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Section 320 of the Companies Act 1955

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CONTENTS

		Page
PART A	INTRODUCTION	1
PART B	HISTORICAL BACKGROUND	4
PART C	FRAUD	11
CHAPTER:	1. Introduction	11
	2. Early Definitions of Fraudulent Trading	11
	3. A Distinction between the _Hardie_ and the _Patrick and Lyon_ Tests	16
	4. The New Zealand Position	20
	5. The United Kingdom Position	24
	6. Can a Bare Preference amount to Fraud?	30
	7. Difficulty of establishing Fraud	33
PART D	THE 1980 AMENDMENTS TO SECTION 320	37
CHAPTER:	1. Introduction	37
	2. Preliminary Issues	37
	3. Contracting Debts Without An Honest Belief On Reasonable Grounds That They Would be Paid	40

		Page
Section (i)	Introduction	40
(ii)	Honest belief on reasonable grounds	41
(iii)	Contracting of a Debt	44
(iv)	Able to pay the debt ... As well as all its other debts	47
(v)	Reintroduction of the _Leitch_ test	52
4. Recklessness		52
Section (i)	Introduction	52
(ii)	_Thompson_ v _Innes_	53
(iii)	Does _Thompson_ v _Innes_ correctly state the test under paragraph (b)?	59
PART E	OTHER ISSUES WITHIN PARAGRAPHS (a), (b) and (c)	66
CHAPTER: 1. Introduction		66
2. Party To		66
Section (i)	Positive Step	68
(ii)	Knowledge	70
(iii)	Definition of 'party to' following _Maidstone_ and _Gerald Cooper_	73
(iv)	A third ingredient in the definition	74
(v)	Definition of 'party to' at present	81
3. Knowingly		82

Page

4. Carrying On of Any Business of the Company 84

Section (i) Single transaction 84

(ii) Cessation of trading 88

PART F PROCEDURAL ISSUES 92

CHAPTER: 1. Introduction 92

2. Locus Standi 92

3. The Distribution of any Sums Recovered 98

4. Extent of the Order - Is Section 320 a Penal Provision 103

5. Enforcement Provisions of Section 320 110

6. Procedure for bringing Application under Section 320(1) 113

PART G CONCLUSION 115

PART H FOOTNOTES

APPENDIX

TABLE OF CASES

INTRODUCTION

This paper examines in some detail section 320 of the Companies Act 1955. That section, which over the years has come to be known as the 'fraudulent trading' provision (inspite of the fact that it now no longer solely refers to fraudulent trading), is one of a group of sections in the Act, including sections 311B, 311C, 315A, 315B, 315C and 364, which requires directors and officers to bear the interests of creditors in mind when carrying on the business of the company.

There is no doubt that section 320 imposes upon directors and officers a statutory duty of care towards the creditors.[1] The duty is a statutory one because at Common Law, at least until very recently, the courts have consistently held that directors did not owe creditors a duty of care. The traditional view was recently stated as follows:

> "... apart from statutory obligations to take into account the interests of creditors ... and the general obligation to maintain the company's capital, directors are not required to have regard to the interests of creditors in exercising their responsibilities: their concern is with the financial interests of the shareholders."[2]

The concept of limited liability has always been seen as a privilege rather than a right.[3] But that privilege

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has at times been the subject of abuse by directors and others in control of a company. Where the loser in any particular instance of such abuse was a creditor of the company, the directors would, at Common Law, be able to get away with their improper conduct. It was therefore left to Parliament to intervene, with provisions like section 320, by stripping away the shield of limited liability and making the delinquent directors personally liable for any loss suffered by the creditors due to the former's improper acts.

During the past few years, however, there have been certain suggestions in some cases that directors might owe creditors a duty of care at Common Law. These suggestions have emanated from cases in the United Kingdom[4], Australia[5] and New Zealand.[6] The most comprehensive discussion of this issue to date has been by Cooke J in Nicholson v Permakraft (NZ) Ltd.[7] Cooke J stated the duty by means of an objective test: whether, when doing the act which caused loss to creditors, the directors should have appreciated or ought to have known that their act would cause loss to creditors.[8] Cooke J's view, however, is far from being prevalent. In the same case both Richardson J and Somers J expressly refrained from commenting on any such proposition[9], and other judges have continued to reiterate the traditional common law position.[10]

For the moment, therefore, one must continue to rely on the statutory provisions in imposing a duty upon directors in relation to creditors. In this respect section 320 is a very important provision. Professor Gower, while discussing the section, has said:

> "There is no doubt that in practice this section represents a potent weapon in the hands of creditors which exercises a restraining influence on over-sanguine directors. The mere threat of proceedings under it has been known to result in the directors agreeing to make themselves personally liable for part of the company's debts. Of all the exceptions to the rule in Salomon's case it is probably the most serious attempt which has yet been made to protect creditors generally ... from the abuses inherent in the rigid application of the corporate entity concept."[11]

With those words in mind, one may proceed to an analysis of section 320.

HISTORICAL BACKGROUND

Section 320 was first enacted as section 75 of the Companies Act 1928 (UK). The section was enacted following a recommendation of the Greene Committee on company law[12] that legislation be introduced to combat the growing instances of fraudulent trading. The Committee stated that its attention had been "directed particularly to the case (met with principally in private companies) where the person in control of the company holds a floating charge and, while knowing that the company is on the verge of liquidation, "fills up" his security by means of goods obtained on credit and then appoints a receiver."[13]

The problem arose primarily in small private companies, which were in many instances one-man ventures. The primary reason for incorporation was to take advantage of the concept of limited liability. The owner could sell the proprietorship to the company as a going concern for a consideration which might not necessarily reflect the true value of the business.[14] The company would therefore take over all the assets and liabilities of the owner. If the company satisfied part of the purchase price by way of debentures over its assets, the owner would himself become a creditor of the company. He would in fact become a secured

creditor and move a step ahead of the unsecured trade creditors, to whom he was previously personally liable, and whose remedy, if any, now lay solely with the company. In such a situation the owner could begin to defraud the trade creditors. It was this sort of mischief which the Greene Committee sought to overcome, and a classical example of it is provided by the facts of the first reported decision on section 320, In re William C. Leitch Bros. Ltd.[15]

In Leitch the respondent incorporated a company and sold his business, which he had carried on as a sole trader, to it for 5000 pounds. The purchase price was satisfied by way of 1000 fully paid one pound shares and a debenture for 4000 pounds secured by a charge over all the assets of the company, present and future. The company also took over all the liabilities of the proprietorship, amounting to 770 pounds.

The accounts at the end of the first two and a half years trading showed that the company had made a net loss. By the end of the following financial year the company was insolvent, with trade creditors being owed 6500 pounds. The respondent, however, ordered further goods on credit to the value of 6800 pounds. This was far in excess of what the company had

normally ordered in previous years over the same period. Two months later the respondent appointed a receiver. To top things off, the respondent was appointed manager by the receiver and drew a salary of 1300 pounds before the receiver discovered the true affairs of the company and dismissed him. The company also had an overdraft with its bank, which was guaranteed by the respondent personally. During the last three months of trading, the respondent had reduced the overdraft almost completely by banking all receipts. None of the trade creditors was paid at all. A month after going into receivership, the company was wound up.

Prior to the enactment of section 320 the respondent would have been paid pursuant to his debenture while the trade creditors would have been left high and dry. Quite clearly the respondent had acted in an improper manner. However, at Common Law he was not liable for the debts of the company to the unsecured trade creditors, since as director he owed them no duty.[16] It was this defect which the Greene Committee intended to remedy. It recommended that the director in such a case should be personally responsible, without limitation, for the debts of the company, and any security over the company's assets held by him and not assigned to a bona fide third party be charged with

the liability.[17] It was also recommended that the director's actions be made a criminal offence.[18]

The Committee's recommendations were accepted in toto by Parliament and enacted as section 75 of the 1928 Act, which was later consolidated and re-enacted as section 275 of the Companies Act 1929 (UK). That section was the same as section 320 of the Companies Act 1955 except that it was limited to directors[19] as the persons who could be made liable for the company's fraudulent acts. A few years later New Zealand followed the United Kingdom's example and reproduced the fraudulent trading provision as section 268 of the Companies Act 1933.

When the Cohen Committee[20] undertook its review of the Companies Act 1929 (UK) it recommended that section 275 be amended by replacing the word 'directors' with the words 'any persons'. Parliament followed that recommendation. Although the Companies Act 1948 (UK)[21] therefore contained a slightly more liberal fraudulent trading provision (section 332), in 1962 the Jenkins Committee[22] did not think that the section went far enough. It said, in relation to the question of fraudulent trading generally:

> "There is widespread criticism that the Companies Act as a whole does not at present deal adequately with the situation arising from fraud and incompetence on the part of directors - particularly directors of insolvent companies..."[23]

The Jenkins Committee was concerned that a director who carried on business in an incompetent manner would not be held liable under section 332 when in fact his incompetency could lead to loss to creditors to the same extent as fraudulent trading could. But because the incompetent director may not have had an intention to defraud in terms of section 332, he would escape liability. Accordingly, the Committee recommended that those who carried on the business of the company in a reckless manner should be liable, without limitation, for all or any of the debts of the company.[24]

Although Parliament has not yet accepted that recommendation, it has instead enacted section 15 of the Insolvency Act 1985 (UK) which provides that a director who "knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation" may be held liable, personally, for the debts of the company.

In New Zealand section 268 of the Companies Act 1933 was reproduced as section 320 of the Companies Act 1955,

except that, following the United Kingdom's example, the word 'directors' was replaced by 'any persons'.

In 1973 the Macarthur Committee submitted its report on the Companies Act.[25] The Committee felt that section 320 was too restrictive in scope. It recommended the repeal of that section and the enactment of a new provision along the lines of section 374C(1) of the Companies (Amendment) Act 1971 (NSW). That section provided that any officer of the company who was knowingly a party to the contracting of a debt by the company and had, at the time the debt was contracted, no reasonable or probable ground of expectation of the company paying the debt, was personally liable for that debt. This broad provision was in addition to liability on the grounds of fraudulent trading.

