*Cambridge Law Journal*, **69(1)**, March 2010, pp. 113–132
doi:10.1017/S0008197310000206

# THE COURT'S JURISDICTION TO RESTRAIN A CREDITOR FROM PRESENTING A WINDING UP PETITION WHERE A CROSS-CLAIM EXISTS

SUET LIN JOYCE LEE*

## I. INTRODUCTION

The aim of this article is to examine a narrow but important issue as to when the court may restrain a creditor of an undisputed debt from presenting a winding-up petition against its debtor company ("the company"), where the company has a cross-claim[1] against the creditor.

A creditor[2] may, pursuant to s. 124 of the Insolvency Act 1986, petition to the Companies Court to wind up the company on the ground that the company is "unable to pay its debts."[3] The creditor may prove the company's insolvency by using the "cash flow" test,[4] the "balance sheet" test[5] or serving a statutory demand for a sum exceeding £750 on the company which it neglected to pay within three weeks.[6] Regardless of which method is used to prove the company's insolvency, it is a pre-requisite that the petitioner must have the locus standi as a creditor to present the petition. According to Ungoed-Thomas J., "Once it becomes clear there is no debt and thus the petitioner is not a creditor, pursuit of the petition would be an abuse of process, and this court would restrain its presentation or advertisement."[7] Thus, a person who fails to establish the petition debt fails to establish he is a creditor of the company. Accordingly such a person has no locus standi to petition to wind up the company and his petition is bound to fail. The company has the onus of showing that the petition is an abuse of

* LLB (Singapore); LLM (Virginia); Associate Professor, Nanyang Business School, Nanyang Technological University, Singapore.

[1] When a creditor presents a petition for a winding up order, the company may plead it has a set-off or counter-claim which equals or exceeds the amount of the petitioner's debt. Set-off operates as a complete defence to a claim and so would deprive the petitioner of his locus standi as a creditor but the debt is not extinguished until judgment is given in favour of the company: *L&D Audio Acoustics Pty Ltd.* v. *Pioneer Electronic Australia Pty Ltd.* (1982) 7 A.C.L.R. 180. A counter-claim is a distinct action on which the practice is to give judgment separately: *Re Portman Provincial Cinemas Ltd.* (1964) 108 S.J. 581. Cross-claim in this article will include both a set-off and a counter-claim.

[2] One of the persons with locus standi to present a petition under Insolvency Act 1986, s. 124(1). The focus of this article is only on the creditor of the company.

[3] Insolvency Act 1986, s. 122(1)(f).

[4] The company is unable to pay its debts as they fall due: Insolvency Act 1986, s. 123(1)(e).

[5] The company's assets are insufficient to meet its liabilities: Insolvency Act 1986, s. 123(2).

[6] Insolvency Act 1986, s. 123(1).

[7] *Mann* v. *Goldstein* [1968] 1 W.L.R. 1091, 1095.

process. Pursuit of a petition which is bound to fail[8] would be an abuse of process of court.[9]

This begs the question. What if the creditor is able to establish an undisputed petition debt but the company has a cross-claim against the creditor which equals or exceeds the petition debt ("cross-claim case")? It seems an intrinsically unattractive proposition to permit the winding up of the company on the petition of a creditor, who may, in the end when all outstanding sums are settled, either be a person to whom the company is not indebted to or is a person who is actually required to make payment to the company.

Because the presentation of a winding up petition may cause severe harm to a company's reputation, a company may, even before the petition has been presented or advertised,[10] apply for injunction to restrain presentation or advertisement of petition, whichever the case may be.[11] If it were incongruous[12] for the Companies Court hearing the petition to wind up a company in a cross-claim case, to restrain a petition on the basis of a cross-claim is just as delicate a decision – the court has to balance the possible injustice that may be caused to the creditor against the potential harm that may be occasioned to the company. What then is the basis of the court's jurisdiction to restrain presentation of a petition in a cross-claim case? What is the standard of proof required of the company when it applies to restrain presentation of a petition – does it have to satisfy the court that the petition is "bound to fail" or is "unlikely to succeed"? Which is the better test?

The next section of this article investigates the basis of the court's inherent jurisdiction to restrain presentation of a petition. It will be argued that the basis is to prevent an abuse of process of court if the petition were proceeded with and one of the grounds is the lack of locus standi of the petitioner; irreparable harm that may be caused to the company is an important consideration, but not the basis, for the court's exercise of its inherent jurisdiction. The final section of the article examines the controversy that surrounds the standard of proof imposed on the company when it applies to restrain presentation of a petition. The differing nuanced approaches by the English, Australian and New Zealand courts will be painted in broad brush strokes and

[8] *Bryanston Finance Ltd.* v. *de Vries (No 2)* [1976] Ch. 63.

[9] Other instances of abuse of process include presentation of petition not bona fide for the legitimate purpose of obtaining a winding up order but for the purpose of applying pressure on the company: *Re A Company* [1894] 2 Ch. 349; the fact that Companies Act provides a more appropriate remedy for the petitioner's complaint: *Charles Forte Investments Ltd.* v. *Amanda* [1964] Ch. 240.

[10] Insolvency Rules 1986, r.4.11.

[11] *Stonegate Securities Ltd.* v. *Gregory* [1980] Ch. 576. The court will restrain advertisement where the presentation of petition is an abuse of the process of the court. Reference will subsequently be made only to injunctions to restrain presentation of petition because the same rules apply to both injunctions to restrain presentation and advertisement of petition.

[12] Because the petitioner may turn out not to be a creditor when the cross-claim is settled.

contrasted. It will be contended that the "bound to fail" test is the correct test to apply because it accords with both principle and policy.

