each of the grounds on which the company seeks to set aside the statutory demand must also be identified within that period. While the evidence that has been adduced may be supplemented, the Court may not permit additional grounds to be raised outside the 21 day period - in *Process Machinery v ACN 057 260 590*[30], Barrett J observed at [22]:

> The real point is that the application and affidavit filed and served within the 21 day period must fairly alert the claimant to the nature of the case the company will seek to make in resisting the statutory demand. The content of the application and affidavit must convey, even if it be by necessary inference, a clear delineation of the area of controversy so that it is identifiable with one or more of the grounds made available by s459H and s459J. That process of delineation may not be extended after the end of the 21 day period, although it is open to the plaintiff to supplement the initial affidavit by way of additional evidence relevant to the area of controversy identified within the period.

One issue that the Court has considered recently is whether an exclusion of rights of set-off in a contract can operate to preclude a party from raising an offsetting claim in the context of a statutory demand. In *Jem Developments Pty Ltd v Hansen Yuncken Pty Ltd*[31], Austin J commented at [30] that:

> There is no good reason for denying effect to a contractual stipulation that is intended to segregate a particular debt and prevent it from being reduced by debts owing by the creditor to the debtor and by counter-claims of the debtor against the creditor. Thus, if A and B enter into a contract by which they agree that in stated circumstances, A will pay B $500,000, without any deduction for any debt that B may owe to A or any claim that A may have against B, and then the payment of $500,000 falls due and payable by A, then as a matter of contractual stipulation, A is prevented from reducing the payment obligation by reference to counter-debts or counter-claims. That being so, if B makes a statutory demand upon A under s 459E for payment of $500,000, A is prevented by the contract from relying on any claim it has against B as an offsetting claim for the purposes of s 459H.

[30] [2002] NSWSC 45

[31] (2006) 205 FLR 432

9. Effect of payment of debt prior to winding up hearing

In a number of cases the Court has considered the position where a company fails to comply with a statutory demand, the creditor files a winding up application and the company then pays the amount it owes to the creditor. In those circumstances, the presumption of insolvency that exists under 459C(2)(a) remains, and that leaves the question of whether or not the creditor is entitled to proceed with the winding up application.

In some cases, there has been a suggestion that once a debt is paid, the plaintiff's creditor status is gone and accordingly they are no longer entitled to petition for the company to be wound up – see for example *Australian Mid-Eastern Club Ltd v Yassim*[32]. However, the better view appears to be that a plaintiff need only be a creditor at the time of filing the winding up application rather than when it is heard. Therefore, even if the debt is paid after the application is filed, that does not preclude the winding up application from proceeding even if the plaintiff is no longer a creditor - see *Deputy Commissioner of Taxation v Visidet Pty Ltd ACN 003 743 986, In the Matter of Visidet Pty Ltd*[33].

However, the Court has a discretion as to whether or not it should make a winding up order under s 467(1) *Corporations Act 2001*. In *Visidet*, Gyles J commented that the grant of a winding up order is a discretionary order, and the fact that the debt had been paid would be a most material factor in the exercise of the discretion. In other words, if the debt has been paid, it is unlikely that the Court will exercise its discretion to grant a winding up order.

That position may however be different if the creditor, even if it has now been paid, is able to demonstrate a positive reason why the winding up proceedings should not be dismissed. That positive reason might be that the creditor is now owed additional monies that have not been paid. To the extent that the debt is paid, and the plaintiff wishes to continue with the winding up application, that plaintiff would not need to adduce some evidence regarding the debt they are now owed. However, s 459S would not preclude the company from challenging whether or not it in fact owes that money.

10. Solvency

In the event that a company seeks to resist a winding up application following a failure to comply with a statutory demand, the principal issue is likely to be whether or not the company is in fact solvent.

The question of whether a company is solvent is determined by a cash flow rather than a balance sheet test. S 95A *Corporations Act 2001* (Cth) provides that :

> *(1) A person is solvent if, and only if, the person is able to pay all the person's debts, as and when they become due and payable.*
>
> *(2) A person who is not solvent is insolvent*.