The Macarthur Committee did not refer to the recommendation of the Jenkins Committee in respect of reckless trading. However, when Parliament came to amend section 320, it adopted the recommendations of both these committees. In doing so Parliament appeared to have been concerned about the risk of loss to creditors in the financial climate then prevailing, and was seeking to minimise such risk by adopting measures introduced in different jurisdictions in relation to

that issue as far as possible.[26]

Thus, the Companies Amendment Act 1980 introduced two grounds of liability to section 320. The first was the contracting of a debt without honestly believing on reasonable grounds that the debt would be paid (section 320(1)(a)) and the second was carrying on business in a reckless manner (section 320(1)(b)). Carrying on business fraudulently was retained as the third ground (section 320(1)(c)).[27]

In considering each of these grounds of liability, it would be more appropriate to deal with fraud first, and then to consider the effect of the 1980 amendments, since fraud was originally the only basis of liability under the section and the 1980 amendments have to be considered in the light of the approach which the courts have taken in relation to fraud.

FRAUD

Introduction

The courts have always experienced much difficulty in dealing with the issue of fraud in the context of section 320.[28] Obviously, the only way of being certain of a person's fraudulent intent is an admission by him to that effect. Generally such an admission will not be forthcoming, either from the evidence before or during the trial. The court, therefore, has to establish an intent from the facts. That difficult task is compounded by the absence of a definition, in the Act, of the phrases 'intention to defraud' and 'fraudulent purpose'.[29]

Early Definitions of Fraudulent Trading

In In re William C. Leitch Bros. Ltd[30] Maugham J posed the following test in relation to fraud:

> "... if a company continues to carry on business and to incur debts at a time when there is to the knowledge of the directors no reasonable prospect of the creditors ever receiving payment of those debts, it is, in general, a proper inference that the company is carrying on business with intent to defraud creditors."[31]

This test sets a low standard of proof. Even though section 320 requires an 'intent' to defraud, it is sufficient to establish such intent by inference from the fact that the director believed that there was no reasonable prospect of the creditors receiving payment. One need not actually establish that there was in fact a motive to, for instance, order goods on credit and not pay for them. Subjective dishonesty need not be proved. The test is partly objective, and partly subjective in that, although the prospect for payment must be objectively ascertained, the director must in fact be aware of that prospect. For present purposes, the test may be referred to as a liberal test.

A year later Maugham J had occasion to consider section 320 again in In re Patrick and Lyon Ltd.[32] After referring to Leitch Maugham J said:

> "... the words 'defraud' and 'fraudulent purpose', where they appear in the section in question, are words which connote actual dishonesty involving, according to current notions of fair trading among commercial men, real moral blame."[33]

Maugham J here is quite clearly adopting a less objective approach than he did in Leitch. To establish 'actual dishonesty' one needs to undertake a subjective exercise, which involves a higher standard of proof and is overall a more difficult exercise. This is apparent from the conclusion reached by Maugham J on the facts

of Patrick and Lyon. The respondent was the major shareholder and sole director of a small private company. The respondent was also an unsecured creditor of the company. He then agreed to advance to the company a further loan, which he secured by way of debentures constituting floating charges over the company's assets. The company then used the new loan to discharge the earlier debt to the respondent. Six months and one day after the debentures were obtained, the respondent placed the company into receivership. Two weeks later the company went into liquidation.

The creditors argued that the company was insolvent when the debentures were granted and that the only reason for carrying on business for the next six months was to validate the debentures.[34] That conduct, it was argued, clearly constituted an intent to defraud creditors. But Maugham J was not so convinced. He found the respondent not liable on the basis that actual dishonesty had not been proved.[35]

If the Leitch test had been applied to these facts, it is arguable that the respondent would have been found liable. By taking the loan when the company was insolvent, the respondent was incurring a debt when there was no reasonable prospect of the company paying

that debt. It would therefore appear, and later cases have generally accepted, that the tests expressed in Leitch and in Patrick and Lyon are irreconciliable.

This is apparent, for instance, from Hardie v Hanson[36], where the High Court of Australia emphatically rejected the Leitch test. Dixon CJ referred to it as being much more like an offence under bankruptcy law. He said:

> "One may be permitted to doubt whether [section 320]is really aimed at the incurring of debts without reasonable prospects of payment and perhaps to suspect that it was this kind of bankruptcy delinquency that influenced the expressions used by Maugham J."[37]

In Hardie the appellant was director of a company which dealt in electrical appliances. The company went into liquidation after only two years of trading, during which period it had been insolvent. The appellant had carried on trading in the hope that with the advent of television sales would increase and the company's liquidity situation would improve. Unfortunately, as Menzies J said, that was simply "an improvident way of carrying on business in the hope that something would turn up."[38]

The High Court held that the appellant was not liable for fraudulent trading. The court adopted a strict

definition of fraud. Dixon CJ said:

> "... the intent to defraud creditors must be express or actual: nothing constructive imputed or implied will do."[39]

Menzies J rejected the objective Leitch test when he said:

> "... even if the chances of payment of all creditors in full were so remote that it belonged to the realms of hope rather than belief, it seems to me that the fault, grievous though it may be, falls short of fraud ..."[40]

The trial judge had found that the appellant had withdrawn sums of money from the company while it was insolvent and incurring more debts. That finding was important in influencing him to the conclusion that the appellant was trading fraudulently. In the High Court both Dixon CJ and Menzies J rejected that finding of fact. Kitto J agreed with the trial judge on the facts, but he came to a different conclusion on the law. He held that an intent to defraud creditors would only be established if it was proved that the appellant had "an actual purpose, consciously pursued, of swindling creditors out of their money."[41] It was not enough if the appellant simply "acted with blameworthy irresponsibility, knowing that he was (in effect) gambling with his creditors' money as well as his own, and with much more of their money than of his."[42] Hence one had to ask what the purpose of the drawings

was. That purpose was simply part of a wider scheme to try and trade the company out of its difficulties. Even though in the circumstances such drawings demonstrated the utter wrongness of the appellant's actions, they did not evidence an intention to defraud. The Leitch test, in Kitto J's opinion, was therefore misleading.

A Distinction between the Hardie and the Patrick and Lyon Tests

The High Court defined fraud in very strict terms. One had to ask what the director's purpose actually was in carrying on business and engaging in prima facie improper acts, such as withdrawing money from the company while it was insolvent. The test, therefore, was clearly subjective. In reaching its conclusion the High Court unequivocally rejected the Leitch test. However, it is not entirely clear that by rejecting Leitch, the court instead necessarily accepted the Patrick and Lyon test. It is true that some subsequent cases (as well as certain writers) have tended to treat the Patrick and Lyon and Hardie tests as one.[43] But when one examines the judgments in Hardie it is clear that none of the judges expressly endorsed the Patrick and Lyon test, and in fact used language different from that used in Patrick and Lyon in defining fraud.

The test in Patrick and Lyon, it will be recalled, was "actual dishonesty involving real moral blame". Dishonesty, however, is a wide term and covers conduct which may not amount to fraud. This is apparent when one compares fraud with the concept of recklessness. Recklessness, in the sense which it is submitted it is used in section 320(1)(b)[44], means the conscious undertaking of an unjustifiable risk. In Hardie the appellant knew that the company was insolvent and that there was very little chance of creditors being paid. Yet he continued with the company's business rather than putting it into liquidation. He was indifferent to the possibility that creditors would suffer further losses if he continued trading. It is submitted that by ignoring the possibility of loss to creditors, the appellant was acting with "actual dishonesty involving real moral blame".

The trial judge in Hardie would appear to have come to the same conclusion. He pointed out that the appellant had twenty years of business experience and, at the appropriate stage during the insolvency, he must have realised that the company had reached a stage where the observance of proper standards of commercial morality would have led him to take the normal steps to make the remaining assets of the company available for the

satisfaction of its debts.[45] In not doing so he had acted dishonestly.

But the High Court did not agree that the appellant's conduct amounted to fraud. According to Dixon CJ:

> "The question is not whether he dealt in all respects honestly with the situation or with all the creditors or other persons involved. The question is whether he carried on the business ... during the final period with intent to defraud creditors. That question cannot, in my opinion, be resolved by considering whether he knew of the weakness of the company's finances, of its lack of capital, of its inability to meet its debts as they became due and of the poorness of its immediate future prospects."[46]

The above factors, according to Dixon CJ, were merely evidentiary matters. But they could, if taken together with certain other factors, give rise to fraud. One such factor adverted to by the learned Chief Justice was if the appellant had a motive to relieve himself "of liabilities or obligations under which otherwise he would lie or recoup his position and to do so at the expense of, that is to say in fraud of, creditors."[47] Menzies J also proceeded along similar lines. He said that a remote chance of payment, more in the realms of hope rather than belief, would not amount to fraud unless it were "coupled with something else, such as misrepresentation of the position or an intention to use goods purchased on credit for the purposes of

dishonest gain, which gives it a fraudulent character."[48]

According to the High Court, therefore, merely acting in a dishonest manner does not necessarily amount to fraud. Ordering goods on credit while the company is insolvent and knowing that it is unlikely that the creditors would be paid is clearly dishonest. However, while such conduct may amount to recklessness, it does not amount to fraud. To establish fraud one would have to show that the goods were ordered with the intention of swindling creditors. That may be established, for instance, by proving that the appellant used the goods to 'fill up' his debenture over the company's assets before placing the company into receivership. Hardie, therefore, contains a stricter test than Patrick and Lyon; it is more subjective and requires a higher standard of proof.

It is submitted that the difference between the Hardie and Patrick and Lyon tests is important in New Zealand following the introduction of reckless trading as one of the two new grounds of liability under section 320.[49] Since recklessness and fraud exist as two separate bases of liability within section 320, the tests in respect of them must clearly be different. The Patrick and Lyon test, while laid down in relation to fraud, is wide enough to cover recklessness without, however,

being precise enough to be a proper definition of the latter concept. The important question, therefore, is what approach the New Zealand courts have taken in their interpretation of fraud in terms of section 320. The issue was before the Court of Appeal recently in the case of Re Nimbus Trawling Co. Ltd.[50] However, on previous occasions a few cases in the High Court (and the former Supreme Court) had also dealt with the issue.

The New Zealand Position

In Re Maney and Sons De Luxe Service Station Ltd[51] Wild CJ purported to apply the Hardie v Hanson test. He found that the respondent was guilty of fraudulent trading by appropriating to himself money from the company's cash register instead of depositing it to the company's bank account. As a consequence of the misappropriations the company suffered liquidity problems and passed a resolution for voluntary winding up. The major loser was the company's principal trade creditor. The Chief Justice also found that by not entering the receipts in the company's books the respondent had caused the company to file false tax returns, which constituted a fraud on the revenue, another creditor of the company.[52]

In Re Casual Capers Ltd[53] Bisson J applied both the Patrick and Lyon and Hardie tests, and in doing so appears to have treated them as one. The respondent operated a retail shop. The company was insolvent due to overstocking. The respondent tried to reduce stock over the next three months. But at the end of that period the company was even more hopelessly insolvent. As at that date the company also had a large bank overdraft secured by the respondent's personal guarantee. The company continued trading for a further three months, incurring more substantial trade debts, and then went into liquidation. By that time the overdraft had been almost completely extinguished.