## II. Basis for the Court's Exercise of Jurisdiction to Restrain

The authorities are divided on the issue of whether the basis for the court's inherent jurisdiction to restrain presentation of petition is lack of locus standi of the would-be petitioner or irreparable harm to the company. According to Ungoed-Thomas J. in *Mann* v. *Goldstein*:[13]

> It is well established that this court has jurisdiction to restrain the presentation or advertising of a winding-up petition and restrain all further proceedings on it. That jurisdiction is a facet of the court's inherent jurisdiction to prevent abuse of the process of the court…For my part I would prefer to rest the jurisdiction directly on the comparatively simple propositions that a creditor's petition can only be presented by a creditor, that the winding-up jurisdiction is not for the purpose of deciding a disputed debt (that is, disputed on substantial and not insubstantial grounds), since, until a creditor is established as a creditor he is not entitled to present the petition and has no locus standi in the Companies Court; and that, therefore, to invoke the winding-up jurisdiction when the debt is disputed (that is, on substantial grounds) or after it has become clear that it is so disputed is an abuse of the process of the court which is the very essence of this court's jurisdiction to restrain the presentation of a winding-up petition.[14]

On the other hand, irreparable harm to the company is the justification given by some Australian courts[15] for the grant of an injunction to restrain presentation of petition. According to McGarvie J. in *Fortuna Holdings Pty Ltd.* v. *The Deputy Commissioner of Taxation of the Commonwealth of Australia (*"*Fortuna* case"*)*:[16]

> When a court restrains the presentation of a winding up petition to that court it exercises it as part of its inherent jurisdiction to prevent abuse of its process. Usually a court acts against abuse of its process after proceedings have been commenced. Thus, existing proceedings may be stayed or dismissed, or documents delivered as a step in the proceedings may be struck out … The law has long recognized that with proceedings to wind up a company, intervention after the commencement of proceedings would often be too late to relieve the company of oppression and damage. The courts have recognized that irreparable damage may be done to a company merely through public knowledge of the presentation of a petition. Usually the damage flows from the loss of commercial

[13] [1968] 1 W.L.R 1091.
[14] *Ibid.*, at pp. 1093–1094, 1098-1099.
[15] See, for instance, *L & D Audio Acoustics Pty Ltd.* v. *Pioneer Electronic Australia Pty Ltd.* (1982) 7 A.C.L.R. 180; *Fortuna Holdings Pty Ltd.* v. *The Deputy Commissioner of Taxation of the Commonwealth of Australia* [1978] 2 A.C.L.R. 349.
[16] [1978] 2 A.C.L.R. 349.

> reputation which results. The courts have also been conscious of the pressure which may be put on a company, by a person with a disputed claim against it, threatening to present a winding up petition unless the company meets his claim. While that threat exists, the company, in order to avoid the damage involved in the presentation of a petition, is pressed to meet the claim although it may have substantial and genuine grounds for regarding itself as not required to do so. The decisions of the courts have established the principle that the presentation of a winding up petition may be restrained by injunction where its presentation would amount to an abuse of the process of the court. The courts apply this principle similarly to restrain the advertisement of a petition already presented. The principle enables companies to be protected from threatened or apprehended oppression and damage from abuse of court process.[17]

It is submitted respectfully that *Mann* v. *Goldstein*[18] is correct in principle in that lack of locus standi of the would-be petitioner serves as justification for the exercise of the court's jurisdiction to restrain the presentation of a petition as an abuse of process of court. In *In re Bayoil SA* ("*Bayoil* case"),[19] the UK Court of Appeal regarded irreparable harm to the company as only one of the considerations but not the basis to grant an injunction. This has to be correct. A winding up petition would invariably cause harm to the company. If irreparable harm formed the basis for the grant of an injunction, few petitions would proceed to hearing before the Companies Court, thus sending a signal to debtor companies that they need not be expeditious in repaying their debt when it is due. In addition, injustice to the creditor is exacerbated if the cross-claim cannot be proceeded with and winding up is the only option available to the creditor.

Irreparable harm to the company as justification for the court's jurisdiction to restrain appears to have been extracted from statements made in some English cases, such as *Niger Merchants Co.* v. *Capper*[20] and *Charles Forte Investments Ltd.* v. *Amanda*.[21] In these cases, the would-be petitioner was a shareholder of the company who intended to petition to wind up the company on the "just and equitable" ground. The position of a shareholder is different from that of a creditor. A shareholder always has locus standi to present a winding-up petition on the "just and equitable" ground. An aggrieved minority shareholder may have no other recourse to redress the wrongs allegedly done to him except by petitioning to wind up the company. In these cases, issues of oppression and the like are usually best aired in the Companies Court

[17] *Ibid.*, at p. 354.
[18] [1968] 1 W.L.R 1091.
[19] [1999] 1 W.L.R. 147.
[20] (1881) 18 Ch. D. 557.
[21] [1964] Ch. 240.

hearing the winding up petition rather than in the court hearing the application to restrain presentation of petition. The court will be reluctant to restrain a petition unless the requirement that irreparable harm will be occasioned to the company with the filing of the petition is also satisfied.

In a cross-claim case, where the creditor has locus standi to petition,[22] his petition may nevertheless still constitute an abuse of process of court, for instance, when he intends to prosecute a petition that is clearly bound to fail.[23] The court hearing the application to restrain in such a case may grant the injunction to prevent an abuse of process without having to resort to the requirement that irreparable harm will be caused to the company.

If it were accepted that the basis for the court's inherent jurisdiction to restrain a petition is abuse of process in general and not irreparable harm to the company in particular, it may be necessary at this juncture to preface a discussion of the court's jurisdiction to restrain a petition in cross-claim cases by reviewing the body of case law pertaining to situations where the petition debt is disputed ("disputed debt cases"), as these cases could provide useful signposts as to the scope of the court's jurisdiction to restrain.

To be able to present a petition, the petitioner must be a person within the ambit of s. 124(1) of the Insolvency Act 1986. The list of persons with standing to petition to wind up a company is exhaustive[24] and a pre-requisite such that, even if the company is *insolvent*, the person who is not within its ambit cannot present a petition.[25] The corollary is also true. A creditor who petitions on the strength of an undisputed debt, and because he comes within the ambit of s. 124(1) of the Insolvency Act, may not only present a petition but may obtain a winding up order, even if the company were *solvent*.[26] Where the creditor's debt is clearly established, the court would not, in general, interfere, even though the company appears to be solvent, for the creditor would be entitled to present a petition and the company would be able to prevent itself from being wound up by paying the undisputed debt.

It may be inferred from the courts' treatment of the issues of the petitioner's locus standi and the company's insolvency that insolvency

[22] Not everyone is agreed that the creditor in a cross-claim case has locus standi to petition. It will be argued later that the creditor in a cross-claim case *does* have locus standi.

[23] This point will be elaborated on in the next section.

