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Contents of this issue	Para
Legislation	
Acts	
Trade Practices Amendment (Cartel Conduct) Act 2009 (No 59 of 2009)	[1567]
Fair Work (State Referral and Consequential and Other Amendments) Act 2009 (No 54 of 2009)	[1568]
Corporations Amendment (No 1) Act 2009 (No 9 of 2009)	[1569]
Corporations Amendment (Short Selling) Act 2008 (No 146 of 2008)	[1570]
Cross-Border Insolvency Act 2008 (No 24 of 2008)	[1571]
Regulations	
Corporations Amendment Regulations 2009 (No 7) (SLI 198 of 2009)	[1572]
Corporations Amendment Regulations 2009 (No 6) (SLI 175 of 2009)	[1573]
Corporations Amendment Regulations 2009 (No 5) (SLI 103 of 2009)	[1574]
Corporations Amendment Regulations 2009 (No 4) (SLI 70 of 2009)	[1575]

ARTICLE

[1588] *Ilhan v Cvitanovic* (2009) 69 ACSR 702

by Farid Assaf, Barrister at law, Blackstone Chambers, Sydney

In the law of company liquidation, appeals against decisions by liquidators to reject proofs of debt are quite common. Most occur within the context of a compulsory winding up. In the recent decision of *Ilhan v Cvitanovic*, Justice Barrett of the NSW Supreme Court was required to decide whether it is open to a liquidator of a company placed into voluntary liquidation to reject a proof of debt based upon a judgment debt.

The facts

The case commenced with the purchase by the plaintiffs of two air conditioning units from Joyce Mayne Mount Druitt (the trading name of Hartrez Pty Ltd (Hartrez)). A dispute arose between the plaintiffs and Hartrez as to the quality and fitness of the air conditioning units and the plaintiffs subsequently took proceedings against Hartrez in the Consumer, Trader and Tenancy Tribunal. The plaintiffs succeeded in the CTTT, and subsequently obtained judgment against Hartrez without any hearing on the merits. A writ of execution was later obtained but returned unsatisfied on a number of occasions. The members of Hartrez later placed the company into voluntary liquidation. The plaintiffs lodged a proof of debt with the liquidator of Hartrez, who rejected it. The plaintiffs then sought a review of the liquidator's decision under s 1321 of the Corporations Act.

The issues

In the matter before Barrett J, the only question raised was one of law, namely, whether a liquidator of a company placed into voluntary liquidation may call into question a judgment debt and seek to go behind that judgment when adjudicating a proof of debt based upon the judgment debt. The plaintiffs argued that in a members voluntary winding up:

- a debt of the company in liquidation that is a judgment debt must be accepted without question; and
- it is not open to a liquidator to canvas the true state of any indebtedness of the company to the judgment creditor.

His Honour disagreed and held that merely because a winding up is a members voluntary winding up and the debt sought to be proved is a judgment debt does not, in itself and without more, preclude rejection by the liquidator of the plaintiffs' proof of debt.

Reasoning

His Honour observed it is well established that, in bankruptcy, a trustee may in certain circumstances go behind a judgment debt.¹ As far back as 1895, the House of Lords confirmed that if evidence is brought before the bankruptcy court of circumstances tending to show that there has been fraud, or collusion, or a miscarriage of justice, the bankruptcy court has the power to go behind the judgment and to inquire into the validity of the debt.² The policy behind this principle is that if there is good reason to question whether the judgment debtor is truly indebted in terms of the judgment, the trustee may, and indeed should, take the view that the judgment is not of itself sufficient to prove the debt. Default judgments are a typical case.³

This well established principle has also been held to apply in the case of the winding up of insolvent companies. In *Re Quatrovision Pty Ltd (in liq) & Companies Act 1961*,⁴ Powell J held that the position of a liquidator of an insolvent company is so strongly analogous to that of a trustee in bankruptcy that the court ought to apply the same principle when dealing with proofs of debt in liquidation. The matter was put beyond doubt when the High Court handed down its decision in *Tanning Research Laboratories Incorporated v O'Brien*.⁵ In that case, the High Court

held that a liquidator may properly reject a proof of a debt if the liability is not a true liability of the company, but is founded merely on some act or omission on the part of the company which unjustly prejudices the interests of the creditors of contributories in the assets available for distribution.⁶ The High Court saw no reason to distinguish between the position of a liquidator and that of a trustee in bankruptcy. *Tanning Research* was, however, a case of a court ordered winding up; although it was not clear from the judgment whether it was an insolvent winding up.

