

# BYPASSING THE Bringing proceedings on behalf

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There are practical issues to consider in representing a plaintiff who wants to take action on behalf of a company, if the company's liquidator is unwilling or unable to do so.

IT IS NOT UNCOMMON FOR PROCEEDINGS to be brought on behalf of companies in liquidation for the purposes of recovering company property or asserting rights held by the company in order to ultimately benefit creditors.

Ordinarily, such proceedings are prosecuted by the appointed liquidator who is able on his or her own initiative to decide whether proceedings should be commenced.<sup>1</sup> Sometimes, however, a liquidator refuses or fails to commence (or continue) proceedings on behalf of the company in liquidation. In such circumstances, who then may bring (or continue) proceedings on the company's behalf?

## Standing

The general rule is that for a wrong done to a company, the company is the proper plaintiff in an action to seek redress (the rule in *Foss v Harbottle*).<sup>2</sup> However, where a company is in liquidation, the liquidator is the appropriate person in whom is vested the authority to decide whether a company should take or continue action to recover damages or secure other relief for injury done to a company.<sup>3</sup> This is because upon liquidation, both the directors and shareholders in general

meeting cease to have authority to institute or continue litigation by the company.<sup>4</sup> Further, where a company has been placed in liquidation, the company's name should only be used as plaintiff by direction of the liquidator.<sup>5</sup>

The Courts have held that where a liquidator refuses to bring proceedings on behalf of a company in liquidation, it is open to other persons to bring such claims. It has been said that the Court has an inherent power to authorise certain persons to bring proceedings on behalf of a company in liquidation<sup>6</sup> (discussed further below). Traditionally, the eligible class of persons is comprised of "parties to the liquidation" – that is, creditors and contributories (shareholders) of the company.<sup>7</sup>

The underlying principle for allowing creditors and contributories to bring such proceedings derives from an analogy with the rights of a beneficiary under a trust where the trustee fails to institute proceedings to recover trust assets or debts.<sup>8</sup> In the relatively recent decision of *Russell and Anor v Westpac Banking Corporation and Ors*,<sup>9</sup> the Full Court of the South Australian Supreme Court held that the eligible class of persons extended to guarantors of the company.

This extension was said to be justified on the basis that the rationale of such applications was that the failure of a liquidator to institute proceedings to recover assets or debts of the company ought not to operate to the prejudice of the persons in whose interests the winding up is carried out and who are entitled to benefit from the assets of the company.<sup>10</sup>

It should also be noted that the Court has the power to appoint a receiver in cases where it decides to permit proceedings to be commenced and prosecuted in the name of a company in liquidation by a person other than the liquidator.<sup>11</sup>

Creditors and contributories may also be authorised to commence proceedings under the *Corporations Act 2001* (the Act). For example, the Act contains a number of provisions which give the Court statutory jurisdiction to supervise the conduct of a liquidator with respect to litigation proposed in the name of or on

behalf of the company.<sup>12</sup> Where a liquidator is invited to commence proceedings to assert rights of a company and declines to do so, an aggrieved creditor or contributory may make an application under these provisions.<sup>13</sup>

In addition to those persons mentioned above, Part 2F.1A of the Act extends the eligible class of persons to include former members, persons entitled to be registered as a member, and officers and former officers of the company.<sup>14</sup> The Act also allows members, former members and persons entitled to be registered as a member of a related body corporate to bring proceedings on behalf of a company. However, there is some question whether Part 2F.1A applies to a company in liquidation (see below).

For completeness, it should be mentioned that the liquidator also has the power to assign a cause of action (being a chose in action and hence, property) to a third party: s.477(2)(c). (It is beyond the scope of this article to discuss the liquidator's power to do this.)<sup>15</sup>

## The Court's inherent power

The Court has an inherent power to permit proceedings to be taken in the name of a company in liquidation upon the application of a creditor or contributory. The existence of such a power was confirmed by McLelland J in *Aliprandi v Griffith Vintners Pty Ltd (in liq)*,<sup>16</sup> where his Honour said that "the power of the court to order that a creditor or contributory of a company in liquidation be authorised to use the company's name as a plaintiff ... [is] a procedure of respectable antiquity and is sanctioned by high authority".<sup>17</sup> In my opinion the Court's inherent power has survived, notwithstanding the enactment of Part 2F.1A of the Act (see below).