[24] Exhaustive with reference to the Insolvency Act 1986. There may be other statutory bases of standing, eg the Financial Services Authority can petition to wind up financial services companies under the Financial Services and Markets Act 2000.

[25] *In re H.L. Bolton Engineering Co. Ltd.* [1956] Ch. 577, 583. This view has been criticized. See, for instance, A Keay, "Insolvent Companies which are able to Dispute Debts Owed to Petitioning Creditors: Should they be Wound Up?" (1998) 19 Company Lawyer 230.

[26] *Cornhill Insurance plc* v. *Improvement Services Ltd.* (1986) 2 B.C.C. 98,942.

is additional to, as opposed to being an alternative to, the condition that the petitioner must be a creditor. In other words, the "creditor" requirement is a vital prerequisite for the presentation of the petition.[27]

Given the paramount importance of the petitioner fulfilling the locus standi requirement at the time of presentation of petition, it follows that a person who does not have locus standi as creditor to petition and yet who insists on going ahead to present a petition to wind up the company should be restrained. The court would exercise its jurisdiction to restrain presentation of petition because the presentation would be an exercise in futility and a waste of court time, hence an abuse of process.

It is clear from *Mann* v. *Goldstein*[28] that a petitioner who relies on a disputed debt as the subject matter of his petition has no locus standi to present the petition and the court will accordingly restrain the petition to prevent abuse of the process. But does it follow that a petitioner whose petition debt is undisputed but against whom the company has a cross-claim that equals or exceeds the petition debt, likewise lacks locus standi to present a petition to wind up the company?

The response of the Privy Council in *Malayan Plant (Pte) Ltd.* v. *Moscow Narodny Bank Ltd.*[29] ("*Malayan Plant* case") is stated unequivocally that "There is no distinction in principle between a cross-claim of substance and a serious dispute regarding the indebtedness imputed against a company, which has long been held to constitute a proper ground upon which to reject a winding up petition."[30]

More recent cases, for instance, *Re Ringinfo Ltd.*,[31] have affirmed that the court's practice of dismissing the petition if the subject matter of the petition were disputed apply with equal force to cross-claim cases:

> A genuine cross-claim, which the company has not had the opportunity to litigate, will, if it amounts to an equitable set-off, operate to extinguish the debt and thus deprive the petitioning creditor of locus standi, but will in any event, even if it does not amount to an equitable set-off, normally justify the court in dismissing or staying a petition which has been presented, and restraining its presentation if it has not.[32]

In a similar vein, the court in *Re MCI Worldcom*[33] stated: "Where a company asserts genuine and serious cross-claims (whether they are counterclaims or set-offs) against the petition debt, the court will

[27] See *Mann* v. *Goldstein* [1968] 1 W.L.R at p.1095.
[28] [1968] 1 W.L.R 1091.
[29] [1980–1981] S.L.R. 8.
[30] *Ibid.*, at p.12.
[31] [2002] 1 B.C.L.C. 210.
[32] *Ibid.*, at p.221.
[33] [2003] 1 B.C.L.C. 330.

exercise its discretion by dismissing or staying the petition if they exceed the amount of the petition debt."[34]

It would appear on the face of it that the courts treat a petition that involves a disputed debt in the same fashion as a petition that involves an undisputed debt but the company has a cross-claim against the petitioner that equals or exceeds the petition debt – the practice is to dismiss the petition in either case. Several observations may be made about these cases.

First, the opinion in the *Malayan Plant* case,[35] *Re Ringinfo Ltd.*[36] and *Re MCI Worldcom*[37] that placed disputed debt cases and cross-claim cases on the same footing is obiter dicta. Although the debt in these cases was undisputed, the company was not seeking to restrain the creditor from presenting a winding-up petition. The statements were made by Companies Courts in the context of winding up petitions, not applications to restrain presentation of petitions. There is a clear distinction between the exercise of the court's discretion on hearing the petition and the exercise of the inherent jurisdiction to restrain presentation of a petition.[38] An application to restrain presentation of petition requires the court to determine if an injunction should be granted to prevent an abuse of court process. A hearing of the petition, on the other hand, requires the Companies Court to determine the merits of the petition.[39] The task of the Companies Court hearing the petition is to exercise its discretion whether to make a winding up order or to dismiss the petition. The existence of a cross-claim is definitely a relevant factor to be considered by the court. As mentioned earlier, the Companies Court will be slow to wind up a company on the strength of a petition debt which may be extinguished once the cross-claim has been settled. For this reason, it is not remarkable that the *practice* to dismiss the petition has evolved in cross-claim cases.

It is important to note that while the practice of dismissing the petition in cross-claim cases has evolved, the Companies Court still retains its discretion even where a cross-claim exists. In *In re L.H.F. Wools*,[40] Edmund-Davies LJ had said:

> I am a little nervous, accordingly, about any decision which appears to lay down almost as a statement or proposition of law that a discretion has to be exercised in any particular direction.[41]

[34] *Ibid.*, at p.335.
[35] [1980–1981] S.L.R. 8.
[36] [2002] 1 B.C.L.C. 210
[37] [2003] 1 B.C.L.C. 330
[38] See, for instance, *Anglian Sales Ltd.* v. *South Pacific Manufacturing Co. Ltd.* [1984] 2 N.Z.L.R. 249.
[39] See, for instance, *Taxi Trucks Ltd.* v. *Nicholson* [1989] 2 N.Z.L.R. 297.
[40] [1970] Ch. 27.
[41] *Ibid.*, at p.42.