Bisson J held that the respondent had not been trading fraudulently when she decided to trade the company out of its difficulties when it first became insolvent. She reduced stock and opened another branch in the hope of increasing turnover. It could not be said that she was acting with actual dishonesty involving real moral blame in terms of Patrick and Lyon. However, three months before liquidation it was clear the company's position was irretrievable and the respondent should have ceased trading. Her only purpose in not doing so was to reduce the bank overdraft and thereby her personal liability. She banked all receipts and left trade creditors unpaid. Bisson J was satisfied, beyond

reasonable doubt, that the respondent had, in terms of Kitto J's test in Hardie v Hanson, an actual purpose, consciously pursued, of swindling creditors our of their money.

Although Bisson J did not distinguish the two tests, that did not make any difference on the facts before him. Hardie has a higher standard of proof than Patrick and Lyon. It follows from this that if the latter test was not satisfied, then a fortiori the former test would not have been satisfied. Conversely, if the Hardie test was held applicable, it follows that applying the Patrick and Lyon test would have led to the same conclusion.

The Court of Appeal recently had occasion to consider the question of fraudulent trading in Re Nimbus Trawling Co. Ltd.[54] Unfortunately, the court did not delve into the issue in any depth. It did not discuss the different tests laid down in Leitch[55], Patrick and Lyon and Hardie. Cooke P agreed with the finding of Prichard J in the High Court[56] that the respondents were liable for fraudulent trading. He accordingly also accepted, without question, the Patrick and Lyon test which Prichard J had applied viz. "that actual dishonesty, morally blameworthy conduct according to current notions of fair trading among commercial men,

had to be proved".[57]

Somers J, with whom Richardson J agreed on this issue, appears to have treated the Patrick and Lyon and Hardie tests as one when he said that fraud meant "actual dishonesty - actual fraudulent intent".[58] But later he appears to have adopted the Hardie test solely when he said section 320 was "directed against persons who deliberately and knowingly set out to cheat or defraud creditors."[59] And immediately before those words Somers J echoed the words of Kitto J in Hardie when he said section 320 was "not aimed at persons who are blameworthy, irresponsible or even hopelessly optimistic."[60]

It is submitted that insofar as the Court of Appeal adopted different tests as to fraud, it is the strict Hardie interpretation which should be preferred. Following the 1980 amendment to section 320[61], that section now provides three separate grounds of liability for carrying on business in certain circumstances. Those grounds attract different standards of proof, reflect different degrees of improper conduct and, it is submitted, should result in different extents of liability. Fraudulent trading attracts not only a civil sanction (pursuant to section 320(1)) but also a criminal sanction. The combined effects of sections 461D(1) and 461E(1) of the Companies Act 1955

is that any person found liable for fraudulent trading is liable on conviction to imprisonment for a term not exceeding two years or to a fine not exceeding $1000, or both. On the other hand, negligent or reckless trading (i.e. a breach of paragraphs (a) and (b) of section 320(1)) do not attract a criminal sanction. It is submitted that this factor, together with the fact that reckless trading must attract liability to an extent falling just short of that for fraudulent trading, suggests that the standard of proof for fraud must be the strict standard as stipulated in Hardie. Patrick and Lyon, with its wide test, capable of covering both recklessness and fraud, but not being precise enough for either, may be safely put to one side by the New Zealand courts.

The United Kingdom Position

It is of significance to note that the Court of Appeal in Nimbus did not refer to the more recent English authorities on the question of fraudulent trading. The position in England is rather different from that in New Zealand and Australia.

In Re White and Osmond (Parkstone) Ltd[62] Buckley J was faced with the apparently irreconcilable tests in Leitch and Patrick and Lyon. In Leitch, as noted above[63],

Maugham J had said that fraud would generally be inferred if the company continued to trade when there was no reasonable prospect of creditors ever receiving payment. In White and Osmond Buckley J attached significance to the word 'ever'. He said:

> "In my judgment, there is nothing wrong in the fact that directors incur credit at a time when, to their knowledge, the company is not able to meet all its liabilities as they fall due. What is manifestly wrong is if directors allow a company to incur credit at a time when the business is being carried on in such circumstances that the company will never be able to satisfy its creditors."[64]

It is arguable whether Maugham J intended to limit his words in the manner stated by Buckley J. Nevertheless, it has been suggested that Buckley J's application of Leitch enables one to reconcile that case with Patrick and Lyon, with the important consideration being what the directors view of the company's position at the relevant time was.[65] But that proposition was recently rejected, albeit indirectly, by the Court of Appeal in R v Grantham.[66]

Grantham was a case on the United Kingdom equivalent of section 461D, which imposes criminal liability for fraudulent trading. The persons charged in that case were accordingly tried before a judge and jury. During the course of his summing up the trial judge said that if the defendant:

> "obtains or helps to obtain credit or further credit when he knows there is good reason for thinking funds will become available to pay the debt when it becomes due or shortly thereafter then ... you might well think that is dishonest and there is an intent to defraud."[67]

The defendants appealed on the basis that this direction was contrary to both Leitch and White and Osmond in that the judge should have directed that liability only arises if there is no reasonable prospect of the creditors ever receiving payment. But Lord Lane CJ, delivering the judgment of the Court of Appeal, and obviously referring in particular to the first part of the judgment of Buckley J quoted above, said:

> "In so far as Buckley J was saying that it is never dishonest or fraudulent for directors to incur credit at a time when, to their knowledge, the company is not able to meet all its liabilities as they fall due, we would respectfully disagree."[68]

Although by rejecting the distinction drawn by Buckley J the Court of Appeal rejected a construction which Maugham J probably never intended, the court also, unfortunately, re-introduced the difficulty of reconciling the apparently different tests in Leitch and Patrick and Lyon, a difficulty which White and Osmond had arguably overcome. The question now arises as to

what test the Court of Appeal laid down in respect of fraudulent trading. The court did not itself state a test but merely approved the direction given by the trial judge. That direction, it is submitted, is based on Leitch. The use of the phrase "when he knows there is no good reason for thinking" by the trial judge suggests that the test is, like the Leitch test[69] partly objective and partly subjective: "Objectively, there must be no good reason for thinking that funds will be available to pay the debt; subjectively, the person in question must know there is no good reason."[70]

It may be noted that the Court of Appeal did not refer to Hardie v Hanson[71] and, perhaps more importantly, to its own previous decision in R v Cox, R v Hodges.[72] In the latter case a differently constituted Court of Appeal had discussed the question of dishonesty in relation to the United Kingdom equivalent of section 320(1)(c). The court had referred to a passage in the judgment of Lawton LJ in R v Landy[73] where his Lordship had said:

> "The dishonesty to be proved must be in the minds and intentions of the defendants. It is to their states of mind that the jury must direct their attention."[74]

In R v Cox, R v Hodges the Court of Appeal had quite clearly stated that dishonesty for the purposes of

fraudulent trading had to be established subjectively. But the passage from the trial judge's summing up in Grantham, referred to above, and which was approved on appeal, suggests that dishonesty is simply a matter of inference: dishonesty would be inferred once it was established that the director had no good reason for thinking that the debt would be paid. This is the same approach as that in Leitch, where an intent to defraud (which according to Patrick and Lyon involves dishonesty) could be inferred once it was established that the director knew there was no reasonable prospect of creditors receiving payment. Inferring dishonesty based upon a partly subjective and partly objective enquiry into the reasonableness of incurring a debt at a particular point in time is quite different from actually establishing dishonesty through a purely subjective exercise. Grantham, therefore, would appear to endorse the liberal Leitch test rather than the stricter Patrick and Lyon test. By doing so, however, Grantham becomes irreconcilable with R v Cox, R v Hodges.

The decision in Grantham may clearly be criticised in terms of the test it stipulates.[75] Nevertheless, it is quite clear that the Court of Appeal reached the correct decision on the facts. Further, the Grantham test may in fact be justified on one particular basis.

In Grantham the defendants had formed a company to speculate in the potato market. The company ordered 88000 pounds worth of potatoes from a French supplier. However, within a month of the order the potato market collapsed. But the defendants continued to sell the potatoes, often at below cost price. They paid the supplier less than 20000 pounds and kept the rest of the proceeds of sale for themselves. Two of the defendants were in fact bankrupts. The company did not have a sufficient capital base from its inception. The scheme of operations quite clearly indicated that the defendants never had any intention of paying, or otherwise compensating, the French supplier in full. Even applying the strict Hardie v Hanson test, it is quite clear that the defendants had a conscious purpose to cheat the French supplier out of his money.

Further, when Grantham was decided, fraudulent trading was the only basis of liability; Parliament had not adopted the recommendation of the Jenkins Committee that reckless trading be introduced as a further ground of liability.[76] By interpreting the fraudulent trading provision liberally, the Court of Appeal broadened the scope of the provision to include the case of reckless trading, as well as that of negligent trading. But following the introduction of section 15 of the Insolvency Act 1985 (UK)[77], the above proposition is no

longer tenable. It is submitted, therefore, that the Grantham test will need to be re-evaluated soon so as to exclude from its scope, at least, the concept of negligent trading, which is now expressly provided for by section 15.

Can a Bare Preference amount to Fraud?

An interesting issue in relation to fraudulent trading is whether the bare fact of preferring one creditor to another constitutes fraud. That question was answered in the negative recently in Re Scarflex Ltd.[78] In that case a company had entered into an agreement to supply another company, SAFE, with a press. The press malfunctioned and a dispute arose between the two parties as to the responsibility for this, which eventually led to SAFE obtaining judgment against the company. Meanwhile the company had passed a resolution to cease trading. Over the next two years it collected its assets and paid off all debts, including one to the parent company which it satisfied by selling to it all its fixed assets and stock. No provision was made for SAFE's judgment debt, which the company did not have sufficient assets to satisfy in any event.

The liquidator argued that the company had traded with intent to defraud a creditor by deliberately ignoring

SAFE's claim. But Oliver J rejected that argument. He said:

> "What is alleged here - and it is all that the liquidator relies upon - is the bare fact of preference and ... the proposition that that, per se, constitutes fraud within the meaning of the section is not one which is, in my judgment, arguable with any prospect of success."[79]

All the transactions entered into by the company, including that with its parent, were legitimate business transactions, duly recorded in the company's books. In the absence of mala fides, a mere preference could not amount to fraud. However, Oliver J did not lay down an absolute rule. He said that there might be "circumstances of a very peculiar nature involving preferential payments from which the intention required by [section 320] could be inferred".[80]

In Re Nimbus Trawling Co. Ltd[81], although Somers J referred to the decision in Scarflex, he left open the question whether the case was correctly decided. His Honour said that in Nimbus there was "rather more" than the bare fact of preferring one creditor over another. However, he did not expand on what that 'rather more' exactly was. With respect, it is difficult to see any material difference between the facts of Nimbus and Scarflex.

