

17/91

**SUPREME COURT OF VICTORIA****SUNSHINE MANAGEMENT SERVICES PTY LTD v RUSSO and ANOR**

Hampel J

18 January 1991 — (1991) 4 ACSR 192; 9 ACLC 1,069

**CIVIL PROCEEDINGS – COMPANIES – DEBT INCURRED – ACTION TAKEN AGAINST DIRECTORS UNSUCCESSFUL – STATUTORY CIVIL LIABILITY OF DIRECTORS – ACTION TAKEN UNDER STATUTORY PROVISION TO RECOVER SAME DEBT – COMPANY DEEMED UNABLE TO PAY DEBT – WHETHER BOTH ACTIONS SHOULD HAVE PROCEEDED TOGETHER – WHETHER DEFENCE OF *RES JUDICATA* APPLIES: COMPANIES CODE, SS553, 556.**

Before an action can be commenced under s556 of the *Companies Code* to impose civil liability on a director of a company unable to pay its debts it is necessary that the provisions of s553(2)(b) be first satisfied – that is, execution of a judgment must have been returned unsatisfied. The fact that guarantees are being exacted from the directors or some reference is made to the Company's being in financial difficulties is insufficient to make a finding under this provision that the company is unable to pay its debts. Accordingly, where the pre-condition contained in s553(2)(b) was not met when earlier proceedings issued against the Directors were heard and dismissed, a magistrate was in error in dismissing subsequent proceedings based on s556 on the ground that both proceedings should have been issued at the same time and that the defence of *res judicata* applied.

*DM Drainage & Construction Pty Ltd v Lewis* (1988) 7 ACLC 74, applied.

**HAMPEL J:** [1] This is an appeal by Sunshine Management Services Pty Ltd against a decision by the Magistrate sitting at Williamstown, whereby a claim against the respondents David Russo and Josie Russo in relation to a debt was dismissed. The background to these proceedings is referred to fully in the affidavit in support sworn by Mr Cicero, the solicitor for the applicant. Briefly stated, the background is as follows: the appellant company provided management and accountancy services to several companies which are listed in paragraph 2 of the affidavit, and a debt resulted as a consequence of those services. The appellant issued proceedings against the companies for the debt and joined the Directors, including the two respondents, and another John Russo, relying on two causes of action, one being against the companies for the debt, and the second being a cause of action based on the guarantees provided by the Directors. Those proceedings resulted in a judgment against the companies and against John Russo on the guarantee, but the claim against David Russo and Josie Russo was dismissed.

Subsequently, on 14th May 1990, further proceedings were issued claiming the debt to which I have referred, pursuant to s556 of the *Companies Code*. That action was dismissed and it is against that dismissal that this appeal is instituted. Section 556 of the *Code* is an unusual provision, in that it creates offences and liability for debt. It provides that:

"If a company incurs a debt, then if [2] immediately before the time when the debt is incurred there are reasonable grounds to expect that the company will not be able to pay all its debts as and when they become due, or there are reasonable grounds to expect that if the company incurs the debt, it will not be able to pay all its debts as and when they become due, and the company is at that time, when the debt is incurred, or becomes at a time later, a company to which this section applies, then any person who is a director of the company or took part in the management of the company at the time when the debt was incurred, is guilty of an offence, and the company and that person, or if there are two or more such persons, those persons are jointly and severally liable for the payment of the debt".

Defences are provided by sub-s(2). In the interpretation part of the *Code*, that is in s553, there are provisions which apply to s556. In so far as it is relevant to this proceedings, s556 applies to a company, "That has ceased to carry on business or is unable to pay its debts." There then follows sub-s(2) which is in these terms:

"For the purposes of this section, the company shall be deemed to be unable to pay its debts if, and only if, execution or other process issued on a judgment, decree or order of any court in favour of a creditor of the company is returned unsatisfied in whole or in part."

The Magistrate upon hearing submissions made to him, found that it was open to the appellant, then the complainant, to proceed for the recovery of the debt under s556 at the time when the proceedings were issued against the companies and against the individual directors as guarantors. In those circumstances, he acceded to a [3] submission that the proceedings subsequently issued under s556 as they related to the same debt, were *res judicata*, and dismissed the summons on that basis. [4] In effect, he found that s553(2)(b) was merely a facilitating section which enabled proof that the company was unable to pay its debts by the method of showing that process issued on a judgment and was returned unsatisfied, and rejected the submission that the only way in which it can be established that the company is unable to pay its debts under ss(f) of s553(1) is by the method set out in s553(2)(b), namely, the proof of an unsatisfied judgment.

It is not necessary for this purpose to set out the Magistrate's reasons in more detail. They appear in paragraph 13 of Mr Cicero's affidavit. His Worship, as I said, took the view that it was open for the then complainant to have pleaded the cause of action under s556 in the original proceedings and that was not done. His Worship went on to say that a basis for the commencement of such an action existed in the affidavit material which referred to the fact that apparently the company was experiencing financial difficulties, and that the complainant agreed to continue to provide accountancy services to the defendants, upon the condition that there would be personal guarantees for professional fees. This, His Worship held, gave rise to the inference that the company was having difficulty in paying its debts. It is in that context that he went on to say: "In my view s553(2) of the *Companies Code* merely facilitates the ability of the commencement of the action under 556 of the Code". He concluded that there was sufficient material available at the time to enable the use of s556 when the original proceedings were heard.

