STATUTORY DEMANDS: Some practice tips and pointers

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1. Introduction

A quick glance at the court lists of either the Supreme Court or the Federal Court on any particular day will reveal that a large proportion of the corporations business of these courts is taken up with winding up applications. Many of these applications proceed on an uncontested basis, however, on any day there are likely to be a number of applications to set aside statutory demands and a smattering of defended applications.

The purpose of this paper is not so much to present a comprehensive summary of the law (which is expansive and way beyond the scope of this presentation) but to give you some practical tips and practice pointers when dealing with these applications.

2. The purpose of liquidation

The main purposes of liquidating a company are to:

(a) To wind up the affairs of a corporation;

(b) To provide for a fair and equitable distribution of the corporation's property, amongst its common creditors, and should there be surplus available, amongst its members; and

(c) In the case of insolvent corporations, to permit an examination to take place of the circumstances giving rise to the liquidation, perhaps revealing unfair dispositions or property potentially recoverable.

Companies can be placed in liquidation either voluntarily or involuntarily. Involuntary winding up is a process which is particularly useful to creditors and to oppressed minority shareholders. The focus of this paper is going to be on creditors and the winding up of companies in insolvency.

3. Who can apply for a winding up and on what basis?

There are two broad categories of grounds on which a company can be wound up:

(a) The circumstances set out in s462 Corporations Act; and
(b) Insolvency (s459P).

The following have standing to apply to the Court to have a company wound up:

(a) The company itself;

(b) A creditor, including a contingent or prospective creditor;

(c) A contributory;

(d) A director;

(e) A liquidator (where the company is in voluntary winding-up), or provisional liquidator

(f) ASIC;

(g) A ``prescribed agency''. The only prescribed agency is the Australian Prudential Regulation Authority (APRA) (*Corporations Regulations 2001* (Cth) Reg 5.4.01).

It is contrary to public policy to allow an insolvent company to continue to trade. However, if an application under s 459P for an order that a company be wound up in insolvency, is going to be made successfully, the Court is going to need to be satisfied that the company is in fact insolvent. There is a statutory definition of insolvency (s9 and 95A) which is that a person is insolvent if he or she is not able to pay all his or her debts as and when they become due and payable

The first practical problem for a creditor is how to prove that a company is insolvent. This is where statutory demands come into their own.

4. Statutory presumptions of insolvency

Section 459C(2) Corporations Act creates a number of rebuttable presumptions of insolvency. A company will be presumed to be insolvent if during or after the three months ending on the day when the application was made:

(a) The company failed (as defined by s 459F) to comply with a statutory demand

(b) Execution or other process issued on a judgment, decree or order of an Australian Court in favour of a creditor of the company was returned wholly or partly unsatisfied

(c) A receiver, or receiver and manager, of property of the company was appointed under a power contained in an instrument relating to a floating charge on such property

(d) An order was made for the appointment of such a receiver, or receiver and manager, for the purpose of enforcing such a charge

(e) A person entered into possession, or assumed control, of such property for such a purpose, or

(f) A person was appointed so to enter into possession or assume control (whether as agent for the chargee or for the company).

A presumption for which s 459C(3) provides operates except so far as the contrary is proved for the purposes of the application (i.e. once the presumption of insolvency is established, the burden of proving solvency rests with the defendant company). It also only has effect for 3 months which means that if a winding up application is not made in that time then the presumption cannot be relied on and it may be necessary to issue another demand. While on the subject of time limits, any winding up application commenced has to be determined within 6 months (unless an extension of time is granted by the court) –

see s459R.

Non-compliance with a statutory demand is by far the most common presumption relied upon.

5. Requirements for a statutory demand

The statutory demand must be in the prescribed form (form 509H – found in Schedule 2 of the Corporations Regulations) and if it is not based on a judgment debt then it must be accompanied by an affidavit verifying that the debt is due and payable. The form of affidavit required is found in form 7 of the Supreme Court (Corporations) Rules. A copy of the form and the affidavit are in appendix 1 to this paper.

The requirements for issuing a statutory demand are:

(a) There is a single debt (or two or more debts) that the company owes to the person, that is (are) due and payable, and whose amount(s) exceeds the statutory minimum, currently $2,000;

(b) the person, or an assignee of that person, has served on the debtor company a demand in writing, signed by or on behalf of the creditor (this means that the demand can be signed by the solicitor for the creditor);

(c) The demand specifies the sum due and payable;

(d)“requires" the company to pay that amount, or to secure or compound for that amount to the creditor's reasonable satisfaction, within 21 days after the demand is served on the company;

(e) The demand must be in writing in the prescribed form (Form 509H);

Once you have prepared your statutory demand it must be served in accordance with s109X Corporations Act. The most usual means of service would be by posting a copy of the demand to the company's registered office.