Harman LJ in the same case had said:

> This is the kind of case [a cross-claim case] which is always troublesome and depends in the ultimate resort on the discretionary view of the judge who tries it.[42]

More recently, the *Bayoil* case[43] clarified that the Companies Court has discretion where there is a cross-claim although the practice is usually to dismiss the petition. Nourse LJ had cited two earlier Court of Appeal decisions, namely, *Re Portman Provincial Cinemas Ltd.*[44] and *Re L.H.F. Wools Ltd.*,[45] as authority for the view that the *practice* (as opposed to applying a principle of law) in cross-claim cases was that the petition ought to be dismissed, unless there are special circumstances[46] justifying a contrary exercise of the court's discretion. Thus, special circumstances may exist to justify the Companies Court making a winding up order, notwithstanding the existence of a cross-claim. Contrast the court's *practice* of dismissing the petition in cross-claim cases with the *rule* of dismissing a petition in disputed debt cases – in the latter, it has been said "the dismissal of the petition in such a case is *not*, at any rate, initially, a matter for the discretion of the court".[47]

Secondly, cross-claims are to be distinguished from disputed debts because a mere cross-claim which provides neither a legal or equitable defence to proceedings for enforcement of a debt will not affect the status of the person to whom the debt is owed as a creditor.[48] The courts do not distinguish between set-offs and counter-claims. Where the company alleges a cross-claim, the authorities[49] do not require that the cross-claim has to be pleaded or be effective as an equitable set-off (therefore it does not *in law* operate in reduction or discharge of the debt owed to the petitioning creditor). It is curious why a cross-claim which does not meet the requirement of set-off may be freely used in an application to restrain presentation of petition, allowing the company practically to set-off the alleged cross-claim against the creditor's undisputed debt.[50] Claims and cross-claims are not one proceeding but

[42] *Ibid.*, at p.36.
[43] [1999] 1 W.L.R. 147.
[44] (1964) 108 S.J. 581.
[45] [1970] Ch. 27.
[46] It is not entirely clear what are the special circumstances which would lead a Companies Court to refuse to dismiss a petition. *Re Richbell Information Service Inc* [2000] B.C.C. 111 is an example of when special circumstances exist. In that case, a US company owed US$48m to the petitioning creditor. The company brought its cross-claim in the US. Although the judge was satisfied the cross-claim was genuine and serious, his Lordship was of the view that the appointment of a liquidator would safeguard the interests of the petitioner in relation to the US action.
[47] *Bayoil* [1999] 1 W.L.R. at p. 151.
[48] *Re Julius Harper Ltd., ex parte Winkler & Co. (Hong Kong) Ltd.* [1983] N.Z.L.R. 215; *Anglian Sales Ltd.* v. *South Pacific Manufacturing Co. Ltd.* [1984] 2 N.Z.L.R. 249.
[49] *Re Ringinfo Ltd.* [2002] 1 B.C.L.C. 210.; *Montgomery* v. *Wanda Modes Ltd.* [2002] 2 B.C.L.C.289; *Bayoil* [1999] 1 W.L.R. 147; *Re L.H.F. Wools Ltd.* [1970] Ch. 27.
[50] *Re Glenbawn Park Pty Ltd.* (1977) 2 A.C.L.R. 288.

two.[51] The cross-claim cannot be regarded as part and parcel of the claim if equitable set-off is in issue. Thus, until the cross-claim is adjudicated upon the claim cannot be extinguished. Until the claim is adjudicated there is no dispute as to the specific debt that is the basis of the petition, although, because of the cross-claim the company's overall indebtedness viz à viz the creditor may be at issue. The would-be petitioner will still be a creditor although eventually he may not be granted a winding up order.

Having established that the cases mentioned above,[52] which treat the existence of a bona fide cross-claim by the company against the petitioner as a de facto dispute as to the petitioner's debt, it is noteworthy that these are perspectives made in the hearings of winding up petition, not applications to restrain presentation of petition. It is submitted, for the reasons stated below, that the creditor should ordinarily not be restrained from presenting a winding-up petition in a cross-claim case[53] because it cannot be an abuse of process of the court for a creditor (who has locus standi and who is creditor of an undisputed debt), to present a winding-up petition against a company which has failed to pay the debt.

First, *Bayoil* case[54] makes clear there is no absolute jurisdictional bar to a petition where a cross-claim existed which supports the view that the petitioner does have locus standi. If the petitioner had lacked locus standi to petition, it should result in the court dismissing the petition as a matter of course, rather than as a matter of practice, because the petitioner would not qualify as a creditor under the statutory framework.

Hardie Boys J. in *Re Julius Harper Ltd., ex parte Winkler & Co. (Hong Kong) Ltd.*[55] ("*Julius Harper* case") held that where the creditor's debt was undisputed, the creditor's *locus standi* in presenting the winding up petition is not in issue and that in petitioning to wind up the company, the creditor was not abusing the process of the court because it had a statutory right to do so. His Lordship noted:

> English cases dealing with the situation where the company asserts a counterclaim do not proceed on the basis that the dispute necessarily puts in question the locus standi of the petitioner. Indeed, if that were the basis, consistency with the cases where the debt is disputed would require the Court to refuse to make a

[51] *Stooke* v. *Taylor* (1880) 5 Q.B.D. 569.
[52] Namely, *Malayan Plant* case [1980–1981] S.L.R. 8; *Re Ringinfo Ltd.* [2002] 1 B.C.L.C. 210; and *Re MCI Worldcom* [2003] 1 B.C.L.C. 330.
[53] It will be contended in the next section that the court may restrain presentation of the petition only if the company can show that such a petition is bound to fail.
[54] See [1999] 1 W.L.R. 147.
[55] [1983] N.Z.L.R. 215.

> winding up order at all; but that is clearly not the approach that is taken. If therefore the making of a winding up order is in the discretion of the Companies Court, it is difficult to see how proceedings upon a petition to bring the matter before that Court, in order that it may itself determine how its discretion should be exercised, can amount to an abuse of process, and so justify the issue of an injunction.[56]

Secondly, cross-claim cases often centered on whether the cross-claim is genuine and substantial, with concomitantly too little emphasis on the fact that the petition debt is actually *undisputed*.[57] As explained earlier, the existence of the cross-claim weighs on the court's exercise of discretion whether to make the winding up order, but should not affect the petitioner's locus standi to file a petition.

