

# TECHNICAL INSIGHTS

Issue 1 - 2016

## Seeking leave to commence or continue with proceedings against a company in winding up or administration

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### Introduction

The prohibition against commencing or continuing court proceedings against a company in winding up is an essential feature of the liquidation process. The prohibition applies with respect to a court winding up, including provisional liquidation (section 471B, Corporations Act) and a creditors' voluntary winding up (section 500(2), Corporations Act).

The purpose and function of these provisions is to ensure that a company in liquidation is not subjected to a multiplicity of actions which would be both expensive and time-consuming, and in some cases unnecessary, taking the liquidator's attention and available funds away from the orderly winding up of the company.

In *Ogilvie Grant & Anor v East* (1983) 1 ACLC 742, McPherson J, a recognised authority on company law, observed that:

"What is substituted for litigation in the ordinary form is a procedure by which a claimant lodges a verified proof of debt with the liquidator, who admits or rejects it wholly or in part, and from whom an appeal lies to a judge... there can be no doubt that ordinarily such a procedure is, and is designed to be, much more expeditious and less expensive than ordinary procedures by way of action."

Note that the restrictions imposed by these provisions do not apply to proceedings directed at realising a secured creditor's security interests: see section 471, Corporations

Act; *MSI (Holdings) Pty Ltd v Mainstreet International Group Ltd* (2013) QCA 27. Also the relevant provisions are concerned to restrict a "proceeding in a court." Accordingly proceedings such as a commercial arbitration submission pursuant to an arbitration clause are not intended to be caught by the sections: see *Auburn Council v Austin Australia Pty Ltd* (2004) NSWSC 141.

Importantly, the statutory restriction on actions and proceedings is accompanied by a power of the court to grant leave to proceed; but the relevant sections give no direct indication of the circumstances in which such leave is to be granted. As a result the power to grant leave has been exercised by the courts with caution and in accordance with well-established judicial guidelines.

### Matters relevant to grant of leave

The courts have on occasions sought to summarise the factors that may influence the decision to grant leave to proceed.

This occurred in *Cassegrain v Gerard Cassegrain & Co Pty Ltd* (in liquidation) (2012) NSWCA 435 where the NSW Court of Appeal adopted the commentary in *Austin and Black's Annotations to the Corporations Act* (para 5.471B), which states:

"The relevant factors to be taken into consideration include the amount and seriousness of the claims; the degree and complexity of the legal and factual issues involved; the stage to which the proceedings, if commenced, have progressed;

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the risk that the same issues would be relitigated if the claims were to be the subject of a proof of debt; whether the claim has arguable merit; whether proceedings are already in motion at the time of liquidation; whether the proceedings will result in prejudice to creditors; whether the claim is in the nature of a test case for the interest of a large class of potential claimants; whether the grant of leave will unleash an avalanche of litigation; whether the cost of the hearing will be disproportionate to the company's resources; delay and whether pre-trial procedures such as discovery and interrogatories are likely to be required or beneficial."

In addition to the above factors a court will usually grant leave to bring claims that could not be proved in the winding up, such as an injunction, or a claim for a proprietary remedy. Cases of this kind will have a bearing on the assets available in the winding up and accordingly court resolution of the issues involved will ultimately benefit both the claimant and the winding up process.

For example, in the recent case *In the matter of Bigdeal Artist Management Pty Ltd (in liquidation)* (2015) NSWSC 936 an order was sought for leave under section 500(2), Corporations Act to proceed with a claim against a company in liquidation where the claim was of a proprietary nature. In the case the claimant was seeking to establish that particular monies paid to the company in liquidation by a third party were monies held by the third party on trust for the claimant such that the monies were held by the company subject to the trust in favour of the claimant.

In granting leave to proceed with the claim against the company the court found that the claim had a solid foundation; and further, that where a proof of debt procedure does not permit proprietary claims to be adequately advanced or adjudicated, granting leave to proceed was appropriate (see para. 16).

Similarly the courts have recognised that leave may be granted in cases where the company was insured against the relevant liability. In such cases the claimant will seek leave to proceed against the company in liquidation in order to obtain payment from the insurer, who will usually be joined to the proceedings. Given that the proposed proceedings will not result in prejudice to other creditors, and that the restriction on proceedings is not intended to provide protection to the company's insurer, the courts have shown a willingness to grant leave to proceed in cases of this kind : see *In the matter of Ozrac Engineering NSW Ltd*

(*in liquidation*) (2013) NSWSC 740.

### Leave applications with respect to company in administration as opposed to winding up

The provisions giving rise to a stay on proceedings against a company in liquidation have an equivalent provision where a company has entered into administration: see section 440D, Corporations Act. However, the courts have consistently recognised that the differences between liquidation and administration are significant, such that an application under section 440D seeking leave to proceed against a company in administration will rarely be successful.

The position was addressed by the court in *Foxcroft v The Ink Group Pty Ltd* (1994) 12 ACLC 1063, SC(NSW) in the following terms:

"The provisions of Part 5.3A... provide that there shall be a complete freeze of proceedings against the company during the administration so that the administrator can have time to assess the situation, and the company's creditors have an opportunity to work out the net position and adopt an attitude under section 439C which will be in their common interest. To allow one creditor or potential creditor to proceed would not only take the administrator's attention from what he needs to do under the division in a relatively short period of time, but it would also involve costs in running the legal action... as well as perhaps giving the claimant some advantage over other creditors... Accordingly, it seems to me that an application under section 440D will rarely be granted."

Although the court recognised that there will be situations in administration where it would be appropriate to grant leave, such as where the company is insured against the liability the subject of the proceedings or where the claim against the company involves a proprietary remedy, it will be difficult in the normal course to obtain leave to continue with proceedings against a company in administration.

Without significant restraint on proceedings against the company in administration, the objectives of administration and the statutory role of the administrator will be easily frustrated. By way of comparison the winding up process is not impeded to the same degree by allowing proceedings to continue, such that the courts are in a position to adopt a higher level of responsiveness to leave applications with respect to a company in winding up than is the case with proceedings against a company in administration.

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### Concluding observations

The reason for imposing a requirement of leave in the case of litigation against companies in liquidation was recognised by the NSW Supreme Court over a century ago when it acknowledged that:

“...a company in liquidation is not to be harassed and its assets wasted by unnecessary litigation, and the leave of the court is therefore required as a safeguard. Before any action can be brought or continued against a company, the court must investigate the intended litigation.”

In more recent times the courts have sought to develop cohesive guidelines and identified factors that will be relevant in determining when leave to proceed will or will not be granted.

The significance of those guidelines will be apparent to claimants who have instituted or intend to institute proceedings against a company, only to learn that the company has proceeded into liquidation or administration.

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