If the demand is sent by post keep in mind that s160 *Evidence Act* creates a presumption that items sent by post are received on the fourth business day after posting. This may be important in reckoning when the time for compliance has expired. Be aware that there are lots of cases that deal with service of documents and whether (and when) service has been effective.

6. Application to set aside the demand

If you are acting for a company which has received a statutory demand, it is vitally important that you obtain accurate instructions in relation to the date on which the demand was actually received by your client. The reason is that the "period for compliance" (as defined in s 459F(2)) is 21 days after the demand is served on the company. This means that either the demand must be complied with or an application made to set it aside within 21 days.

This time frame cannot be extended: *David Grant & Co Pty Ltd* v *Westpac Banking Corporation* (1995) 13 ACLC 1,572 (High Court).

If an application is made to set the demand aside, an initiating process and a supporting affidavit must be filed in either the Supreme Court or the Federal Court. The initiating process and the affidavit must both be filed AND served within the 21 day period.

An application to set aside a demand (pursuant to s459G) is contemplated by the Corporations Act to be based on one of the following grounds:

Section 459H

(a) That there is a genuine dispute between the debtor and the creditor serving of the notice about the existence or amount of the debt to which the demand relates, and/or

(b) That the debtor has an offsetting claim

Section 459J

(c) Because of a defect in the demand, substantial injustice will be caused unless the demand is set aside, or

(d) There is some other reason why the demand should be set aside.

The court must be convinced that there is a *genuine dispute* between the company and the creditor about the existence of or amount of the debt, or that the company has a *genuine offsetting claim* against the creditor, before s 459H applies and the court can make an order under that section. The legislation does not provide any guidance as to what is required to prove a genuine dispute or claim. This has left the matter to be determined by the courts, with the result that there are several judicial formulations of what is a "genuine dispute".

In, one of the first decided cases on setting aside statutory demands under the current regime, *Re Morris Catering (Australia) Pty Ltd* (1993) 11 ACSR 601 Thomas J said: "*It is often possible to discern the spurious, and to identify mere bluster or assertion. But beyond a perception of genuineness (or lack of it) the court has no function...The essential task is relatively simple – to identify the genuine level of a claim (not the likely result of it) and to identify the genuine level of an offsetting claim (not the likely result of it).*"

This is quite a low threshold and if after service of a statutory demand the company asserts (prior to commencing proceedings) that there is a genuine dispute then serious consideration should be given to withdrawing the demand. If proceedings to set aside the demand are commenced and are ultimately successful then your client won't thank you for the costs order which will almost invariably be made.

Although it is not possible to extend the time for compliance, if the company applies to the court, in accordance with s 459G, for an order setting aside the demand there is no presumption of insolvency until the application is finally determined. In that case the period for compliance is determined as follows:

(i) if, on hearing the application under s 459G or an application by the company under this paragraph (s 459F(2)(a)) the court makes an order that extends the period for compliance with the demand, then the period for compliance is the period specified in the order, or in the last such order, as the case requires, or

(ii) if the court does not make an order under s 459G, then the period for compliance is the period beginning on the day when the demand is served and ending seven days after the application under s 459G is finally determined (see below) or otherwise disposed of: s 459F(2)(a).

The company may apply to the court pursuant to s 459F(2)(a)(i) for an order extending the compliance period. The High Court has recently (26 March 2008) held that section 459F(2)(a)(i) does not empower the court to extend the period for compliance after it has expired: *Aussie Vic Plant Hire Pty Ltd* v *Esanda Finance Corporation Limited* (2008) 82 ALJR 564; [2008] HCA 9.

Although this right to apply for an extension of time appears to be a "stand alone" one, it appears that the situation is that no extension will be granted unless an application is also made to set aside the demand under s459G.

7. The Graywinter Principle

The Courts have recognised that 21 days is not a very long time in which to prepare an application to set aside a demand. In fact, my (unfortunate) experience is that solicitors often have considerably less time than this in which to prepare applications as clients are not always diligent in bringing these matters to the attention of their solicitors. Consequently there is some leniency in the form of the affidavit but it is still essential that it properly identify the ground of dispute. This has come to be known as the Graywinter Principle (after the case in which it was first discussed).