In Nimbus NTC, a small private company, operated a fishing trawler in conjunction with GFD. The operation ceased to be profitable and the major shareholder was about to wind the company up when the respondents bought him out. Included in the takeover was an assignment to the respondents of the benefit of a loan account which the company owed to the vendor shareholder. The respondents then sold the trawler to GFD and applied the proceeds to meet all the company's debts, including the loan account to themselves. They then purchased with that sum half the shares in GFD. In the meantime NTC had had a disputed debt with PVM over repairs to the trawler. PVM had obtained judgment against NTC. However, the respondents completely ignored PVM's claim in disposing of the proceeds of sale of the trawler. But there was no suggestion that the transactions in question were other than bona fide.

In the High Court Prichard J referred to Oliver J's dictum in Scarflex that in some circumstances a preference may amount to an intention to defraud. Prichard J accordingly distinguished that case on its facts and held the respondents liable. But the Court of Appeal, by a majority, reversed his decision on the basis the facts did not disclose an intention to defraud. It is submitted that the Court of Appeal should have followed one of two courses of action. It should have either affirmed

Prichard J's decision that Scarflex could be distinguished on its facts; or it should have followed Scarflex and overruled Prichard J. It is submitted that Nimbus is as much a bare preference case as was Scarflex, and it is difficult to see how the Court of Appeal distinguished Scarflex and yet reached the same conclusion as in that case.[82]

Difficulty of establishing Fraud

While the fraudulent trading provision has been in existence for over half a century, there appear to have been, in fact, relatively few cases under it. The major reason for that would appear to be the difficulties involved in establishing fraud.

Those difficulties may be ascertained from the cases themselves. Perhaps the most illustrative case is Nimbus. In the High Court Prichard J relied on two factors in finding the respondents liable: the sale of the trawler and the discharge of the loan account. Taken against the background of PVM's impending claim, that amounted to fraud. In the Court of Appeal Cooke P agreed with that conclusion. But Richardson and Somers J J thought otherwise. Somers J said that the transactions were entered into or contemplated before

PVM filed writs against the company.[83] The respondents also had a valid counterclaim against PVM and only abandoned it on the advice of counsel. The evidence was therefore not conclusive of an intention to defraud a creditor, to wit PVM.[84]

In In re Patrick and Lyon Ltd[85] the respondent appeared to have deliberately set out to convert his unsecured debt into a secured one. But Maugham J was not entirely satisfied that the respondent had acted fraudulently even though six months and one day after obtaining his security he placed the company into receivership. It may be noted that there is, in this respect, a suggestion in the judgment that merely because the respondent did not purchase goods on credit to 'fill up' his debenture, as was the case in In Re William C.Leitch Bros.Ltd,[86] he was not liable for fraudulent trading. It is submitted that insofar as Maugham J thought that section 320 was only directed towards the Leitch type of case, he was in error. It is quite clear that the intention behind the enactment of section 320 was to deal with all forms of fraudulent trading, of which the Leitch type of case was the predominant example.[87]

Re Day - Nite Carriers Ltd[88] was also a difficult case. It was, in fact, similar to Nimbus in that there was a disposition of the company's assets by the respondent

in anticipation of a judgment for a liquidated sum and enforcement proceedings thereon. The company had a disputed debt with CSI Ltd, which eventually obtained judgment. The company intended to appeal, but in the meantime a winding up order was presented in respect of the company. By that stage the respondent had withdrawn from the company by way of salary all available cash. White J held that the respondent's actions had come "close to the borderline" but did not quite amount to fraud for the purposes of section 320.

It is quite difficult, therefore, to say with any degree of certainty as to what conduct would amount to fraudulent trading. The standard of proof is fairly high. It was difficulties such as these which led to the amendment of section 320 in 1980. The broadening of section 320 means that in some of the cases decided under the former section 320 the respondent might be held liable for negligent or reckless trading when previously he had been absolved of liability for fraudulent trading. For instance, Hardie v Hanson[89] is clearly a case of reckless trading.[90] The appellant there knew that there was a possibility of loss to creditors, but he ignored that and carried on trading in the vain hope that he would salvage the company from insolvency. He completely disregarded the interests of creditors.

It would be appropriate, therefore, to turn to the 1980 amendment to section 320 and to the two new grounds of liability introduced thereby.

THE 1980 AMENDMENTS TO SECTION 320

Introduction

Two new grounds of liability were introduced into section 320 by section 32 of the Companies Amendment Act 1980. The first is stated as paragraph (a) of subsection (1) of section 320 and provides that an officer of the company who was knowingly a party to the contracting of a debt by the company and did not then honestly believe on reasonable grounds that the debt would be paid, is liable for that debt. The second ground is contained in paragraph (b) of subsection (1) and provides that an officer who is knowingly a party to the carrying on of any business recklessly is liable for debts so incurred by the company. The original ground of liability based on fraudulent trading is now reproduced as paragraph (c).[91]

Preliminary Issues

The first point which may be noted is that insofar as the potential respondent to a section 320 application is concerned paragraphs (a) and (b) are more restrictive in scope than paragraph (c). While paragraph (c) refers to 'any person' who was trading fraudulently, paragraphs (a) and (b) refer to 'any person ... while an

officer of the company' who was trading negligently or recklessly. While paragraph (b) is based on a recommendation of the Jenkins Committee[92], the restriction mentioned in fact was counter to the recommendation of that committee, which had said that section 320 should be extended to make "directors and others" liable for reckless trading.[93]

The implications of the difference in language between paragraph (c) on the one hand and paragraphs (a) and (b) on the other is quite clear. Parliament must be taken to have regarded fraud as a more serious offence. It was not only the officers[94] of the company, but any person who might have been involved in fraudulent trading[95], who could be held personally liable to an unlimited extent. But where the charge was one of negligent[96] or reckless trading, then the problem was not seen to be so serious as to warrant persons other than the officers of the company being made liable. This conclusion may be supported by the fact that it is fraudulent trading only which attracts a criminal sanction pursuant to section 461D, besides the civil liability under section 320 itself.[97]

The second point which may be noted is that the 1980 amendment merely introduced the two new grounds of liability. It did not alter section 320 in any other way, and in particular it did not alter the form or substance

of the fraudulent trading limb of the section. Accordingly, the cases decided under section 320 prior to its amendment, and as discussed above[98], are equally applicable to paragraph (c) of subsection (1) of section 320 as it now stands.

There is, however, a suggestion by Vautier J in the recent case of Re Southmall Hardware Ltd[99] that the position might be different. The liquidator there had relied upon section 320(1)(c) and argued that the test for fraudulent trading was that stated in In re William C. Leitch Bros. Ltd.[100] Vautier J appears to have accepted that proposition when he said that paragraph (c) "effectively restores the test propounded in In re William C. Leitch Bros. Ltd".[101] But his Honour went on to hold that the case fell to be decided under the former section 320[102] and the test under that provision was that stated by Kitto J in Hardie v Hanson.[103]

These remarks of Vautier J suggest that there has been a substantive change in the meaning of fraudulent trading following the 1980 amendments, and it would follow that the earlier cases dealing with the former section 320 are no longer applicable; the test under paragraph (c) of section 320(1) now being that stated in Leitch. It is submitted, with respect, that his Honour was clearly in error. There is no difference in the phraseology of

paragraph (c) following the amendments. Further, it is submitted that the Leitch test is now incorporated into paragraph (a) of section 320(1)[104] and if Vautier J were correct then that provision would be redundant. Paragraph (c), therefore, must be taken to reflect the test as stated in Hardie v Hanson.

Contracting Debts Without An Honest Belief On Reasonable Grounds That They Would Be Paid

Introduction

As has been noted previously, the Macarthur Committee recommended that section 320(1) be amended to include a second ground of liability in terms of section 374C(1) of the Companies (Amendment) Act 1971 (NSW). Section 374C(1) provided:

> If an officer of a company to which this section applies was knowingly a party to the contracting of a debt by the company and had at the time the debt was contracted no reasonable or probable grounds of expectation, after taking into consideration the other liabilities, if any, of the company at the time, of the company being able to pay the debt, the officer is guilty of an offence against this Act.[105]

One of the reasons for the introduction of this ground of liability was the restrictive interpretation of fraud

given by the High Court of Australia in Hardie v Hanson.[106] In 1980 Parliament adopted the Macarthur Committee's recommendation and enacted paragraph (a) of section 320(1).[107] Paragraph (a), although slightly different in form from the Australian provision, would not appear in fact to be any different in substance. This will become apparent from the following discussion.

Honest belief on reasonable grounds

Perhaps the most important aspect of section 320(1)(a) is that to escape liability the officer must have contracted debts on a two-fold basis: he must have had an honest belief that the debt would be paid, and that belief must have been based on reasonable grounds. The test to ascertain the belief is clearly a subjective one.[108] It is what the officer actually believed that is important, and not what he ought to have believed in the circumstances. However, the test as to what are reasonable grounds, it is submitted, must be an objective one. It is not what the particular officer believed, honestly or otherwise, were reasonable grounds, but what the ordinary prudent officer in the circumstances would have believed were reasonable grounds. This interpretation is in accord with the interpretation of the phrase 'no reasonable or probable ground of expectation' in

section 374C(1) of the Australian legislation. Section 320(1)(a) would appear to be a codification of the judicial interpretation of the Australian phrase.