The Court's approach in such applications has been described in the following terms: "A judge in winding up is the custodian of the interests of every class affected by the liquidation. It is his duty ... to see to it that all assets of the company are brought into the winding up. In authorising proceedings, especially if they may or will involve some drain upon the

# LIQUIDATOR

## of a company in liquidation

assets, he must satisfy himself as to their probable success; where ... they involve no possible charge on assets, he will nevertheless be careful to see that any action taken in the company's name under his authority is not vexatious or merely oppressive".<sup>18</sup>

In considering applications by a party other than a liquidator to bring proceedings on behalf of a company in liquidation the Court takes into account the following factors.

### Arguable case

The Court needs to consider whether the cause of action asserted in the pleadings, together with such evidence as is relied on in the application, demonstrates an arguable case for the relief which the proposed litigation would seek.<sup>19</sup> In *Aliprandi*, McLelland J inquired as to whether there was an arguable case in support of the claims which the applicant wished to make, concluding that there was no arguable case except in one instance.<sup>20</sup> His Honour made his inquiry by reference to the material which was placed before the Court by the parties to the application, not by reference to a draft pleading.

McLelland J's formulation was approved by the Full Federal Court in *Magarditch v ANZ*.<sup>21</sup> In the latter case, the Federal Court referred to the decision of *Vagrand Pty Ltd (in liq) v Fielding*,<sup>22</sup> where it was said that an applicant for leave to proceed against a company in liquidation was required to satisfy the court that the claim had a solid foundation and would give rise to a serious dispute, although it was not necessary for the applicant to establish a *prima facie* case in the accepted sense.<sup>23</sup>

It is not necessary for an applicant to produce to the Court evidence sufficient to establish affirmatively that the proposed proceedings will necessarily be successful. The Court is entitled to infer, if appropriate, from the evidence before it, that additional relevant evidence is likely to be or may be available from other sources for the hearing.<sup>24</sup> Also, every

application will of course be subject to the general prohibition on vexatious and oppressive proceedings.<sup>25</sup>

### The liquidator's attitude to the proposed proceedings

The Court is entitled to have the assistance of the liquidator in making its assessment as to whether an arguable case has been demonstrated. The Court will normally give weight to the liquidator's view.<sup>26</sup> In *Partnership Pacific Ltd v Aliprandi*,<sup>27</sup> the Court said that for the application to succeed, more must be shown than the simple provision of an indemnity in the liquidator's favour. In particular, if the liquidator is of the view that the proposed litigation is soundly based, but he cannot

and

□ the liquidator is not exposed to personal liability without proper protection.

The Court may also have regard to the risks which the litigation poses for the other party (or parties), given that the plaintiff is a company in liquidation, the assets of which are to be protected. To this end, the Court may require that the person who conducts the litigation gives an indemnity supported by security for the benefit of the company and the liquidator, and perhaps also security for costs to protect the other party to the litigation.<sup>28</sup>

It may also be possible for the Court to make an order permitting the liquidator

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pursue it because of absence of funds, a court will be more disposed to permit proceedings by a contributory in the company's name than if the liquidator has decided that there is no reasonable foundation for the claim.

### Practical considerations

In addition to the above matters, the Court needs to be satisfied that practical considerations support the initiation of the proceedings. Typically, the applicant offers to indemnify the company in liquidation and the liquidator in respect of the proceedings, and to conduct the proceedings in such a fashion that liability to pay costs is undertaken by the applicant rather than the company to the extent that it is possible to do so. In particular, the Court will wish to be satisfied that:

□ the assets of the company in liquidation are not put at risk by the proceedings;

to be excused from the proposed proceedings, in order to protect the liquidator from personal liability for such proceedings.<sup>29</sup> In that regard, it should be noted that there is no legitimate basis (except where the liquidator has been guilty of misconduct) on which a costs order could be made against the liquidator personally in proceedings between the company and a third party, to which the liquidator is not a party. Similarly, there is no principle to justify the making of an order for costs against a liquidator who is not a party, where the court authorised the use of the company's name in proceedings by some other person.<sup>30</sup>