In the case before Barrett J, there was no suggestion that Hartrez was insolvent. Indeed, at the time special resolution for winding up was passed, the directors formed and recorded an opinion that the company would be able to pay its debts in full within a period not exceeding 12 months after the commencement of the winding up. Notwithstanding, Barrett J referred to a number of authorities which demonstrated that regardless of whether the winding up was a members' voluntary winding up or a creditors' voluntary winding up, the essential characteristics of the scheme for dealing with the assets of the company do not differ.⁷

Indeed, in *Commissioner of Taxation v Linta Textiles Australia Ltd (in liq)*⁸ the High Court observed that the essential characteristics of the scheme for dealing with the assets of a company do not differ between a voluntary winding up and a compulsory winding up. For Barrett J, having regard to these authorities, the result was inevitable:

The statements of ... the High Court in both *Tanning Research Laboratories* and *Linta Textiles* ... emphasise that the process of winding up and the functions to be performed by a liquidator do not, in any aspect of substance, differ as between a voluntary winding up and a compulsory winding up or as between an insolvent winding up and a solvent winding up. Section 501 of the Corporations Act applies to a voluntary winding up, whether it be a creditor's voluntary winding up or a members voluntary winding up ... [and] ... requires a liquidator to apply the company's property in the first instance, 'in satisfaction of its liabilities'. In the case of a winding up in insolvency or by the court, the obligation with respect to liabilities, although slightly differently worded, is really identical: to 'cause the company's property to be collected and applied in discharging the company's liabilities': section 478(1)(a).⁹

No difference in liquidator's task regardless of nature of winding up

In particular, his Honour could see no difference in a liquidator's task regardless of whether the winding up was voluntary or compulsory:

Under each provision [section 501 and section 478(1)(a)] the same process is envisaged. The need for the liquidator to ascertain the company's 'liabilities' is precisely the same. The system of proving debts common to all modes of winding up is directed towards determining the company's 'liabilities'. There is no reason why that process should proceed on one footing if the company is insolvent and on another if it is solvent.¹⁰

In each winding up, the process is one of equitable administration of an estate.¹¹ His Honour pointed out that although the principle today is regarded as a rule of bankruptcy, its origins lay in equity:

It may therefore be regarded as reflecting an equitable principle applying generally to cases in which an estate falls to the benefit of persons interested in it — whether the ceased estate, a bankrupt estate or estate of a company in the course of being wound up. In the case of a bankrupt estate, of course, the situation will always be one of insolvency. In the other cases, the estate may or may not be insolvent ...¹²

Conclusion

The judgment has significant legal and practical implications for the law of company liquidation. The plaintiff's arguments, if accepted, would have effectively meant that a liquidator of a company placed into voluntary liquidation would be estopped from considering the admissibility of a proof of debt based on a judgment debt. In the law of company liquidation this is clearly not the case.¹³

His Honour's decision is correct in principle and will ensure that the same rules that apply to liquidators in rejecting proofs of debt in the context of an insolvent winding up apply to rejections of proofs of debt in a solvent winding up.

Footnotes

1. *Ilhan v Cvitanovic* (2009) 69 ACSR 702; [2009] NSWSC 160; BC200901607 at [14]–[18].
2. *Re Flatau; Ex parte Scotch Whisky Distillers Ltd* (1888) 22 QBD 83 at 85 per Lord Esher MR.
3. *Ilhan v Cvitanovic* (2009) 69 ACSR 702; [2009] NSWSC 160; BC200901607 at [18].

4. *Re Quatrovision Pty Ltd (in liq) & Companies Act 1961* [1982] 1 NSWLR 95; (1982) 39 ALR 146; 61 FLR 214; 6 ACLR 711.
5. *Tanning Research Laboratories Incorporated v O'Brien* (1990) 169 CLR 332; 91 ALR 180; [1990] HCA 8; BC9002954.
6. *Tanning Research Laboratories Incorporated v O'Brien* (1990) 169 CLR 332 at 339; 91 ALR 180; [1990] HCA 8; BC9002954 per Brennan and Dawson JJ.
7. *Ayerst (Inspector of Taxes) v CNK (Construction) Ltd* (1976) AC 167 at 176.
8. *Commissioner of Taxation v Linta Textiles Australia Ltd (in liq)* (2005) 220 CLR 592; 215 ALR 1; [2005] HCA 20; BC200502292.
9. *Ilhan v Cvitanovic* (2009) 69 ACSR 702; [2009] NSWSC 160; BC200901607 at [27]–[28].
10. *Ilhan v Cvitanovic* (2009) 69 ACSR 702; [2009] NSWSC 160; BC200901607 at [29].
11. *Ilhan v Cvitanovic* (2009) 69 ACSR 702; [2009] NSWSC 160; BC200901607 at [30].
12. *Ilhan v Cvitanovic* (2009) 69 ACSR 702; [2009] NSWSC 160; BC200901607 at [31].
13. See for example *Ex parte Kibble; In re Onslow* (1875) LR Ch App 373 and *Ampol Ltd v Matthews* (1991) 4 ACSR 592; 9 ACLC 757; BC9100438.