The leading case on the Australian phrase is Shapowloff v. Dunn.[109] The defendant argued that 'no reasonable or probable ground of expectation' involved a purely subjective test. The High Court of Australia, affirming the decision of the New South Wales Court of Appeal, rejected that argument. Wilson J, with whom Gibbs CJ, Stephen, Murphy and Aicken JJ agreed, said that it must be shown that:

> "... at the time of contracting the debt the defendant himself had no expectation, reasonably grounded in the whole of the circumstances then existent as he knew them, of being able to pay the debt. It will be seen that the test involves a blending of subjective and objective considerations. The test of reason imports an objective standard, but it is to be applied to the facts as known to the defendant."[110]

And later Wilson J continued:

> "The defendant himself cannot be the arbiter of the reasonableness or otherwise of an expectation that he would be able to meet the debt. However, it is a question of his expectation, and whether that expectation is objectively reasonable."[111]

The phrase 'no reasonable or probable ground of expectation', far from being subjective is, it is submitted, prima facie an objective test.[112] But whether objective or subjective, the phrase has been interpreted as involving both those

elements. The use of the words 'honest belief' in section 320(1)(a) codifies that interpretation. The approach under this section, therefore, is as follows. The officer must in fact believe that the debt would be paid. That belief must be based on reasonable grounds. But those grounds are not grounds as someone else would have seen as existing, but grounds which the particular officer in question was aware of. However, in evaluating the validity of those grounds, it is not the subjective interpretation of the particular officer, but the objective assessment of a reasonable officer in the circumstances, which is of relevance. In other words, one must consider the issue as a reasonable person in the officer's position would.

It is quite clear that in order to prevent liability under section 320(1)(a) one must have both an honest belief and reasonable grounds for holding that belief. In Dunn v Shapowloff Mahoney JA, in the Court of Appeal, stated that if a defendant did have a subjective expectation, he would still be liable if there were no reasonable grounds for that expectation. If the defendant did not advert to the question of reasonable grounds at all, or if having adverted to it he subjectively had no expectation of payment, then he would still be liable if in fact objectively there were no reasonable grounds for any expectation.[113]

The question arises whether, if in fact there were reasonable grounds for an expectation, the defendant would escape liability if he either did not advert to the question of expectation at all, or if having done so, he decided there was no expectation of payment. The language used by Mahoney JA is open to an interpretation that the defendant would escape liability. But while the language of section 374C(1) may be open to that interpretation, it is submitted that section 320(1)(a) is not. The latter provision does not merely refer to a ground of expectation, but to an honest belief as well. In section 320(1)(a) the honest belief and the grounds for that belief are independent criteria and both are a prerequisite for preventing liability. Hence, even if there are in fact reasonable grounds for the belief that the company would be able to pay the debt, the defendant is still liable if in fact he does not hold such a belief.

Contracting of a debt

Before a person is liable under section 320(1)(a), he must have been party to the 'contracting of a debt' by the company. In most cases the debts of a company are easily ascertainable. But there might be difficulties in certain cases, and in particular the issue arises whether 'debt' includes future and contingent debts.

It may be argued that since Parliament did not expressly refer to future and contingent debts in relation to the word 'debt' where it first occurs in paragraph (a), but did so in relation to where it last occurs in that paragraph, Parliament intended not to impose liability where future or contingent debts were contracted. It is submitted, however, that the correct position is to the contrary. The very fact that the officer is required to assess the company's ability to pay future and contingent debts must mean that such debts were in fact created at some earlier point in time. Parliament could not have intended that officers need not, when contracting such future or contingent debts, consider the company's ability to pay those debts when they fell due for payment but that the officers be required to do so in respect of all other debts. It is submitted that any such distinction is difficult to uphold in principle; it would simply impose an undesirable restriction on the scope of paragraph (a).

This conclusion may be supported by the interpretation of the phrase 'contracting of a debt' in section 374C(1) in Shapowloff v Dunn. In that case a company, while insolvent, placed an order with its sharebrokers for the purchase of certain speculative shares. It was agreed that the company would pay the purchase price when the

brokers for the vendors tendered the scrip to the company's brokers. The shares were duly purchased, but the company soon went into liquidation and an action was brought against the director pursuant to section 374C(1). At the hearing, however, it was not proved that the scrip had actually been delivered. The defendant, therefore, argued that since that condition had not been fulfilled, there was nothing 'contracted', and even if there was, what was contracted was not a 'debt'.

That argument was rejected by both the Court of Appeal and the High Court of Australia. In the High Court Stephen J, with whom Gibbs CJ, Murphy and Aicken JJ agreed, said:

> "On that day [ie the purchase date] the broker began and completed the execution of the company's buying order and the company became liable to indemnify the broker for the purchase of the shares. That liability was contingent, as was the broker's liability to the selling broker, the contingency in both cases being the delivery of the scrip by the selling broker. But such a contingent liability falls within section 374C(1) and is enough to constitute a debt falling within that section".[114]

The reasons for that interpretation were stated more fully by Mahoney JA in the Court of Appeal. He said that the relevant inquiry must be made at the time the

agreement was initially entered into. Later events which may prevent the complete performance of the contract could not detract from the fact that the contract had in fact been entered into. By way of example, Mahoney JA said:

> "... the fact that, following the contracting of a debt by a company, the contract came to an end because the commencement of its winding up prevented the property being tendered or otherwise the conditions being fulfilled, would not, in my opinion, have been a fact intended by the legislature to render the section inapplicable; I think the intention was to the contrary."[115]

It is submitted, with respect, that the foregoing applies equally to section 320(1)(a). If the facts of Shapowloff v Dunn were to arise in New Zealand today, the case would be decided no differently from the way the High Court did.

Able to pay the debt ... As well as all its other debts

In order to prevent liability under section 320(1)(a) the officer must believe, at the time of contracting the debt, that the company would be 'able to pay the debt' in question, 'as well as all its other debts (including future and contingent debts).' The two phrases in question are interelated and it would be convenient to consider them together.

In Dunn v Shapowloff Mahoney JA said that ability to pay did not mean merely whether the company was solvent or whether in an instant liquidation it would have sufficient assets to meet all liabilities. The determination of that issue instead involved a number of factors such as the nature of the assets and liabilities and of the circumstances of the company's business; the cash available; promises to provide financial assistance by loan, subscription for share capital or the provision of a guarantee. In determining the cash available, it would be relevant to consider whether the company could pay by borrowing, whether it would be able to realise its assets and at what price and whether the transactions involved in paying the debt might be voidable, for example for being in breach of trust.[116]

Conversely, as both Reynolds JA and Mahoney JA recognised, it was not a prerequisite in establishing liability for the applicant to prove, in Reynolds JA's words:

> "that at the date in question the liabilities of the company exceeded its assets. By way of example, a director may have knowledge of what has happened or is likely to have happened which will bear upon the company's capacity to pay the debt in question, notwithstanding its present insolvency ..."[117]

Quite clearly then a wide range of factors must be taken into account in establishing whether the company was, at the relevant time, able to pay its debts. The necessity for that is quite obvious given the various activities different companies may engage in. A company speculating in shares may have the value of its assets reduced by half if the share market were to suddenly take a tumble. The factors to be considered when determining such a company's ability to pay would be different from those in respect of an ordinary merchandise company. At the end of the day the question must be considered "in a realistic way by reference to the facts of the particular case."[118]

The phrase 'as well as all its other debts', as it appears in section 320(1)(a) is, it is submitted, ambiguous. It is capable of two interpretations. It may mean that the officer must believe, at the time of contracting the debt, that the company would be able to pay that particular debt and all its other debts at the time when that particular debt becomes due and payable. Alternatively, it may mean that the officer must, at the time of contracting the debt, believe first that the company would be able to pay that particular debt when it became due and owing, and secondly that the company would be able to pay all its other debts as and when each of those debts becomes due and owing.

It is submitted that the second interpretation above is the preferable one. A company may have a long term debt, such as a mortgage, on its books. It may then purchase stock on credit, payable in one month's time. At the time of purchase the company may be in no doubt that it would be able to discharge the long term debt when it became due and owing. The company may be equally certain of its ability to pay for the goods in a month's time. Such a situation is a typical example of businessmen operating on a long term basis. Payment of the future debt here may depend on some factor, not yet in existence perhaps, but quite independent of the company's ability to pay the purchase price incurred during its normal trading activities. Conversely, the existence of the mortgage (leaving aside the question of interest payments) would not normally affect the ability to pay the purchase price.

Accordingly, it would be unreasonable to make the satisfaction of one debt dependent on the other. That is what the first interpretation discussed above would lead to and hence, it is submitted, that interpretation is incorrect. It would be unreasonable to expect the company, at the time of purchasing the stock, to be able to discharge the mortgage in a month's time when that is not the expectation on anybody's part due to the very nature of that debt. The trade creditor

himself would not refuse to extend credit even if he knew the company was in no position to discharge the mortgage at the same time as his debt became payable. If the company were then to suddenly experience difficulties, it would be unreasonable to make an officer of the company personally liable to the trade creditor. The second interpretation above leads to a more practical and reasonable result. At the time of purchasing the stock, the officer may have been certain that the goods would be paid for in a month's time, and that the mortgage would be satisfied when it became due and payable. The incurring of the one debt is independent of the ability to pay the other. The company has the ability to pay both debts.

There are, however, no hard and fast rules. Like the interpretation of the phrase 'able to pay the debt', the interpretation of 'as well as all its other debts' must depend on the facts of particular cases. If, for instance, in the above example, the company also had another major debt payable in five weeks from the date it purchased the stock on a month's credit, and the officer was not quite certain whether the company would have sufficient funds to meet the two debts within a week of each other, then it cannot be said that, at the date of purchase of the stock, there were reasonable

grounds for an honest belief that the company would be able to pay each debt as it became due and owing.

Reintroduction of the Leitch test

It has been suggested[119] that section 320(1)(a) incorporates or reproduces the test for fraud as stated in In re William C.Leitch Bros. Ltd.[120] It was said there that carrying on business and incurring credit "when there is to the knowledge of the directors no reasonable prospect" of payment would amount to fraudulent trading. Section 320(1)(a) states that an officer is liable if he does not "honestly believe on reasonable grounds" that the debt would be paid when it becomes due. That latter phrase, as discussed above, is a partly objective and partly subjective test. And that, as discussed previously[121], is also the case with the Leitch formulation. In both cases the issue must be considered from the perspective of a reasonable person in the officer's position, considering the facts as known to that officer.

Recklessness

Introduction

Paragraph (b) of subsection (1) of section 320 provides

that any officer of the company who is knowingly a party to the carrying on of any business of the company in a reckless manner may be personally liable for all the debts of the company. That provision, as noted above, was introduced in 1980 to broaden the scope of section 320.[122] Recklessness is a concept more commonly associated with criminal law. It is not surprising, therefore, to find that in the only reported decision to date on this section, the court relied heavily on the leading decisions in the area of criminal law.

Thompson v Innes

In Thompson v Innes[123] a company was incorporated for the purpose of dealing in industrial supplies, but just over two years later, in November 1983, it went into voluntary liquidation. The two respondents were the sole shareholders and directors of the company. During the two years ending March 1983 the company made a slight loss of $1200. But between then and November there was a net loss of $32700 while trade creditors during the same period increased by $40000. Over that period the company, against the advice of its accountants, continued to increase its operating costs by purchasing another car and hiring a computer. On 30 June the company obtained an increase in its overdraft from $7000 to $12000. At that stage the company was already insolvent.