[32] (1989) 1 ACSR 399

[33] [2005] FCA 830

In determining this, the Court may take into account contingent or prospective liabilities of the company (s 459D).

The effect and implications of s 95A were summarised by Dodds-Streeton J in *Crema Pty Ltd v Land Mark Property Developments Pty Ltd*[34]:

> Section 95A of the Act enshrines the cash flow test of insolvency which, in contrast to a balance sheet test, focuses on liquidity and the viability of the business. While an excess of assets over liabilities will satisfy a balance sheet test, if the assets are not readily realisable so as to permit the payment of all debts as they fall due, the company will not be solvent. Conversely, it may be able to pay its debts as they fall due, despite a deficiency of assets.

Under 459S(1) *Corporations Act 2001* (Cth) a company is not entitled to rely on a ground that it could have raised in an application to set aside the statutory demand without leave of the court. That means that it will not be able to claim that the amount claimed in the statutory demand is not due and payable for the purposes of demonstrating solvency.

However, the question of what other debts the company faces may well be relevant to a consideration of whether or not it is solvent. That can give rise to various issues in determining whether or not certain liabilities constitute 'debts' that can be taken into account in the solvency analysis can raise numerous issues. By way of example:

- the test can involve some forward looking. The most extreme example is a life insurance case decided by the High Court in 1953 (*Insurance Commissioner v Associated Dominions Assurance Society Pty Limited*[35]*)* which found a life insurer to be insolvent in 1953 although the evidence was that it would pay all of its claims in full for about 7 years; and
- by contrast, the New South Wales Court of Appeal in *Attorney General v Edwards*[36] found that the particular companies there, namely Amaca Pty Ltd, Amaba Pty Ltd and MRCF (Investments) Pty Limited were probably not insolvent even though actuarial studies indicated that tort claims against them would be likely to continue and exhaust their assets in 2 or 3 years. That decision was on the basis that individuals who might in the future have tort claims against the company were not contingent creditors unless or until their cause of action had accrued and could not be taken into account in assessing present solvency prior to that point.

S 459 provides that in determining an application for a company to be wound up in insolvency, a contingent or prospective liability can be taken into account. However, the Court has adopted a narrow construction of the term 'prospective liability' - for example in *Re Simionato Holdings Pty Ltd*[37] Mansfield J commented that phrase

> may encompass the circumstance where the liability will, not may, arise at some uncertain time in the future from an existing set of circumstances. (emphasis added)

In that case, the company sought to resist a winding up application on the grounds of solvency. In that context, the Court considered whether a possible liability pursuant to a $3.3m claim that had

[34] (2006) 58 ACSR 631 at p 652

[35] (1953) 89CLR 78.

[36] (2004) 60 NSWLR 667

[37] (1997) 15 ACLC 477

been brought against the company in separate proceedings. On the facts, it was held that claim was a contingent claim that could be taken into account in assessing solvency.

11. Opposing a winding up application on grounds of solvency

As described above, where there has been a failure to comply with a statutory demand, there is a presumption that the company is insolvent. However, under s 459C(3) *Corporations Act 2001*, the company is able to rebut that presumption by proving that it is solvent.

In *Ace Contractors & Staff Pty Ltd v Westgarth Development Pty Ltd*[38] Weinberg J set out a number of principles in relation to proving solvency:

- to discharge the onus of proving solvency, the company should ordinarily present the Court with the "fullest and best" evidence of its financial position;
- unaudited accounts and unverified claims of ownership or valuation are not ordinarily probative of solvency, and nor are bald assertions of solvency arising from a general review of the accounts;
- there is a distinction between solvency and a surplus of assets – a company may be at the same time insolvent and wealthy. The nature of the company's assets and its ability to convert those assets into cash within a relatively short time, at least to the extent of meeting its debts as and when they fall due, must be considered in determining insolvency;
- the adoption of a cash flow test does not mean that the extent of the company's assets is irrelevant to the enquiry, and credit resources must also be taken into account; and
- the question of solvency must be assessed at the date of the hearing. However, this does not mean that future events are to be ignored.