Hardie Boys J. in *Julius Harper* case[58] acknowledged that there were Australian and New Zealand decisions which adopted the view that a substantial counterclaim does raise the question of whether the petitioner has sufficient *locus standi*, but his Lordship held a contrary view:

> As the debt upon which the petition here is based is not disputed, the petitioner has the locus standi to bring its petition. The counterclaim asserted by the company, even though it be bona fide and based on substantial grounds, is in my opinion no automatic bar to a winding up order. Thus I do not think it is an abuse of process for the petition to be presented or proceeded upon. I do not consider it a proper function of the Court in the exercise of its inherent jurisdiction to embark upon a consideration of matters relevant to the exercise of a discretion – and indeed to exercise the discretion – which is conferred by the Companies Act and properly belongs to the Court when hearing the winding up petition itself. I would accordingly dismiss the present motion as being without foundation in law.[59]

McMullin J in *Anglian Sales Ltd.* v. *South Pacific Manufacturing Co. Ltd.*[60] ("*Anglian Sales* case") endorsed the reasoning in *Julius Harper* case[61] in the following terms:

> It follows that where the existence of the debt on which the petition is founded is unchallenged it cannot be said with the same confidence that the proceedings amount to abuse of process by

[56] *Ibid.*, at p.220.
[57] As early as 1865, Lord Cranworth in *Bowes* v. *Hope Life Insurance Company*, 11 H.L.C. 389 crafted the dictum that a creditor whose debt is presently due, and who cannot get payment of it, is *ex debito justitiae* entitled to a winding up by the Companies Court, and that, ordinarily speaking, it is the duty of the court to make the order.
[58] [1983] N.Z.L.R. 215.
[59] *Ibid.*, at p.223.
[60] [1984] 2 N.Z.L.R. 249.
[61] [1983] N.Z.L.R. 215.

> reason of an alleged counterclaim. Where therefore the debtor, while admitting the debt, advances a counterclaim in attempted answer to a petition, the latter should *normally* proceed to determination, with the Court retaining a discretion as to whether it ultimately makes a winding up or not.[62]

The significance of an undisputed debt is that it leaves the locus standi of the petitioner intact and curtails the application of the abuse of process in a cross-claim case in that it does not make the purpose and motive of the creditor suspect. In terms of whether the creditor is presenting the petition with an improper purpose, Millett J in *Re a Company (No 006273 of 1992)*[63] has made it clear that it is not an abuse of process to bring pressure for payment of an undisputed debt. His Lordship was of the view that there is nothing improper about the creditor using the winding up procedure for the purpose of collecting an undisputed debt.

In terms of whether the creditor is presenting the petition with a collateral motive, Ungoed-Thomas J. in *Mann* v. *Goldstein*,[64] had opined:

> I come now to the allegation of lack of bona fides and to abuse of process. It seems to me that to pursue a substantial claim in accordance with the procedure provided and in the normal manner, even though with personal hostility or even venom, and from some ulterior motive, such as the hope of compromise or some indirect advantage, is not an abuse of the process of the court or acting mala fide but acting bona fide in accordance with the process.[65]

In a similar vein, Buckley LJ in *Bryanston Finance Ltd.* v. *De Vries (No. 2)*[66] ("*Bryanston* case") held that if a petitioner has sufficient ground for petitioning, the fact that his motive for presenting a petition, or one of his motives,[67] may be antagonism to some person cannot render the ground any less sufficient.

[62] [1984] 2 N.Z.L.R. at p.252.
[63] [1992] B.C.C. 794.
[64] [1968] 1 W.L.R 1091.
[65] *Ibid.*, at p.1095.
[66] [1976] Ch. 63.
[67] There has been a line of authorities dealing with the distinction between 'motive' and 'object', for instance, see *Re A Company* [1983] B.C.L.C. 492; *Re Bellador Silk Ltd.* [1965] 1 All E.R. 667; *Re A Company* [1894] 2 Ch. 349; *Niger Merchants Co.* v. *Capper* (1881) 18 Ch. D. 557; *Cadiz Waterworks Co.* v. *Barnett* (1874) L.R. 19 Eq. 182; *Ward* v. *Corlon* [1986] P.C.C. 57; *Fortuna Holdings Pty* v. *Deputy Commissioner of Taxation* (1976) 2 A.C.L.R. 349; *Mincom Pty Ltd.* v. *Murphy* [1983] A.C.L.C. 749; [1983] 1 Qd. R. 297; *QIW Retailer Ltd.* v. *Felview PtyLtd.* (1989) 7 A.C.L.C. 510. 'Motive' would ordinarily mean the cause or reason for any action whereas 'object' is the goal or end of any action.

The decisions on creditors' winding-up petitions based on disputed debts can be explained on this basis. What motivates such a petitioner is the belief that he may achieve his object, which is the payment of his disputed debt. That is an abuse of the process of the court because his real purpose is not to wind up the company but to secure the payment of his disputed debt. On the other hand, in a cross-claim case where the petition debt is undisputed, the only interest of a creditor is to get paid, and if he has no other practical way of obtaining payment, he is entitled to exercise his statutory right to wind up the company. The petitioner's object is not to, say, force the company to negotiate with him, with the latter being an instance of abuse of process.

To sum up, it is submitted that the basis for the court exercising its inherent jurisdiction to restrain presentation of a petition is abuse of process. It cannot be an abuse of process for a creditor of an undisputed debt and who has locus standi to present a petition. The liberal view of the courts to permit the company to "set-off" the cross-claim against the petitioner's debt were enunciated by the Companies Courts hearing of petition because those courts definitely had to consider the existence of a cross-claim as a weighty factor before exercising their discretion to wind up the company.

## III. Standard of Proof

Having established above that in a cross-claim case, the court's inherent jurisdiction to restrain a petition in a cross-claim is not grounded on lack of locus standi of the petitioner, but rather the futility of permitting the petition to be prosecuted, the gravamen issue is whether the company has to show that the petition is "bound to fail" (the "bound to fail" test), or that it is unlikely that the petition will succeed (the "unlikely to succeed" test). Is there a different standard of proof demanded of the company – a higher standard of proof demanded of the company at the hearing to restrain presentation of petition and a lower standard of proof at the hearing of the petition? If one takes the view that the existence of a genuine cross-claim will amount to sufficient reason for the Companies Court to dismiss the petition it seems an injunction should be granted as long as the existence of a cross-claim is shown. If, on the other hand, one takes the view that the existence of such a cross-claim does not justify the dismissal of the petition but merely constitutes a consideration in the exercise of the Companies Court discretion, the burden on the company would be heavier. It is apparent that the "bound to fail" test is more stringent than the "unlikely to succeed" test. The authorities do not speak with one voice as to which is the correct standard of proof to be imposed on the company.