A recent description of the principle was given by White J in *Hansmar Investments Pty Ltd v Perpetual Trustee Company Ltd* [2007] NSWSC 103:

"27 Exceptionally in this area of the law, an affidavit under s 459G may read like a pleading (Graywinter Properties Pty Ltd v Gas & Fuel Corporation Superannuation Fund at 459). Thus, a supporting affidavit may raise a ground of dispute in a form which is inadmissible to prove the facts giving rise to the dispute, and those facts may be proved in a later affidavit filed and served outside the 21-day period. However, there is no requirement in s 459G that the supporting affidavit read like a pleading.

28 The implication is now firmly established that the grounds for applying to set aside a statutory demand must be raised in the supporting affidavit, so that a ground which is not so raised cannot be relied upon. It is one thing to draw that implication from the requirement that an application be accompanied by a supporting affidavit. It is quite another to imply from the requirement that there be a supporting affidavit anything as to the precision with which such a ground must be expressed, other than that it be raised. Whether it is raised expressly, by necessary inference, or by a reasonably available inference, provided it is raised, in my view the requirements of s 459G are satisfied."

What this means is that the first affidavit must at least identify the ground of dispute. It is permissible to file supplementary affidavits at a later date, but those later affidavits cannot raise new grounds of dispute. A further gloss on this principle was stated by Barrett J in *Saferack Pty Ltd v Marketing Heads Australia Pty Ltd* [2007] NSWSC 1143:

"a ground is "raised", as referred to in Energy Equity, if the ground is evident from the supporting affidavit, even if only because it can be discerned from some annexed document the content of which "reveals" it."

8. 459S – what happens if I miss the deadline?

In so far as an application for a company to be wound up in insolvency relies on the failure by the company to comply with the statutory demand, the company may not, without leave of the Court, oppose the application on a ground (s 459S(1));

(a) That the company relied on for the purposes of an application by it for the demand to be set aside, or

(b) That the company could have so relied on, but did not so rely on (whether it made such an application or not).

Furthermore, the Court is not to grant leave under s 459S(1) unless it is satisfied that the ground is material to proving that the company is solvent.

The reason for this is that the granting of leave under s459S does not displace the presumption of insolvency created by non-compliance with the statutory demand and the grant of leave does not by itself result in the statutory demand being set aside. So what do you have to do to get leave of the Court?

The principles were set out in *Chief Commissioner of Stamp Duties v Paliflex Pty Ltd*, Austin J said (at 193 [49]):

"*[49] In my opinion the exercise of the discretion to grant leave under* s459S(1) *involves three considerations, namely:*

(i) a preliminary consideration of the defendant's basis for disputing the debt which was the subject of the demand;

(ii) an examination of the reason why the issue of indebtedness was not raised in an application to set aside the demand, and the reasonableness of the party's conduct at that time; and

(iii) an investigation of whether the dispute about the debt is material to proving that the company is solvent."

9. Statutory Demands issued by the ATO

A very recent decision of the High Court (handed down on 3 September 2008) has looked at the issue of whether there can ever be a genuine dispute (for the purposes of s459G) about a taxation debt. It appears from *Deputy Commissioner of Taxation v Broadbeach Properties Pty Ltd* [2008] HCA 41 that the answer to that question is "no".

The Court's logic involved the following steps:

- With respect to income tax, the production of a notice of assessment shall be conclusive evidence of the due making of the assessment and, except in Pt IVC proceedings, shall be conclusive evidence "that the amount and all the particulars of the assessment are correct" (Assessment Act, s 177(1));
- An amount of a "tax-related liability" that is due and payable as indicated by the tables in s 250-10, is a debt due to the Commonwealth and payable to the Commissioner (s 255-5(1)), and may be sued for recovery in a court of competent jurisdiction (s 255-5(2)). The phrase "tax-related liability" means a pecuniary liability to the Commonwealth "arising directly" under a statute of which the Commissioner has the general administration (s 2(1) of the Administration Act and s 5-1 in Sched 1 of that statute; s 995-1 of the 1997 Act). The consequence is that liabilities for income tax and GST are within the scope of these provisions.

- The pendency of the AAT proceedings under Pt IVC of the Administration Act does not impede recovery in the meantime. Section 14ZZM of the Administration Act provides:

  "The fact that a review [by the AAT] is pending in relation to a taxation decision does not in the meantime interfere with, or affect, the decision and any tax, additional tax or other amount may be recovered as if no review were pending."

The Court held at [57]:

"*Section 459G applications by taxpayers are not Pt IVC proceedings and production by the Commissioner of the notices of assessment and of the GST declarations conclusively demonstrates that the amounts and particulars in the assessments and declarations are correct. That being so, the operation of the provisions in the taxation laws creating the debts and providing for their recovery by the Commissioner cannot be sidestepped in an application by a taxpayer under s 459G of the Corporations Act to set aside a statutory demand by the Commissioner*".