Proving solvency is therefore an onerous task and likely to be an expensive process for the company.

A 2007 decision by Finkelstein J in the Federal Court demonstrates that the type of evidence required to prove solvency will vary from case to case. *In Deputy Commissioner of Taxation v De Simone Consulting Pty Ltd*[39], the Deputy Commissioner of Taxation issued a statutory demand to De Simone Consulting Pty Ltd for unpaid tax in the sum of $408,000. No application was made to set aside the statutory demand, and a winding up application was commenced by the Deputy Commissioner of Taxation. At the return date, the company's director produced a suitcase containing several hundred thousand dollars in cash and the application was adjourned in order that the company be given the opportunity to file proper evidence of solvency. The director later filed an affidavit and paid part of the debt. The winding up application was withdrawn and the Deputy Commissioner was awarded his costs. That costs award was appealed. The Deputy Commissioner argued the director's affidavit did not prove solvency as audited accounts had not been produced. Finkelstein J however rejected the proposition that audited accounts would always be required to prove solvency. He held that the type of evidence required will vary from case to

[38] [1999] FCA 728 at paragraph 44

[39] [2007] FCA 548

case. The greater the degree of doubt regarding the financial position of the company, the better the evidence that will be required and that might include the need for audited accounts along with verified proof of ownership. Here, Finkelstein J held that while the company had not put on the 'best and fullest' evidence of solvency, the evidence (if unchallenged) established a prima facie case of solvency. The Deputy Commissioner was awarded his costs up to the date of the affidavit, with each party to pay its own costs after that date.

12. Other grounds for opposing a winding up application

There are a number of other grounds upon which a company can oppose a winding up application (a winding up order being a discretionary remedy) including:

- where creditors have a better prospect of payment without winding up – for example in *Re Presha Engineering (Aust) Pty Ltd*[40], the court acknowledged that an adjournment may be justified:

  > in exceptional circumstances where there would be better prospects existing for the creditors as a whole if the company were allowed to trade on than there would be if the company were wound up.

- where the winding up application is based on an unpaid judgment debt in circumstances where that judgment has been appealed;

- where a voluntary liquidation is in progress. In *Deputy Commissioner of Taxation v Tull Reinforcing Pty Ltd*[41] Besanko J commented:

  > A Court will not make an order winding up a company in insolvency in circumstances where the company is already the subject of a creditors' voluntary winding up unless there is good reason to do so. The reason for this is that in the ordinary case, there is little practical difference between a creditor's winding up and a form of winding up imposed by order of the court.

- the Court may take into account the views of other creditors and whether those creditors oppose the application when deciding whether or not to exercise its discretion to make a winding up order.

Examples of cases in which the court has exercised its discretion not to make a winding up order are:

(a) *Ace Contractors & Staff Pty Ltd v Westgarth Development Pty Ltd* in which Weinberg J exercised the discretion to decline to order winding up (notwithstanding the company's failure to rebut the presumption of insolvency) in circumstances where the applicant accepted that the evidence did not demonstrate that the company was insolvent, the amount claimed under a statutory demand was not substantial when compared with the projected profit from the project, and the winding up would put at risk a going concern which could adversely affect other unsecured creditors; and

[40] (1983) 1 ACLC 675 at 677

[41] (2006) 24 ACLC 726

(b) *Fire & All Risks Insurance Co Ltd v Southern Cross Exploration NL*[42] in which Hodgson J granted an adjournment in circumstances where the company had substantial assets, the adjournment sought was short and particular problems which had contributed to its inability to pay its debts may have been due to the activities of another company and its controller.

However, in other cases the courts have commented that there is a public interest in not allowing a company that is insolvent to continue to trade, and the circumstances in which the court will decline to exercise its ability to make a winding up order are rare.

13. Disposition of property after commencement of winding up

Under s 468(1) Corporations Act 2001,

> Any disposition of property of the company, other than an exempt disposition, and any transfer of shares or alteration in the status of the members of the company made after the commencement of the winding up by the Court is, unless the Court otherwise orders, void.