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On these facts the liquidator argued that the respondents should have ceased trading on 30 June since there was no hope of trading the company out of its difficulties and creditors were clearly being exposed to great risk. But Bisson J rejected the charge of reckless trading as from 30 June, and held that the respondents were only liable as from the end of September. When the overdraft was increased, the respondents were trying to trade the company out of its difficulties with the help of their accountant and that did not amount to reckless trading.

Bisson J first considered recklessness in the context of paragraphs (a) and (c) of subsection (1) of section 320 and said:

> "In the field of directorship responsibilty for carrying on the business of the company within the shield of limited liability I see in those three paragraphs a gradation of conduct sufficiently blameworthy to piece that shield and to render a director [liable]".[124]

By 'gradation of conduct' Bisson J is referring to the different levels of improper conduct which are caught by section 320, each requiring a different standard of proof and attracting different levels of liability.[125]

Bisson J held that the test in respect of paragraph (b)

was an objective one. He first referred to a dictum of Lord Hailsham LC's in R v Lawrence[126] that, in a legal context, "the state of mind described as 'reckless' is discussed in connection with conduct objectively blameworthy as well as dangerous."[127] Bisson J then drew a distinction between the element of dishonesty present in paragraphs (a) and (c) of section 320(1), and the absence of it from paragraph (b), and held that recklessness did not necessarily involve blameworthy behaviour to the extent of dishonesty. In doing so Bisson J had relied on the decision in R v Bates[128] where Donovan J was faced with a section similar to section 320(1) in that it contained three categories of liability. Donovan J there defined recklessness as carelessness. His Lordship said that in the context of the statute before him, recklessness did not amount to something approaching dishonesty. It simply carried its ordinary meaning of carelessness, and there was nothing in the section before him which prevented him from adopting that meaning.[129] Accordingly, although Bisson J does not specifically say so, it may be concluded that in his Honour's opinion, recklessness in the context of section 320(1)(b) means mere carelessness. This proposition may be supported by reference to a dictum of Lord Diplock's in R v Lawrence, a case on which Bisson J placed much reliance. Lord Diplock had said that

reckless carried its popular or dictionary meaning of careless, regardless or heedless of the possible harmful consequences of one's acts.[130]

Having concluded that section 320(1)(b) contained an objective test, Bisson J proceeded to adopt a dictum of Lord Diplock's in R v Lawrence[131], and basing himself on that dictum, formulated the test for recklessness as follows:

> "Was there something in the financial position of this company which would draw the attention of an ordinary prudent director to the real possibility not so slight to be a negligible risk, that his continuing to carry on the business of the company would cause the kind of serious loss to the creditors of the company which section 320(1)(b) was intended to prevent?"[132]

A number of points may be noted about this test. The yardstick of measurement is the ordinary prudent director in the position of the respondent officer in the circumstances existing at the relevant moment. The possibility of loss to creditors has to be a real possibility, as perceived by the reasonable officer. If there is simply a negligible possibility of loss then it may be safely disregarded. But what exactly amounts to a 'real possibility' and what is merely a 'negligible risk' are issues left untouched by Bisson J. These, or similar, expressions occur in relation to

recklessness in the context of criminal law as well[133] and it is generally accepted that the degree of risk in each case is a matter of weighing up various factors in relation to the facts of that particular case.[134] Presumably, such will be the situation in relation to section 320(1)(b) as well.

The degree of risk does not matter if the potential loss to a creditor is not a 'serious loss' of the type contemplated by section 320(1)(b). Again, what amounts to a 'serious loss' is probably a matter to be decided on the facts of each particular case. To an extent, it may be said that the concluding words of Bisson J's test begs the question in that one may ask what sort of loss was section 320(1)(b) actually intended to prevent. It is arguable whether liability for reckless trading should only arise if the possible loss to creditors was a serious loss. There is no indication that Parliament intended to qualify the section in any such manner. A creditor who suffers loss due to an officer's reckless trading should be entitled to relief; whether the loss suffered was serious or not should not matter. While the possibility of loss may be qualified by onl making a real possibility of loss subject to li once such a real possibility is establishe question of the amount of loss which ma be irrelevant. Such a further qualificat ng

submitted, is against the intention of the section.[135]

Applying the test to the facts before him, Bisson J held that the two respondents were liable for reckless trading as from the end of September 1983. Although his Honour agreed that the company was insolvent since June, he rejected the liquidator's argument that liability should attach as from that date. According to Bisson J, while continued trading could be seen as reasonable up till the end of September, from then it would have been quite clear to an ordinary prudent director that to continue trading would result in serious loss to the creditors.

Even though in Thompson v Innes recklessness was held to import an objective test, the actual application of that test causes, or is likely to cause, as much difficulty as the application of the subjective test for fraudulent trading. This is apparent from Thompson v Innes itself. In reaching his conclusion Bisson J relied on the fact that the budgeted figure for sales for the July - September period was down substantially, while creditors over the same period had increased dramatically. However, the company was insolvent, sales were falling and creditors were increasing well before September, and an ordinary prudent director may well have decided to cease trading

much earlier.[136] The point at which to draw the line, therefore, may well be an open question and, if necessary, the benefit of the doubt is given to the respondents. Further, ceasing business at an earlier point in time may not necessarily be of benefit to creditors. As Bisson J recognised:

> "When to call a halt is not an easy decision for any director and there is a natural reluctance to approaching creditors as it may precipitate a panic situation with worse consequences."[137]

Although these difficulties may exist, the consequences of calling a halt at an earlier or later point in time may be quite significant. The liquidator, alleging that the respondents were trading recklessly as from the end of June, sought an order against them for $50000, being the debts incurred between then and the date of winding up. Bisson J, however, in finding the respondents liable as from the end of September, made an order in the sum of $25000 only. Quite clearly, if liability had been held to have arisen any earlier, the amount of the order would have been larger.

Does Thompson v Innes correctly state the test under paragraph (b)?

Being the first, and to date only, decision on

section 320(1)(b), the question naturally arises whether Thompson v Innes states the correct test in relation to recklessness as it appears in that section. The question may be best considered by comparing the three different tests in respect of paragraphs (a), (b) and (c) of section 320(1).

The concept of fraud may be distinguished from recklessness quite easily. To establish an intent to defraud in terms of paragraph (c) one must prove a subjective intention to consciously swindle creditors out of their money. Recklessness is established if, objectively, the officer should have appreciated the risk of loss to creditors if the company continued to carry on business, but in fact did not do so. Similarly, fraud may be easily distinguished from the contracting of a debt without an honest belief on reasonable grounds that the debt would be paid. One is liable on the latter ground if there is no reasonable basis, from an objective point of view, for holding the belief that the debt would be paid.

Since fraudulent trading imports a purely subjective test, the issue is whether there is any material difference between the two objective tests in respect of paragraphs (a) and (b). Under paragraph (b) the intention of the officer is irrelevant. Liability is

established if the ordinary prudent officer in those circumstances would have recognised the real possibility of serious loss to creditors. Under paragraph (a), while an honest belief is required, that belief counts for nought unless it is based on reasonable grounds, and what constitutes reasonable grounds is determined from the perspective of the ordinary reasonable officer in those circumstances. The exercise under paragraph (a) is basically to determine whether there were reasonable grounds for thinking the company would have the ability to pay. The exercise under paragraph (b) is essentially to establish whether there were reasonable grounds for thinking the creditors would not suffer loss. But these two propositions are in fact two sides of the same coin; there is no material difference between them. It is submitted, therefore, that the tests in respect of paragraphs (a) and (b) of section 320(1) are the same.

This conclusion may be supported by the argument that the concept of contracting a debt without reasonable grounds for a belief as to payment is simply an instance of the wider concept of recklessness. It was submitted to the South African Commission of Inquiry into the Companies Act that the Act should expressly prohibit the carrying on of business in insolvent circumstances and the carrying on of business while liability exceeded assets. In dealing with this submission the Commission said:

> "It may be argued, however, that these instances would invariably be elements of contracting debts without a reasonable expectation of paying for them; that recklessness is a wide concept which would include that offence; and therefore if the principle of recklessness is imported into the section, these specific cases would automatically be included."[138]

Consequently, the South African equivalent of section 320 was amended to make reckless trading a second ground of liability, in addition to fraudulent trading.[139]

The question now arises whether, notwithstanding the foregoing discussion, the test laid down in Thompson v Innes should stand. The answer, it is submitted, is no. It is significant to note that both the Australian and the South African Companies Acts have, besides fraudulent trading, either the equivalent of paragraph (a) or of paragraph (b) as the alternative basis of liability, but not both. In the United Kingdom the Jenkins Committee[140] only recommended that recklessness be introduced as the second ground of liability; it did not refer to the contracting of debts without reasonable grounds for a belief as to payment. In New Zealand the latter ground only was the basis of the Macarthur Committee's Report;[141] that Committee did not refer to recklessness. However, Parliament decided to introduce both those grounds as two separate bases of liability to broaden the scope of section 320. It must be presumed, therefore, that Parliament intended them to mean different

things. However, the tests in respect of paragraphs (a) and (b) suggest that there is no material difference between those two grounds, and if that position is accepted it follows that one of paragraphs (a) and (b) is redundant. It is submitted, however, that effect should be given to Parliament's intention and hence the test in respect of reckless trading should be different from that stated in Thompson v Innes.

It is submitted, with respect, that the problems in Thompson v Innes arise from two factors: the reliance placed by Bisson J on the criminal law cases dealing with recklessness, and a failure to fully consider the meaning of recklessness within the overall context of section 320. As noted above, Bisson J relied on R v Bates where Donovan J held that recklessness, as it appeared in the statute before him, did not necessarily connote actual dishonesty.[142] But it must be realised that Donovan J was, as he himself was at pains to point out, confining his comments to the particular statute before him, and was interpreting recklessness in the context of that particular statute.[143] R v Bates is, therefore, clearly distinguishable.