If there can't be a genuine dispute about a tax liability, can there be some other reason (see s459J) why the demand should be set aside? Both the judge at first instance (and the Queensland Court of Appeal) had indicated that proceedings under Part IVC could constitute a reason. However, the High Court said (at [61-62]):

"*...The "material considerations"[51] which are to be taken into account, on an application to set aside a statutory demand, when determining the existence of the necessary satisfaction for par (b) of s 459J(1) must include the legislative policy, manifested in s 14ZZM and s 14ZZR of the Administration Act, respecting the recovery of tax debts notwithstanding the pendency of Pt IVC proceedings.*

The result is that the exercise of discretion by the primary judge under s 459J(1)(b) miscarried, and the Court of Appeal erred in upholding and supplementing it. Against the possibility of this Court so concluding, the respondents submitted that the matter should be remitted to the Supreme Court for re-exercise of the discretion under that provision. However, no fresh ground upon which the respondents might then succeed was suggested beyond reference to the time which has elapsed and the progression of the Pt IVC proceedings towards determination. But such a consideration, if it were supported by evidence of the state of progression of the Pt IVC proceedings, would be relevant in the operation of Pt 5.4 of the Corporations Act, if at all, at the later stage of the hearing of any winding up application. There should be no re-exercise of the discretion conferred by s 459J(1)(b)."

This decision effectively means that except in circumstances where there are Pt IVC proceedings on foot and well advanced the chances of being able to avoid a winding up application commenced by the ATO based on failure to comply with a statutory demand appear to be remote.

10. Winding up as an offensive weapon

There have been two recent cases in NSW where applicants sought to argue the s459J "other good reason" on the basis that the statutory demand was issued for an improper purpose.

In *TS Recoveries Pty Ltd v Sea-Slip Marinas (Aust) Pty Ltd* [2007] NSWSC 1410, Sea Slip had been engaged by Abel Point to construct a marina at Airlie Beach. The parties had been in a long running commercial dispute about progress payments and other matters. TS Recoveries (which had the same ownership and management as Sea Slip) took an assignment of a $233K debt owing by Abel Point to a third party and proceeded to issue a statutory demand for its payment (this was actually the second time that a statutory demand had been issued on an assigned debt). Winding up proceedings were commenced and Sea Slip sought to resist the order on the basis that it was an abuse of process or that the discretion should be exercised not to.

These arguments did not impress Justice Barrett who said (at 107-109):

"Applicable to the present case, in my opinion, is the following observation of Gibbs J (with whom Stephen J and Jacobs J agreed) in IOC Australia Pty Ltd v Mobil Oil Australia Ltd (1975) 49 ALJR 176 at 182:

"Nor is there any evidence that Mobil's decision to seek a winding-up order against the appellant was actuated by any motive other than a desire to avail itself of one of the remedies open to a creditor of a company which cannot pay its debts; if it be surmised that Mobil was pleased at the prospect that the appellant might have to cease business, that is immaterial, for it is not the law that only a creditor who feels goodwill towards his debtor is entitled to a winding-up order."

A purpose of seeing a liquidator supplant the incumbent management is a purpose entirely consistent with the proper pursuit of winding up proceedings. Appointment of a liquidator and cessation of business are results for which the law allows – more precisely, they are results that are part and parcel of the winding up regime. It follows that, even if supplanting of Mrs Brighton had been the plaintiff's sole or predominant purpose (I have found only that it was supplementary to the purpose of securing satisfaction of the assigned debt), the proceedings would not have been an abuse of process.

SSM's contention that the winding up application of the plaintiff is an abuse of process and ought to be dismissed accordingly cannot succeed."

The other "offensive weapon" case is *Australian Beverage Distributors Pty Ltd v The Redrock Co Pty Ltd* [2007] NSWSC 966. In that case (which had similar facts) White J found that the Plaintiff's purpose was "to crush Redrock by putting it into liquidation", but that "it is not an abuse of process to seek a winding-up order to achieve that outcome."

11. Conclusion

This paper has set out some of the basic principles that apply to issuing demands and making applications to set them aside. Statutory demands are a powerful weapon in the armoury of parties engaged in commercial disputes and their power should not be underestimated. However, they should not be abused as costs orders will flow if creditors stubbornly hang on to their demands in the face of genuine dispute about the debt. However, if there is one thing that must be stressed to practitioners (particularly those who act for the recipients of demands) is that time limits must be strictly observed. Statutory demands are time bombs with accurate preset fuses.