[5] The matter came before the Master on 4th October 1990, who ordered that there was an arguable case for appeal and the following questions of law should be determined: (a), whether it was open to the learned Magistrate to hold, on the evidence before him, that the appellant should have instituted proceedings under s556 at the time it commenced the earlier proceedings against the respondents seeking moneys due pursuant to the guarantees; (b), whether it was open to the learned Magistrate to hold, on the evidence before him, that the opportunity existed for the appellant in the earlier proceedings to have commenced an action under s556; (c), whether there was evidence to justify the Magistrate finding that it was open to the appellant to have pleaded its rights accruing under s556 of the *Companies Code* in the earlier proceedings, and (d), whether the Magistrate was correct in holding that the respondents could rely on the defence of *res judicata*.

The matter was argued before me on a fairly limited basis because Mr Bristow, who appeared for the appellant, conceded that if the position was that the appellant could have proceeded at the original proceedings, in addition to his other causes of actions, upon the basis of s556, then he could not succeed in this appeal. Mr Bristow argued that s553(2)(b) was the only way in which it was possible, for the purpose of s556, to establish a claim for a debt in these circumstances. He submitted that that provided, in effect, a code and that the plaintiff was not in a position at the time when the original action was before the Magistrate, or at any other relevant time to rely on such a cause of action. It was [6] said that the Magistrate erred in upholding the submission that the claim was *res judicata* and that it should be dismissed on the basis that the proceedings could have been brought at the same time.

Mr Bristow relies on a decision of Master White, a Master of the Supreme Court of Western Australia, in a case of *DM Drainage & Construction Pty Limited v Lewis* (1987) 7 ACLC page 74. In construing the very same provision in that case, the Master found that because of its nature, s556 should be construed strictly and in a limited way, imposing as it did both civil and criminal liability on persons caught by its provisions. He held that s553(2)(b) of the *Code* had to be satisfied before s553(1)(f) could be said to be established, that is, before it could be said for the purpose of this kind of claim that the company was unable to pay its debts. The Master relied on the wording of the sub-section and, in particular, the words "if and only if" contained in it which he equated with the concept of "but not otherwise." The Master relied on what Rogers J said in *Bush v Wright & Ors*, a case referred to at p76 of the *DM Drainage case*. Although Rogers J was dealing

with another issue and the effect of *Bush's case* was that the whole of the cause of action must be complete before the proceedings are issued in respect of this section, His Honour did observe that subs(1)(f) of s553 can only apply if the provisions of sub-s(2)(b) of s553 are satisfied.

[7] It follows that Mr Bristow's approach to the interpretation of s553 is supported by the view taken by the learned Master and Rogers J. Mr Sandbach, who appeared for the respondents, contended to the contrary, namely, that the sub-section was merely one which facilitated the proof of what is required in s553(1)(f), namely, the inability by the company to pay its debts. He contended that it was a deeming provision and did not cover the field. In other words, that the inability of the company to pay its debts can be proved for this purpose in all sorts of ways, as well as by the deeming provision if there is an unsatisfied judgment. Mr Sandbach further submitted that in this case there was sufficient material on which the Magistrate could have come to the conclusion which he reached. He pointed out that the logic of the situation required or compelled that to be so because if the company was not able to pay its debts then, *ipso facto*, there was a basis for the bringing of the proceedings under s556 at the same time. If, on the other hand, the company was able to pay its debts then the complainants below would have to have succeeded in the proceedings in any event.

In my opinion, the correct interpretation of the provisions of s553 is that arrived at by Master White and indicated by Rogers J. This is a very specific and unusual provision which enables criminal proceedings to take place against the directors in the circumstances set out in s556 and, at the same time, enables civil proceedings to be taken for debt so incurred. [8] I agree with the general views expressed by Master White that this provision should be interpreted narrowly and not extended. Despite the use of the words "deemed to be unable to pay its debts" in the context of this sub-section the words "if and only if" and the general nature of the provisions all point to the proposition that there is a limited and precise basis on which such proceedings can be instituted.

Even if I were wrong about this view of the sub-section, in my opinion, the appeal would still have to succeed because I do not accept Mr Sandbach's argument that there is a logical position which compels the conclusion that in a case such as this one the proceedings have to be capable of being brought at the same time on the basis that he contended. Also there would have to be a proper evidentiary basis on which it could be found that the company was, in fact, at the relevant time, unable to pay its debts.

There was no such evidence in the present case and I think the Magistrate was in error in his findings that a sufficient inference can be drawn that the company was unable to pay its debts from the fact that guarantees were being exacted and from the fact that there was a reference to the company being in financial difficulties.

In my opinion, that sort of fairly general and imprecise evidence is one reason why it ought not to be the basis for proceedings under s556. It follows that in my view the appeal should be allowed.