Bisson J also relied on the two leading cases of R v Caldwell[144] and R v Lawrence[145] which define recklessness in the area of criminal law. But those

cases have been much criticised as having introduced confusion into the area of recklessness in criminal law.[146] Prior to those cases, a clear distinction was drawn between recklessness and negligence. This distinction has been explained thus:

> "Recklessness was the conscious undertaking of an unjustifiable risk, negligence the inadvertant taking of an unjustifiable risk. If D was aware of the risk and decided to take it, he was reckless; if he was unaware of the risk, but ought to have been aware of it, he was negligent."[147]

If this approach is applied then, in order to prove recklessness, one must establish that the officer in fact was aware of the risk but ignored it; and that involves a subjective exercise. If he was not aware of the risk at all, but an ordinary prudent officer in his position would have been, then he is merely negligent. That, it will be observed, is the position expressly under paragraph (a) of section 320(1). That paragraph refers to the need for having 'reasonable grounds' for holding a belief. No such phrase occurs in paragraph (b), which simply refers to 'reckless'.[148]

A subjective test for recklessness would not amount to the test for fraud. To be fraudulent, the director must have consciously pursued a course of conduct with the intention of cheating creditors out of their money.[149] But recklessness does not require any such intention,

what is required is simply a deliberate disregard for the interests of the creditors. The distinction may be illustrated by reference to Hardie v Hanson[150], the facts of which have been stated previously.[151] The defendant there was held not to have been liable for fraudulent trading because he did not have any intention, consciously pursued, of swindling creditors out of their money. However, he was clearly aware of the risk of loss to creditors but ignored it in the vain hope that the company's liquidity situation would improve. Such conduct, it is submitted, is reckless.

It is submitted that the foregoing discussion leads one to draw a clear distinction between the three grounds of liability stipulated in section 320(1). Those grounds may be summarised in these terms: paragraph (a) imposes liability for negligent trading; paragraph (b) for reckless trading; and paragraph (c) for fraudulent trading. That analysis would truly result in what Bisson J appropriately described as "a gradation of conduct" represented by section 320(1). Each paragraph reflects improper conduct to a different degree; each requires a different standard of proof; and each should result in different extents of liability.[152]

OTHER ISSUES WITHIN PARAGRAPHS (a), (b) AND (c)

Introduction

So far the discussion of section 320(1) has concentrated specifically on the particular basis of liability under each of paragraphs (a), (b) and (c). Each of these bases is different from the other. There are, however, certain words and phrases which are common to two or all of the three paragraphs. 'Knowingly' and 'party to' are common to all three paragraphs while 'carrying on business' occurs in paragraphs (b) and (c). These three expressions have given rise to some difficulties in interpretation, and each will now be considered individually.

Party To

In order to incur liability under section 320(1), one need not have actually done any of the activities stated therein; it is sufficient to incur liability if one has merely been a 'party to' the doing of one of those acts. The issue arises as to what sort of activity or what extent of involvement is required before a person may be held to have been a party to those acts.

These issues arose squarely in Re Maidstone Buildings Provisions Ltd.[153] The liquidator sought orders pursuant to the United Kingdom equivalent of section 320(1)(c) against the company's directors and secretary. The company had carried on business while it was insolvent. The directors pruned overheads, including their salaries, but the position did not improve. Meanwhile the company continued purchasing goods on credit. The respondent was secretary of the company for much of that period. He was in fact a partner in a firm of accountants who were the company's auditors, and acted as secretary at the company's request. He also acted, to some extent, as financial adviser to the company.

The liquidator argued that by virtue of his position, the respondent owed a duty to the company to give it certain advice viz to cease the business of the company so as to prevent loss to the creditors. A failure to do that made him a party to the carrying on of the business of the company in a fraudulent manner. But Pennycuick V-C rejected that argument. He held that mere silence and omission to give advice did not amount to being a party to the carrying on of business. His Lordship adopted the ordinary meaning of the phrase and said:

> "... so far as I can see, the expression 'party to' must on its natural meaning indicate no more than 'participate in', 'take part in' or 'concur in'. And that, it seems to me, involves some positive steps of some nature. I do not think it can be said that someone is party to carrying on a business if he takes no positive steps at all."[154]

The respondent did not actually take any part in the running of the business; that was confined to the directors. His position as secretary was only a nominal one. His only failure was not to advise the directors to cease business on the basis the company was hopelessly insolvent. Such an omission did not make him a party to the company's business activities.[155]

Positive step

Prima facie, it may be inferred from Pennycuick V-C's opinion, as stated above, that if the respondent had in fact tendered advice to the company, he would have taken a 'positive step' and therefore been a party to the carrying on of business. It is submitted, however, that such an inference does not necessarily mean that the respondent would be liable under the section, since to be liable, he must not only have been a party to the carrying on of business, but he must have been party to the carrying on of business with intent to defraud creditors. The above inference overlooks the important question of what type of advice the respondent might

have tendered to the company. It is submitted that the respondent would only be liable if he had advised the company to continue trading; and not if his advice had been to cease trading.

While Pennycuick V-C did not specifically address the issue, it is submitted that he did not intend to rule out any such distinction. The definition stated by his Lordship was 'participate in', 'take part in' and 'concur in'. These phrases, and the last one in particular, suggest that the respondent, to be liable, must have agreed to the business being carried on. This proposition is supported by Thompson v Innes.[156] The charge there was one of reckless trading. During the period that the respondents were alleged to have traded recklessly, they had been advised by their accountant in an active, positive manner. But that advice was to curb expenditure and to take other stringent steps in an attempt to prevent liquidation. The advice was, unfortunately, ignored by the respondents. Bisson J applied Re Maidstone Buildings Provisions Ltd and held that the accountant was not a party to the carrying on of the business in a reckless manner. Although the accountant, by giving the advice, had acted positively, one also had to consider the nature of that advice and the overall level of his involvement in the company's business.[157]

Pennycuick V-C emphasised that the respondent must have taken some 'positive step' in the running of the business before he could be said to be a party to it. However, what exactly would amount to such a positive step is a matter of some doubt and difficulty. It may mean active participation in or contribution to the management of the business; or it could mean something less direct. Perhaps it was difficulties such as these which led to the positive step approach not being expressly adopted in Re Gerald Cooper Chemicals Ltd.[158]

Knowledge

The respondents in Gerald Cooper had agreed to provide a company with 150000 pounds to enable it to start production of indigo. The company agreed to repay that sum in three months' time, together with certain sums from out of profits at a future date. But within four months of receiving the payment the company was insolvent. The respondents knew this and agreed to defer repayment of the 150000 pounds for a further ten days. No payment was made at the end of that period either. The company then entered into a contract with the appellant whereby it received an advance payment in return for a promise to deliver to the appellant a supply of indigo in two months' time. As soon as the company received the payment, it paid it to the respondents in discharge of

the original debt.

Templeman J had no difficulty in holding the respondents were parties to the fraudulent trading of the company even though they had no power of management or control over the company's business, and did not themselves assist in carrying on that business. The respondents knew that the company was insolvent, and the only way it could raise finance was by purported forward sales of indigo. Hence when the money became available, the respondents knew that if they pressed for payment, some particular creditor would not receive its indigo because without that money, the company could not have produced any indigo in the first place. No doubt the company traded fraudulently, and by accepting the money the respondents were a party to that fraud.

Templeman J drew a distinction between two possible courses of action available to a creditor in the respondents' position. He first said:

> "[A] lender who presses for payment is not party to a fraud merely because he knows no money will be available to pay him if the debtor remains honest".[159]

However,

> "[A] creditor is party to the carrying on of a business with intent to defraud creditors if he accepts money which he knows full well has in fact been procurred by carrying on the business with intent to defraud creditors for the very purpose of making the payment."[160]

The respondents, therefore, could have pressed for payment, but once the company was in a position to discharge the debt, the respondents were not entitled to accept any payment from the company. What, if any, remedy did they then have? According to Templeman J, "The honest debtor is free to be made bankrupt."[161] Therefore, if the company had not accepted the advance payment, the respondents could have wound up the company. But they would have realised little, if anything, from out of such a winding up. If the respondents had been unaware of the company's business activities, then of course they could not have been a party to the company's fraud. Further, it is submitted that if the company had actually started to manufacture the indigo, and the respondents had then presented an ultimatum for payment, any payments then made to the respondents could not have been impugned. The company in this case would not have perpetrated a fraud on the appellant; the payment would have been a normal response to avoid a winding up by a creditor. In such a case, though, the company's officers may be liable for reckless or negligent trading, although the respondents themselves would not be parties to such a charge. The ratio of <u>Gerald Cooper</u> may therefore be rested on the fact that the company intended to, and did, defraud the appellants for the benefit of the respondents and the respondents, being aware of that

fact, accepted the benefit conferred on them. It is submitted that if the ratio is expressed in any wider terms, a general duty of care would be created on the part of one creditor towards another; and that may be an onerous and undesirable consequence. A creditor should generally be allowed to receive what is his due entitlement. He should not be required to sacrifice his interest for the interests of other creditors. It is only if, like the respondents in Gerald Cooper, he has acted in an improper manner should he be made liable for the fraud, recklessness or negligence of another.

Definition of 'party to' following Maidstone and Gerald Cooper

The two cases considered above suggest that the definition of 'party to' comprises two elements. First the respondent must commit an act, and thereby take a positive step, in relation to the carrying on of the business. Secondly, he must do so with the knowledge that the particular transaction is effected, or the business of the company is being carried on, in a negligent, reckless or fraudulent manner. In Gerald Cooper the second element was present and, although Templeman J did not refer to a positive step, the receipt of the payment by the respondents may be taken

to have amounted to the positive step. In Maidstone the respondent arguably had knowledge of the company's fraudulent trading, but he did not act positively in the carrying on of the business. His was a failure or omission to act and that did not constitute a positive step.

A third ingredient in the definition

In the discussion above the liability of persons parties to fraudulent, reckless or negligent trading has depended on the fact that the principal company, ie the company now in liquidation, had itself engaged in such trading. Thus in Gerald Cooper there was no suggestion that the company which took the advance payment order was not trading fraudulently[162] while in Maidstone a charge of fraudulent trading had in fact been laid against the directors of the company.[163] The question arises whether the respondents in either case may have been held liable as parties to fraudulent trading if the principal company itself had not been held to have, or not been alleged to have, traded fraudulently. In the recent case of Re Augustus Barnett and Son Ltd[164] that question was answered in the negative.

In that case a charge pursuant to the United Kingdom equivalent of section 320(1)(c) was laid against the parent company (Rumasa) of the company which had gone into liquidation (the company). Throughout Rumasa's period of control the company had a substantial deficiency of assets. The auditors refused to certify the accounts without an assurance from Rumasa that it would continue to support the company. Rumasa accordingly provided letters of comfort for three consecutive years, and by 1981 it had injected 4 million pounds in subsidies. But a year later the company had a deficiency in working capital. The directors advised Rumasa that unless further funds were injected the company would have to go into receivership to avoid a charge of fraudulent trading. Rumasa provided further funds and a senior official of Rumasa assured everyone that the company would continue to receive funds. However, two months later Rumasa reneged on its promise and the company went into voluntary liquidation.