Form 509H

(paragraph 459E (2) (e)) *Corporations Act 2001*

CREDITOR'S STATUTORY DEMAND FOR PAYMENT OF DEBT

To (*name and A.C.N. or A.R.B.N. of debtor company)* of *(address of the company's registered office)*

1. The company owes (*name)* of (*address) (* "the creditor")

*the amount of $(*insert amount),* being the amount of the debt described in the Schedule.

*the amount of $(*insert total amount),* being the total of the amounts of the debts described in the Schedule.

*2. The amount is due and payable by the company.

*2. Attached is the affidavit of (*insert name of deponent of the affidavit)* , dated (*insert date of affidavit),* verifying that the amount is due and payable by the company

3. The creditor requires the company, within 21 days after service on the company of this demand:

(a) to pay to the creditor the *amount of the debt/*total of the amounts of the debts; or

(b) to secure or compound for the *amount of the debt/*total of the amounts of the debts, to the creditor's reasonable satisfaction.

4. The creditor may rely on a failure to comply with this demand within the period for compliance set out in subsection 459F (2) as grounds for an application to a court having jurisdiction under the *Corporations Act 2001* for the winding up of the company.

5. Section 459G of the *Corporations Act 2001* provides that a company served with a demand may apply to a court having jurisdiction under the *Corporations Act 2001* for an order setting the demand aside. An application must be made within 21 days after the demand is served and, within the same period:

(a) an affidavit supporting the application must be filed with the court; and

(b) a copy of the application and a copy of the affidavit must be served on the person who served the demand.

A failure to respond to a statutory demand can have very serious consequences for a company. In particular, it may result in the company being placed in liquidation and control of the company passing to the liquidator of the company.

6. The address of the creditor for service of copies of any application and affidavit is (insert the address for service of the documents in the State or Territory in which the demand is served on the company, being, if solicitors are acting for the creditor, the address of the solicitors).

SCHEDULE

Description of the debt	Amount of the debt
(indicate if it is a judgment debt, giving the name of the court	

and the date of the order)

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*Total Amount

Dated:

signed:

Print name: capacity:

Corporation or partnership name (if applicable):

NOTES:

1. The form must be signed by the creditor or the creditor's solicitor. It may be signed on behalf of a partnership by a partner, and on behalf of a corporation by a director or by the secretary or an executive officer of the corporation.

2. The amount of the debt or, if there is more than one debt, the total of the amounts of the debts, must exceed the statutory minimum of $2,000.

3. Unless the debt, or each of the debts, is a judgment debt, the demand must be accompanied by an affidavit that:

(a) verifies that the debt, or the total of the amounts of the debts, is due and payable by the company; and

(b) complies with the rules.

4. A person may make a demand relating to a debt that is owed to the person as assignee.

5. This form was amended in 2006 as part of amendments of the *Corporations Regulations 2001* . For the period of 12 months after the commencement of those amendments a person may comply with paragraph 459E (2) (e) of the *Corporations Act 2001* in relation to a statutory demand for payment of debt by using:

(a) the version of this form that was in force immediately before the commencement of the amendments; or

(b) this version of the form.

*Omit if inapplicable

Form 7 - Affidavit accompanying statutory demand

(rule 5.2)

[Name of creditor(s)]
Creditor(s)

[Name of debtor company]
Debtor company

I, [name] of [address and occupation], *say on oath/*affirm:

1 I am [state deponent's relationship to the creditor(s), eg, 'the creditor', '(name), one of the creditors', 'a director of the creditor', 'a director of (name), one of the creditors'] in respect of *a debt of $ [amount]/*debts totalling $ [amount] owed by [name of debtor company] to *me/*us/*it/*them relating to [state nature of debt or debts, ensuring that what is stated corresponds with the description of the debt or debts, to be given in the proposed statutory demand, with which this affidavit is to be served on the debtor company].

2 [If the deponent is not the creditor, state the facts entitling the deponent to make the affidavit, eg 'I am authorised by the creditor(s) to make this affidavit on its/their behalf].

3 [State the source of the deponent's knowledge of the matters stated in the affidavit in relation to the debt or each of the debts, eg 'I am the person who, on behalf of the creditor(s), had the dealings with the debtor company that gave rise to the debt', 'I have inspected the business records of the creditor in relation to the debtor company's account with the creditor'].

4 *The debt/*The total of the amounts of the debts mentioned in paragraph 1 of this affidavit is due and payable by the debtor company.

5 I believe that there is no genuine dispute about the existence or amount of the *debt/*any of the debts.

*Sworn/*affirmed at: [place of swearing or affirmation] on [date]

Signature of deponent

Before me:

Signature and designation of
person before whom deponent
swears or affirms affidavit

* Omit if not applicable