In *Fortuna* case,[68] after a review of the English and Australian authorities, McGarvie J. was able to reduce the decisions into a single principle with two branches. His Lordship had stated:

> The authorities which have been discussed illustrate the distinction between the application of the first and second branches of the principle. The first branch applies to cases where the petitioner is incapable of success as a matter of law or through absence of supporting evidence. Where the petitioner is not entitled to present a petition or where the ground alleged is not a ground which can found a winding-up order, the petition is incapable of success as a matter of law. If there is no sufficient evidence to establish an otherwise sufficient ground, the petition is incapable of success for that reason. Thus the first branch applies where the proposed petition cannot succeed. The second branch applies to cases where there is more suitable alternative means of resolving the dispute involved in a disputed claim against the company. They are not necessarily cases in which, as a matter of law or through absence of evidence, there is an inherent incapacity of success. They may be cases where the petitioner is entitled to present the petition, the ground is sufficient in law and there is evidence to support the ground. They are cases, though, where, due to the availability of the more suitable alternative remedy, the court hearing the petition would in the circumstances, in the exercise of its discretion, decline to make a winding-up order, at least while the circumstances remain as they are at the time of the application for an injunction. Thus the second branch applies where, because of the availability of a suitable alternative procedure, the petition is unlikely to succeed in the circumstances existing at the time.[69]

McGarvie J. further stated[70] that the second branch of the principle has often been applied to cross-claim cases. McGarvie J. explained, why in that case, which concerned a cross-claim, the standard of proof required of the company was that of the petition being "unlikely to succeed":

> I consider that before restraining the presentation of a petition against a plaintiff company I would need to be satisfied on the material before me, that it is unlikely that a winding up order would be made by any judge in the exercise of his discretion … I do not accept the submission that before granting an injunction I would need to be satisfied that the Deputy Commissioner had no chance of success in obtaining a winding up order. The present case is to be determined upon the second branch of the general principle, where the presentation of a petition may be restrained despite the fact that there is a chance that a winding up order may be made. This chance may exist in at least two ways. First, the test that it is unlikely that a winding up order would be made by any

[68] [1978] 2 A.C.L.R. 349.
[69] *Ibid.*, at p.396.
[70] *Ibid.*, at p.398.

> judge in the exercise of his discretion, does not exclude all possibility of such an order being made. Second, if the test is stated in different words, the position is that an injunction may be granted where it is likely that if a petition were presented, any judge would either dismiss it or stand it over. The purpose of standing over a petition is to enable the disputed claim to be determined in other proceedings. If the other proceedings result in favour of the petitioning creditor, the court may then make a winding up order…The company does not have to show that the winding-up petition is bound to fail, but that there is a likelihood that it may fail or that it is unlikely that a winding-up order would be made.[71]

In *Re a Company No 1122 of 2003*,[72] the English High Court had considered the standard of proof to be met by the company in a cross-claim case. Etherton J. stated:

> Where a debt was undisputed, but it was alleged that there was a cross claim, the court would generally restrain presentation or advertisement if; (i) the cross claim was substantial; (ii) the company had been unable to litigate the claim; and (iii) the claim was greater in value than the claim of the respondent…On the facts, the court could not say, in the absence of oral evidence or cross-examination, the applicant's claim had no prospect of success. Accordingly, the court would grant the order sought.[73]

What does Etherton J. mean when he stated the cross-claim must be "substantial"? The accepted wisdom is that the company must do more than simply assert a cross-claim exists, and establishing "some chance of success"[74] is considered "substantial" enough. It is submitted, with respect, that there a clear distinction is to be drawn between the standard of proof to be applied at the hearing of the application to restrain presentation of petition and hearing of petition itself. A lax formulation as to what amounts to a "substantial" cross-claim is warranted at the hearing of the petition because the draconian consequences of premature liquidation would necessitate a construction that is favourable to the company. On the other hand, there are English and New Zealand authorities that propose a higher standard of proof at the hearing of application to restrain presentation of petition, for reasons that will be elaborated below.

Support for the "bound to fail" test may be found in Millett J.'s judgment in *Re a Company (No. 006273 of 1992)*.[75] His Lordship had endorsed the opinion of Morritt J. in *Re Leasing and Finance Services*

[71] *Ibid.*, at pp. 403–404.
[72] [2003] All E.R. (D) 338.
[73] *Ibid.*, at p.338.
[74] Per Harman LJ in *Re L.H.F. Wools Ltd.* [1970] Ch. at p.37.
[75] [1992] B.C.C. 794.

*Ltd.*[76] that it could not be said at the preliminary stage, when an application was made for an injunction to restrain the application of a petition, that the existence of the cross-claim meant that the petition was bound to fail when it came to be heard, because new evidence may surface at the actual hearing of the petition.

Millett J.'s judgment is in accord with New Zealand authorities.[77] For instance, Greig J. in *Anglian Sales* case,[78] was persuaded that:

> The test is whether it is impossible for the petitioner to succeed in its claim. In cases where there is a disputed debt, that is to say, a substantial dispute that the debt is payable at all, then in accordance with the ordinary rule the petition is bound to fail because the petitioner has not shown he is a creditor and the Court on hearing the petition will not enter into the dispute…Other considerations apply when the debt is not disputed in whole, as is the situation in this case, but there is a cross-claim or counterclaim which is alleged to equal or exceed the amount of the creditor's debt. In that case the creditor is still a creditor. On the hearing of the petition it remains a matter of discretion as to whether the petition will be granted or not. That is clear from *Re L.H.F. Wools Ltd.*, but it is not a discretion which is invariably or inevitably exercised against the petitioner. That being the case it cannot be said in these proceedings that the petitioner is bound to fail even though there may be some doubt as to whether the petition will be granted.[79]

Thus, Millett J. in *Re a Company (No 006273 of 1992)*[80] and the New Zealand authorities[81] hold the company to an exacting standard – that it has to show that a winding-up petition against it is bound to fail before the court will exercise its inherent jurisdiction to restrain the creditor of an undisputed debt from presenting a petition against it, notwithstanding the existence of a cross-claim.

It is suggested respectfully that there are several difficulties with the petition being "unlikely to succeed" test. First, applying the petition being "unlikely to succeed" test at the hearing of the application to restrain presentation of petition will invariably mean the injunction will be granted. As Etherton J. aptly pointed out, "where the court is unable to say that there is no prospect of success without oral evidence or cross-examination, the court will grant the injunction."[82] In other words, a rule of evidence as to the standard of proof effectively becomes a principle of granting an injunction to restrain.