### Derivative action under Part 2F.1A of the Act

Part 2F.1A of the Act provides for a statutory derivative action and supplants

the general law exceptions to the rule in *Foss v Harbottle*. In NSW there is differing opinion as to whether Part 2F.1A applies to companies in liquidation, although the balance of authority suggests that it does.<sup>31</sup> The dissenting view is that of Justice Einstein in *BL & GY International Co Ltd v Hypec Electronics Pty Ltd*.<sup>32</sup> The view that Part 2F.1A does apply to a company in liquidation is supported by the fact that ss.236 and 237 apply to a "company", which is defined in s.9 of the Act to include a company in liquidation. In the absence of a clear statutory provision to the contrary, Part 2F.1A would seem therefore to apply to a company in liquidation.

**Satisfy requirements**

Sub-section 237(2) of the Act provides that the Court must grant the application to bring proceedings on behalf of a company if it is satisfied of certain matters. The applicant bears the onus of satisfying the Court that, on the balance of probabilities, those requirements have been fulfilled.<sup>33</sup> The requirements were discussed in detail by his Honour Justice Palmer in the recent decision of *Swansson v R A Pratt Properties Pty Ltd and anor*<sup>34</sup> and are summarised below:

**Probable that company will not itself bring proceedings**

In most cases this should be easy to establish as the liquidator will have indicated a reluctance to bring proceedings on behalf of the company in liquidation. However, where there is no clear-cut and authoritative refusal by the company to take specific proceedings after a proper request to do so by or on behalf of the applicant, the applicant bears the onus of establishing that in all of the relevant circumstances actual refusal or the probability of refusal, is to be inferred.<sup>35</sup>

**Applicant is acting in good faith**

In *Swansson*, Palmer J was of the view that there are at least two interrelated factors which the courts will always consider in determining whether the good faith requirement of s.237(2) (b) is satisfied.<sup>36</sup> The first is whether the applicant honestly believes that a good cause of action exists and has a reasonable prospect of success. Whether the applicant honestly holds such a belief would not simply be a matter of bald assertion: the applicant may be disbelieved if no reasonable person in the circumstances could hold that belief.

The second factor is whether the applicant is seeking to bring the derivative suit for such a collateral purpose as would amount to an abuse of process. Good faith will be relatively easy for the applicant to demonstrate where the application is made by a current shareholder and the derivative action seeks recovery of property so that the value of the applicant's shares would be increased. However,

where the applicant is a former shareholder or officer with nothing obvious to gain by the success of the derivative action, the Court will scrutinise carefully the purpose for which the derivative action is said to be brought.

**Best interests of the company**

Section 237(2) (c) requires the court to be satisfied, not that the proposed derivative action *may be, appears to be, or is likely to be*, in the best interests of the company but, rather, that it *is* in its best interests.<sup>37</sup> The requirement under this limb requires the applicant to establish, on the balance of probabilities, a fact which can only be determined by taking into account all of the relevant circumstances.

According to Palmer J, such an inquiry will normally require the applicant to bring forward evidence at least to the following matters:

- evidence as to the character of the company; that is, whether the company is a small proprietary company, and so on;
- evidence as to the business of the company, if any, so that the effect of the proposed litigation may be appreciated;
- evidence enabling the court to form a conclusion whether the substance of the redress which the applicant seeks to achieve is available by a means which does not require the company to be brought into litigation against its will; and
- evidence as to the ability of the defendant to meet at least a substantial part of any judgment in favour of the company in the proposed derivative action so that the court may ascertain whether the action would be of any practical benefit to the company.

Sub-section 237(3) sets out a number of rebuttable presumptions that granting leave is not in the best interests of the company. For example, where it is established that the proceedings are by the company against a third party and the company has decided not to bring the proceedings. However, it is doubtful if these rebuttable presumptions apply to a company in liquidation.<sup>38</sup>

**Serious question to be tried**

If the applicant is applying for leave to bring proceedings, sub-section 237(2) (d) provides that the applicant must demonstrate that there is a serious question to be tried.