In *Re Country Stores Pty Ltd* the company reached an agreement to sell its business to a purchaser on 1 February 1987, with the property to pass on 4 February 1987. On 2 February 1987, the company went into provisional liquidation. The issue for the Court was whether that constituted a void disposition. The Court found that between 1 February 1987 and 4 February 1987, the purchaser was entitled to the stock, and on 1 February 1987 in equity there was a disposition of the stock and other assets. It was held by Williams J that completion of the proposed purchase would not constitute a void disposition. That decision relied on the judgment in *Re Margart Pty Ltd (in liq), Hamilton v Westpac*[43]:

> ..whatever meaning the word "disposition" may have when used in the phrase "any disposition of property of the company" in s368, it does not include the process by which a person with the beneficial interest in the property obtains that property, or the proceeds of its realisation, from the company at a time when he is entitled to have it. In all reality a person would not normally be described as disposing of his property when he hands it over to another to whom he had previously promised to deliver it on the happening of a certain event when that event occurs. This is only another way of stating in legal terms the proposition that the word "disposition" when used with reference to property normally has the meaning of connoting a change in the beneficial ownership of an asset by transfer or other type of dealing.

In *Re Country Stores* Williams J put the position as follows:

> If because of a transaction entered into by the company prior to the commencement of the winding up, the beneficial interest in some part of the company's property has passed to another then there is no "disposition" of that property when after commencement of the winding up the property is handed over to that other to whom the company is obliged to deliver it.

In this decision, the fact that the contract dealt with property and the Court would order specific performance appears to have been critical to the decision. It remains to be seen whether a contract dealing with cash would have been treated in the same way.

[42] (1986) 10 ACLR 683

[43] (1984) 79 FLR 330

Sheppard and Lindgren JJ in *Wily v Commonwealth*[44] found that s468(1) only operated in respect of property in which the company has a beneficial interest in the sense of it being available in a winding up and to the extent of that interest. Sackville J in dissent took a narrower approach commenting at s 554 that *Re Margart* assumes that s468 can work where the company does or does not have the beneficial interest but it does not apply where there is a dealing by someone who has the right to say how the property is to be dealt with and "*whatever interest the company has in that property gives it no control or management over the company or power to interfere.*"

It seems to be the case that where a beneficial interest in property exists by reason of, for example, a prior unconsummated sale, s468 does not apply.

14. Choosing a liquidator

When a winding up application is made, the creditor will generally file a consent from a liquidator agreeing to be appointed as liquidator if the company is wound up. In certain circumstances, careful consideration may need to be given as to whether or not a particular individual should be put forward as the proposed liquidator. Liquidators (unlike private receivers and administrators) are officers of the court where the liquidator is a Court liquidator. Section 532 Corporations Act 2001 (Cth) contains a number of circumstances in which a liquidator will be disqualified from consenting to act as liquidator of a company without leave of the court including:

(c) if the person, or a body corporate in which the person has a substantial holding, is indebted in an amount exceeding $5,000 to the company or a body corporate related to the company;

(d) if the person is, otherwise than in his or her capacity as liquidator, a creditor of the company or of a related body corporate in an amount exceeding $5,000;

(e) if the person is an officer of employee of the company (otherwise than by reason of being a liquidator of the company or of a related body corporate); and

(f) if the person is an auditor (or partner or employee of an auditor) of the company.

The provisions of s 532(6) should also be noted – that section provides that a person is taken to be an officer, employee or auditor of a company if they have held that role at any time within the last two years (unless ASIC directs that paragraph will not apply).

However, even if a particular liquidator is not precluded from consenting to act by the provisions of s 532, careful consideration should nonetheless be given as to whether it would be appropriate to put that person forward. The Court has given a number of indications in that regard:

- a liquidator must not only be independent but must also be seen to be independent.
- where there is a real prospect, even if small, of a conflict of interest and duty, a liquidator should not accept an appointment as liquidator; and
- the liquidator must be impartial and if there is any evidence of possible bias that person will not be appointed.