[76] [1991] B.C.C. 29.
[77] See, for instance, *Julius Harper* case [1983] N.Z.L.R. 215.; *Anglian Sales* case [1984] 2 N.Z.L.R. 249.
[78] [1984] 2 N.Z.L.R. 249.
[79] See [1984] 2 N.Z.L.R. at p. 254.
[80] [1992] B.C.C. 794.
[81] *Julius Harper* case [1983] N.Z.L.R. 215.; *Anglian Sales* case [1984] 2 N.Z.L.R. 249.
[82] [2003] All E.R. (D) at p. 338.

Secondly, the approach taken in *Fortuna* case[83] is not without difficulties. Although his Lordship's categorization of the cases into two branches provides for ease of analysis, it is submitted that it may not always be possible to compartmentalize the cases into one or the other branch. For instance, consider the facts of *Charles Forte*.[84] Briefly, Amanda, the defendant, became a shareholder of CF, a private company, when he was employed by CF. After he left CF, he executed transfers of his shares, some to third parties and some to his own nominee company. The directors of CF, in exercise of their absolute discretion under the articles, refused to register the transfers and also refused to give any reasons for their refusal. Amanda wrote a letter threatening to present a winding-up petition if CF refused to register the transfer of those shares sold to third parties.

The Court of Appeal in *Charles Forte* case[85] applied the test of whether the company proved the petition was "bound to fail". It may be argued that the case came within the first branch because based on express provision in the company's article, the winding up petition was "incapable of success as a matter of law". Equally it may be argued that the case came within the second branch because there was a suitable alternative procedure – an action for minority oppression.[86] Which then is the test to apply if a case can plausibly fit into either of the two branches? Although the analysis of McGarvie J. is a valuable exposition of the law in Australia, Victoria had a statutory provision[87] which gave the court a discretion not to grant a winding-up order if an alternative remedy is available. The use of the words "unlikely to succeed" by McGarvie J. in the last sentence in the above passage has to be understood in that context.

Aside from the difficulties with the "unlikely to succeed" test, it is submitted that the "bound to fail" test accords with principle as well as policy. First, the higher standard of proof accords with the principle that the Companies Court retains discretion to make the winding up order in a cross-claim case, albeit the court will only do so in special

[83] [1978] 2 A.C.L.R. 349.
[84] [1964] Ch. 240.
[85] *Ibid.*
[86] Not everyone is agreed that a member's right to present a winding-up petition against his company should be restrained if his complaint is sufficient to found another action for which another remedy is available. There are those who hold the view that so long as the complaint, if substantiated, is also a sufficient ground to wind up a company, the petition should proceed. Australian cases, for example, *Fortuna Holdings Pty Ltd.* v. *The Deputy Commissioner of Taxation of the Commonwealth of Australia* [1978] 2 A.C.L.R. 349 and *Mincom Pty Ltd.* v. *Murphy* [1983] A.C.L.C. 749 support the view that the company should be restrained if an alternative remedy exists. On the other hand, New Zealand cases, for example, *Tench* v. *Tench Bros Ltd.* [1936] N.Z.L.R. 403 stated it was not at all clear that because the petitioner had an alternative remedy, i.e. an action to quash the alteration of the articles to remove him as a director, he could not proceed on the 'just and equitable' ground to wind up the private company.
[87] Section 225(3) of the Companies Act 1961 of Victoria. In England, where "just and equitable" petitions are concerned, s. 125(2) of the Insolvency Act 1986 applies.

circumstances. It is the Companies Court that should consider all the facts of the case to determine if a winding up order should be made, not the court that hears the application to restrain a creditor from presenting a winding up petition. At the risk of belaboring the point, it is important to note the distinction between the jurisdiction of the court to make a winding up order and its discretion to do so. Upon a company being established to be unable to pay its debts, the court has jurisdiction to wind up the company. It is clear that the court is given an overriding discretion as to whether the winding up order should be made, in the light of a cross-claim by the company against the creditor that equals or exceeds the petition debt. Prior judicial decisions cannot fetter or limit the discretion conferred by statute which is why the courts have emphasized that there is only a *practice*, as opposed to a principle of law, not to grant the winding up order. The higher standard of proof espoused by the "bound to fail" test will mean courts will not so readily restrain a creditor from presenting a petition, such that cross-claim cases will eventually be heard at the proper forum, i.e. the Companies Court, which will exercise its discretion whether or not to make the winding up order. The lax standard of proof will mean effectively substituting the Companies Court's discretion whether to grant a winding up order with the court's exercise of discretion as part of its inherent jurisdiction to prevent an abuse of process.[88]

Secondly, the higher standard of proof accords with the principle that a person who has locus standi to petition to wind up the company should not have the statutory right conferred on him taken away unless presentation of petition is clearly proven to be an abuse of process. Otherwise the court would be refusing to give effect to the very right which the statute has conferred upon a creditor to have the petition itself heard.[89] If the creditor has an undisputed debt claim against the company and the company is of doubtful solvency, the creditor is entitled to present a petition to wind up the company. If, when the petition comes up for hearing, the debt is not proved, then the petition will be dismissed with costs. If such a proceeding is taken maliciously, and without any fair or honest cause, the company would have an action for damages against a person who proceeded in that way. But the company should not ask the court to restrain the creditor from taking proceedings which legislature says he is entitled to take. The company is in effect seeking temporary protection pending the trial of the action, i.e. "the right not to be involved in litigation which would constitute an abuse of the process of the court", which according to Buckley L.J., "the company cannot assert such a right in respect of any particular

[88] *Julius Harper* [1983] N.Z.L.R. 215.
[89] *Anglian Sales* [1984] 2 N.Z.L.R. 249.; *Re a Company (No 006273 of 1992)* [1992] B.C.C. 794; *Re Leasing and Finance Services Ltd.* [1992] B.C.C. 794.

anticipated litigation without demonstrating that, at least prima facie, that litigation would be an abuse."[90] The jurisdiction to restrain the presentation of a petition is a jurisdiction to be exercised with caution, to be exercised sparingly and in exceptional cases.[91] To deprive a person who has a statutory right to petition by using the court's inherent jurisdiction to restrain ought to necessitate a very stringent standard, that is, only in plain and obvious cases where that the petition is "bound to fail".