There is no definition of the expression "serious question to be tried" in the Act. However, in *Swansson* the Court held that the applicant has the same relatively low threshold to surmount as in the case of an application for an interlocutory injunction.<sup>39</sup>

In summary, practitioners should always remember that although there are general considerations which a Court will take into account in determining whether to grant permission to a party to bring proceedings, each case will ultimately

turn upon its own facts. Importantly, the Court will need to be satisfied that the proceedings are not oppressive or vexatious, that the assets of the company (if any) are not put at risk and the liquidator is not exposed to personal liability. □

ENDNOTES

1. *Gray v Bridgestone Aust Ltd* (1986) 4 ACLC 330. See also Keay, *The Law of Company Liquidation*, 4th edition at p.335.
2. (1843) 67 ER 189.
3. *Scarel v City Loan & Credit* (1988) 79 ALR 483 at 490.3 per Gummow J. See also *Russell v Westpac Banking Corp* (1994) 13 ACSR 5. The cases dealing with *Foss v Harbottle* and its exceptions involve going concerns and hence are of little relevance to the present discussion.
4. *Scarel v City Loan & Credit* (1988) 79 ALR 483 at 490.5 per Gummow J.
5. *Ibid* at 487.3 per Gummow J.
6. *Aliprandi v Griffith Vintners Pty Ltd (in liq) and anor* (1991) 6 ACSR 250.
7. *Cape Breton Co v Fenn* (1881) 17 Ch D 198 at 208 per Cotton LJ.
8. *Ibid* at 207 per Jessell MR.
9. (1994) 13 ACSR 5.
10. *Ibid* at 8.5.
11. *Vouris as liquidator of Cadima Express Pty Ltd and ors v Deputy Commissioner of Taxation* (1999) 33 ACSR 527 at 539.3 per Austin J. See also the series of Butler Pollnow cases referred to by his Honour at 538.4.
12. Section 477(6) of the Act – Court to control exercise of powers of a liquidator; s.511 of the Act – applications to the Court to have questions determined or powers exercised; s.1321 of the Act – appeals from decision of liquidators.
13. *Vouris* op cit at 536.3 per Austin J.
14. Section 236(1).
15. See for example *Bank of Melbourne Ltd v HPM Pty Ltd (in liq)* (1997) 26 ACSR 110; *UTSA Pty Ltd (in liq) v Ultra Tune Australia Pty Ltd and ors* (1996) 21 ACSR 251 and *Movitor Pty Ltd (in liq) v Sims* (1996) 19 ACSR 440.
16. (1991) 6 ACSR 250.
17. 6 ACSR 250 at 252.3. The 'high authority' to which his Honour refers is probably that in *Re Bank of Gibraltar and Malta* (1865) LR 1 Ch App 69; *Re Imperial Bank of China India and Japan* (1866) LR 1 Ch App 339; *Lloyd-Owen v Bull* (1936) 4 DLR 273 (Privy Council) and *Cape Breton Co v Fenn* (1881) 17 Ch D 198.
18. *Lloyd-Owen v Bull* [1936] 4 DLR 273 at 276 (Privy Council).
19. *Vouris* op cit at 536.8.
20. *Ibid* at 253.
21. (1999) 32 ACSR 367 at 377
22. (1993) 10 ACSR 373 at 380
23. The test applies is akin to that now used in considering whether interlocutory relief should be granted, that is, a serious question to be tried. See *Castlemaine Tooheys Ltd v South Australia* (1986) 161 CLR 148 at 153 where Mason ACJ made it clear in the context of an interlocutory debate that the test of a serious question to be tried is generally to be preferred to that of a *prima facie* case.
24. *Eros Cinemas Pty Ltd v Nassar* (1996) 14 ACLC 1374.
25. *Ibid* at 1378.
26. *Vouris* op cit at 537.
27. (1990) 4 ACSR 51 at 54 per Cole J.
28. *Vouris* op cit at 537.9.
29. *Ibid*.
30. *Ibid* at 538.2.
31. *Roach v Winnote Pty Ltd (in liq)* [2001] NSWSC 822 per Santow J; *Brightwell v RFB Holdings Pty Ltd (in liq)* [2003] NSWSC 7 per Austin J.
32. [2001] NSWSC 705.
33. *Swansson v R. A. Pratt* (2002) 42 ACSR 313 at 319.2 per Palmer J.
34. *Ibid*.
35. *Ibid* at 319.3.
36. *Ibid* at 320.5.