[44] 136 ALR 527

In *Re Biposo Pty Ltd; Condon v Rodgers*[45], liquidators were removed on the application of the directors of the company because they were perceived by the Court to be too closely associated with the major creditor of the company in liquidation. Young J was of the view that an unacceptable risk of conflict was created in the circumstances of that case, by reason of the closeness of the relationship between the liquidators and the creditor. The liquidators had been approached to act by a barrister acting for the creditor, examinations of the directors were proposed and there was some evidence tending to suggest that the liquidators had accepted the creditor's views in relation to the conduct of the examinations. Information about the company had been provided by the liquidators to the creditor. There was existing litigation between the creditor and the company. There was also the possibility of an unfair preference claim being available to the company against the creditor.

Young J was of the view that these and some other factors taken together would show to a reasonable bystander that the liquidators had got "too close" to the creditor and their impartiality was impaired. He stood the matter over to enable the liquidators to resign and held that they should pay the costs of the proceedings.

15. Terminating a winding up

Winding up proceedings come to an end when a company is either deregistered or the proceedings are terminated or stayed. Deregistration is the final step that is taken after the affairs of the company have been wound up by the company. After deregistration, the company ceases to exist.

S 482 CA provides that at any time during the winding up of a company, the court may make an order terminating the winding up indefinitely, for a limited time or on a specified day. An application to terminate the winding up of a company may be made by the liquidator, a creditor or a contributory of that company or, in the case of life insurance companies, APRA.

The power of the court to terminate the winding up of a company is a discretionary power. In *Taylor, in the matter of Origin Internet Solutions Pty Ltd (in liquidation) (No 2)*[46] the Federal Court noted the following in relation to its assessment of the merits of an application to terminate a winding up:

- the court will not simply act on the assent of the creditors, although their views are important;
- the views of the shareholders must also be taken into account; and
- it is necessary to consider whether the termination will be conducive or detrimental to commercial morality and in the interests of the public at large.

In *De Groot and Sydney Dive Centre Ltd*[47] Justice Gyles indicated that "*caution needs to be exercised before a winding up is stayed or terminated lest an insolvent company is returned to commerce*." In that case, the company's liabilities, when loans from the company to its directors

[45](1995) 13 ACLC 1271

[46] [2004] FCA 1354

[47] [2006] FCA 159

were taken into account, exceeded its assets. His Honour was therefore prepared to make orders that the winding up be terminated only upon the directors of the company undertaking that:

- they would personally guarantee the company's debts;
- they would not make any demand for the amounts owed to them by the company; and
- in the event of a future winding up, they would not make a claim for the amounts owed to them by company in priority of other unsecured claims.

If the original application for winding up is made on the basis of an error or irregularity, the court will still use its discretion as to whether the winding up should be terminated. However, a company will have a right to have its winding up terminated if the error or irregularity is 'fundamental'. Accordingly, in *Double Bay Newspapers* v *The Fitness Lounge*[48] the plaintiff company was able to have the winding up of the defendant company terminated following its realisation that the original application for winding up had been made in breach of an agreement reached between the companies.

16. Conclusion

The effects of a winding up order are drastic. The company ceases to be able to carry on business except for the limited purpose of the winding up and creditors lose their right to commence proceedings and must instead prove in a winding up.

A winding up order is a discretionary remedy and in considering whether or not to make such an order, the Court must weigh up a number of competing factors. Those factors include a public interest in not allowing companies that are insolvent to continue trading, a public interest that solvent companies are not placed into liquidation and the broader interests of the creditors as a whole.

Applying for a winding up order can be a costly and time-consuming process. While a successful application may ultimately be reimbursed their taxed costs out of the property of the company, they must prosecute the winding up proceedings at their own expense until a liquidator is appointed.

As outlined above, there are a number of other issues that a person of company applying for a company to be wound up in insolvency, including:

- whether the leave of the Court needs to be sought to make the application;
- whether to issue a statutory demand to the company;
- whether to seek the appointment of a provisional liquidator;
- who to put forward as the proposed liquidator;
- how to react in the event that the debt owed by the company is paid after the winding up application is made; and
- ensuring that the procedures set out in the Corporations Act and court rules are strictly adhered to.

[48] [2006] NSWSC 226

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