Thirdly, the "bound to fail" test accords with the principle that it is best left to the Companies Court hearing the petition (rather than the court hearing the application to restrain presentation of petition) in its exercise of discretion, to weigh the strength of the cross-claim.

As a matter of evidence, until the cross-claim is tried, it would be extremely difficult to tell what the decision of the court would be, either on the merits of the cross-claim or whether its quantum would equal or exceed the undisputed debt. The court treads an extremely fine line between deciding whether a substantial cross-claim existed and actually deciding the cross-claim itself.

Given what is at stake should an application to restrain presentation of petition prove successful, it is not unexpected if companies raise questionable objections to a petition in order suggest there is a cross-claim. Companies have the incentive to obstruct the progress of a winding up petition by generating the impression that a cross-claim exists, when in substance there is none. If such suspicions are aroused in the judicial mind, despite apparently voluminous objections adduced by the company on affidavit, the court may conclude that the ends of justice are best served by allowing the petition to proceed.[92] As Neuberger J. had pointed out:

> It is important to emphasise that a judge, whether sitting in the Companies Court or elsewhere, should be astute to ensure that, however complicated and extensive the evidence might appear to be, the very extensiveness and complexity is not being invoked to mask the fact that there is, on proper analysis, no arguable defence to a claim, whether on the facts or law.[93]

Finally, the "bound to fail" test provides a delicate balance between the policy consideration of protecting the creditor (who has a statutory right to present a winding up petition) and protecting the company (that its commercial viability should not be put in jeopardy by the premature presentation of a winding-up petition against it where a cross-claim exists).

[90] *Bryanston* [1976] Ch. at pp. 66-67.
[91] *Ibid.*
[92] *Re A Company (No. 006685 of 1996)* [1997] B.C.C. 830.
[93] *Re Richbell Strategic Holdings Ltd.* [1997] 2 B.C.L.C. 429, 434.

A petition will undoubtedly have severe implications[94] for the company. Creditors, clients and customers will naturally be very cautious in future dealings with the company if a winding up petition were presented. It may, inter alia, adversely affect the reputation and the business of the company; trigger cross-default or crystallization provisions in loan documents; cause credit to dry up which thereby cut the company off from further sources of financing and worsen its precarious financial position. Presentation against one company in a group may seriously affect the group as a whole. There may be dangers to the company's shareholders and employees from the mere presentation of a petition. Proponents of the less stringent test – the petition is "unlikely to succeed" test – may argue that so long as the court is satisfied on the evidence that the cross-claim may exceed the undisputed debt, it should give the company the opportunity to prove its claim rather than to allow a winding-up petition to be filed and accordingly grant the injunction sought.

However, there is also merit in the argument that in applications to restrain, the court must be mindful of injustice being caused to the creditor. Such restraining orders have the potential of defeating the rights of creditors who may not have the same financial resources as the company, thereby denying them equal access to the court after a pre-emptive strike.[95] If the filing of the petition were restrained, the commencement of winding up[96] may be postponed till after the cross-claim has been determined first. Certain transactions are void or voidable only if they fall within a specific timeframe calculated with reference to the commencement of winding up. Most of the persons who petition to wind up a company are unsecured creditors.[97] If the designated period for avoiding a preference runs out, a liquidator who is eventually appointed will be deprived of the opportunity to challenge or avoid some dubious transactions entered into by the company, and resulting in severe repercussions for the unsecured creditors of the company. It has been pointed out that unsecured creditors are badly treated as a class[98] and the unfairness should not be exacerbated by the court's readiness to restrain the creditor's petition unless the higher standard of proof, namely, the "bound to fail" test is fulfilled.

[94] See, for instance, comments made in *Cadiz Waterworks Co.* v. *Barnett* (1874) L.R. 19 Eq. 182; *Re Golden Breed Pty Ltd.* (1979) 22 S.A.S.R. 392.
[95] *Re A Company (No. 009080 of 1992)* [1993] B.C.L.C. 269.
[96] Which dates from the time of presentation of petition.
[97] Unsecured creditors are the ones most likely to petition to wind up a company because they do not have the option of appointing a receiver to realize charged assets.
[98] See for instance, RM Goode, "Is the law too favourable to secured creditors ?" (1983–1984) 8 Can. Bus. L.J. 53; V Finch, "Security, Insolvency and Risk: Who Pays the Price?" (1999) 62 M..L..R. 633.

It may be timely to note that in the *Bryanston* case,[99] while Buckley LJ recognised that the presentation of a winding up petition might cause great damage to a company's business and reputation, his Lordship cautioned that the potential damage to the company might have been exaggerated. One can think of situations, for instance, involving companies that have no commercial creditworthiness to lose, or companies that are dormant, in which these companies may not be negatively impacted by public knowledge of a petition. Buckley LJ reminded his court:

> It has long been recognized that the jurisdiction of the court to stay an action in limine as an abuse of process is a jurisdiction to be exercised with great circumspection and exactly the same considerations must apply to a quia timet injunction to restrain commencement of proceedings. These principles are, in my opinion, just as applicable to a winding up petition…The restraint of a petition may also gravely affect the would-be petitioner and not only him but also others, whether creditors or contributories.[100]

## IV. Conclusion

There appears to be a clear distinction between the Companies Court's exercise of discretion on hearing the petition and the court's exercise of the inherent jurisdiction to restrain presentation of a petition. What the company invokes in cases of applications to restrain is to restrain presentation of petition as an abuse of the court's process. It is not appropriate for the court to conclude on the merits of the petition. It should be the Companies Court's overriding discretion to refuse to make a winding up order, where a substantial cross-claim exists, at the hearing of the petition, that provides the control mechanism against companies being wound up on the petition of a person, who when all outstanding sums are settled, either is a person to whom the company is not indebted to or is a person who is instead required to make payment to the company. Given that the petitioner has locus standi to file the petition and the petition debt is undisputed, then notwithstanding the existence of a cross-claim, the court should only issue an injunction in a compelling case, where the company is able to satisfy the court that the petition is "bound to fail".

[99] [1976] Ch. at 66.
[100] *Ibid.* at p.78.