The liquidator alleged that Rumasa's letters of comfort, subsidies and continued promises, in particular to creditors, to support the company while it was insolvent induced creditors to continue supplying goods and made Rumasa a party to fraudulent trading. There was no charge of fraud against the directors themselves. In rejecting the liquidator's arguments Hoffmann J made

two points. He first said that the section unequivocally required a finding that someone had done some act which was a carrying on of business, and in doing so had acted with intent to defraud creditors, before it could be said that a third party was a party to such conduct. Since no fraudulent intent was alleged against the directors, there were no fraudulent acts to which Rumasa could be a party. Secondly, Hoffmann J stated that the third party's (the respondent's) own state of mind was an irrelevant consideration. The phrase 'with intent to defraud creditors', upon this interpretation, therefore, refers back to the words 'the carrying on of any business of the company' and not to the words 'any person was knowingly a party to'. On the facts of Augustus Barnett it did not matter whether Rumasa itself in fact had an intention to defraud the company's creditors; since the directors themselves had no such intention the intention and acts of Rumasa were irrelevant.[165]

Assuming that the decision in Augustus Barnett as stated above is a correct interpretation of paragraph (c), the question arises whether the same interpretation would apply in relation to paragraphs (a) and (b). Generally the issue that arose in Augustus Barnett in relation to paragraph (c) will not arise in relation to paragraphs (a) and (b). The reason is that the offences

in the latter two paragraphs are restricted to, or only apply in relation to, officers of the company, whereas paragraph (c) applies to any person who may have been carrying on the company's business, or been a party to it. Hence, if the charge in Augustus Barnett had been one of negligent or reckless trading, Rumasa, not being an officer of the company, could not have been made liable.

The term 'officer' includes a director, manager or secretary of the company.[166] In most cases the officers will in fact be contracting debts on behalf of the company or carrying on the business of the company. Their liability, therefore, will usually be direct in that they themselves would have been negligent or reckless or fraudulent in conducting the company's affairs, rather than indirectly as parties to such conduct. The latter was the case in Gerald Cooper, where the respondent was not an officer but a creditor of the company in liquidation, and hence an outsider.

Notwithstanding that general position, there may be cases where an officer may not be involved in the day to day activities of the company's business and would not, therefore, be directly engaged in carrying on the business of the company or contracting a debt on behalf of the company. Such might be the case, for example,

where the company's accountant holds a nominal position as the company secretary (and thus becomes an officer) but is involved in the company's business to no greater extent than in his capacity as auditor and, from time to time, as financial advisor.[167] Suppose that the company becomes insolvent and the directors, not being entirely clear about the company's financial position, ask the accountant whether they should continue trading and whether they could incur a particular debt. The accountant's advice is to continue trading and to incur the debt. It may be assumed that in doing so he acted recklessly and negligently. The company soon goes into liquidation and the liquidator begins proceedings against the accountant on the basis that, being an officer, he was party to reckless and negligent trading. The liquidator does not begin proceedings against the directors.

It is submitted that in such a case, in respect of the reckless trading charge the <u>Augustus Barnett</u> decision would apply mutas mutandis, but that in respect of the negligent trading charge that decision would have no application. This follows from the difference in phraseology between paragraphs (a) and (b). The language of paragraph (b) is similar to that of paragraph (c). Following the <u>Augustus Barnett</u> approach, it is clear that there must have been the carrying on of

a business by someone, and it must have been done so recklessly. And just as under paragraph (c) it is irrelevant whether the respondent had an intention to defraud, so under paragraph (b) it would be irrelevant whether the respondent had foresight of the consequences (applying the subjective test) or should have been aware of the possibility of serious loss (the Thompson v Innes[168] test). The words 'in a reckless manner' in paragraph (b) must refer back to the phrase 'carrying on of any business of the company' rather than to 'any person was ... knowingly a party to'.

The Augustus Barnett approach does not, however, lend itself to paragraph (a). The relevant part of paragraph (a) is 'knowingly a party to the contracting of a debt by the company and did not, at the time the debt was contracted, honestly believe on reasonable grounds [that the debt would be paid.]'. Although there must be the contracting of a debt by the company (through the agency of its officers) paragraph (a) does not go on to provide that the debt must have been contracted negligently. This contrasts with the position under paragraphs (b) and (c), where the business must have been carried on recklessly or fraudulently. Further, negligence on the part of those actually contracting the debt is not a prerequisite to imposing liability on the respondent as a party. This again

contrasts with the position under paragraphs (b) and (c) where recklessness and fraud on the part of those carrying on the business is a prerequisite to imposing liability on the respondent.

The above conclusion in respect of paragraph (a) follows from the language of that paragraph. The use of the word 'and' relates the words 'honestly believe on reasonable grounds' back to the words 'any person was ... knowingly a party to'. This means that the state of mind of the respondent is a relevant consideration to establish liability under paragraph (a), therefore, it must be shown that the respondent himself either did not hold an honest belief, or that he held an honest belief but on unreasonable grounds.

The different conclusions reached in respect of paragraph (a) on the one hand and paragraphs (b) and (c) on the other hand inevitably follows from the different phraseology of those two sets of provisions. The decision in Augustus Barnett in relation to paragraph (c) was, it is respectfully submitted, clearly correct, and the extension of that decision to paragraph (b) is also clearly unavoidable given the similar language of those two provisions. It is submitted that the differences in position as between the two sets of paragraphs should be seen as an anomaly, and should

be rectified. The proper remedy, it is submitted, is to amend paragraph (a) so as to bring it into line with paragraphs (b) and (c). The position in principle should be as stated in Augustus Barnett viz. that before a person can be held liable as a party to improper trading, there should in fact have been improper trading by those actually carrying on the business of the company.

Definition of 'party to' at present

For the moment, however, the combined effect of Maidstone, Gerald Cooper and Augustus Barnett upon the definition of 'party to' in section 320 may be summarised as follows. To establish liability under paragraph (a) it must be shown that:

(i) there was a positive act.

(ii) there was the contracting of a debt by the company.

(iii) the respondent did not honestly believe on reasonable grounds that the debt would be paid.

It follows from (iii) that the respondent had knowledge of the contracting of the debt. It need not be established that the debt was contracted negligently by the company.

To establish liability under paragraphs (b) and (c) it must be shown that:

(i) there was a positive act.

(ii) the respondent knew that the business was being carried on recklessly/fraudulently.

(iii) the persons carrying on the business of the company were in fact doing so recklessly/ fraudulently.

In the absence of (iii) the foresight/intention of the respondent is irrelevant.

Knowingly

Section 320(l) provides that a person is only liable for carrying on business negligently, recklessly or fraudulently, or is only liable for being a party to the carrying on of such business, if he does so 'knowingly'. The meaning of that term in the context of section 320(l) is a matter of some doubt, and the term may, in fact, be redundant.

Prima facie 'knowingly' imports the element of mens rea and gives all the tests in the section a subjective element. But in In re J. E. Hurdley and Son Ltd[169] the Court of Appeal, considering a predecessor of section 364 of the Companies Act 1955[170], which is not materially

different from section 320(1) on this point, held otherwise. The effect of the word 'knowingly' in section 364 was explained by Myers CJ as follows:

> "[All] that it means is that, before an order can be made [under section 364(1)] it must be shown that the member of the company sought to be mulcted knew that the particular debts were being incurred and also had knowledge generally of the company's affairs, so that, as a reasonable person, he should have known that, at the time the particular debts were being contracted, the company could not have had any reasonable or probable expectation of being able to pay the same as well as all its other debts."[171]

Two points arise out of this definition. First it must be proved that the respondent knew that the particular improper act was taking place. But this requirement is in fact simply a restatement of the 'knowledge' element in the definition of 'party to' discussed above. The second requirement, however, is a slightly different one; the respondent must also have had a knowledge generally of the company's affairs.[172] Generally a person carrying on the company's business would have knowledge of the company's affairs. The second requirement would, therefore, probably only apply to someone who is charged as a party to negligent, reckless or fraudulent trading; such a person may not necessarily have a general knowledge of the company's affairs, although he must, by virtue of the definition of 'party to', have knowledge of the particular transaction or

business which is sought to be impugned. If the Hurdley interpretation of 'knowingly' is accepted in relation to section 320[173] then it is submitted that it does no more than qualify the definition of 'party to' in the manner stated above. It is further submitted that, following Hurdley, 'knowingly' should not be seen as importing the element of mens rea into section 320. That means that the tests in respect of the three grounds of liability in section 320(1) are as discussed previously.

Carrying On of Any Business of the Company

While there is no case on the meaning of 'knowingly' as it appears in section 320(1), a number of cases have considered the meaning of the phrase "carrying on of any business of a company".

Single transaction

Two of the issues which arise out of that expression were considered in Re Gerald Cooper Chemicals Ltd.[174] One of the arguments of the respondents in that case was that the principal company (now in liquidation) had not, by accepting the advance payment order from the applicants, done anything which could amount to a

'carrying on of the business of the company'. The respondents argued that the advance payment order was a single transaction and on the authority of In re Murray Watson Ltd[175] could not constitute a carrying on of business.

In Murray Watson Oliver J, referring to the United Kingdom equivalent of section 320, said that the section was

> "aimed at the carrying on of a business ... and not at the execution of individual transactions in the course of carrying on that business. I do not think that the words "carried on" can be treated as synonymous with "carried out", nor can I read the words "any business" as synonymous with "any transaction or dealing"."[176]

The respondents in Gerald Cooper prima facie had a strong argument. While the company's acts may have amounted to fraud, they may not have amounted to fraudulent trading in the sense of carrying on business. But Templeman J rejected that argument. He purported to rely on a passage from the judgment of Oliver J where, immediately after the passage quoted above, Oliver J had said:

> "The director of a company dealing in second-hand motor cars who wilfully misrepresents the age and capabilities of a vehicle is, no doubt, a fraudulent rascal, but I do not think he can be said to be carrying on the company's business for a fraudulent purpose, although no doubt he carries out a particular business transaction in a fraudulent manner."[177]

Templeman J interpreted this passage as stating that one of the elements in the definition of 'carrying on business' fraudulently was a loss to creditors. His Lordship said that in the example given by Oliver J there was no loss to creditors and hence the single transaction in that example could not amount to a carrying on of business. According to him, section 320 was

> "... contemplating a state of facts in which the intent of the person carrying on the business is that the consequence of carrying it on (whether because of the way it is carried on or for any other reason) will be that creditors will be defrauded ..."[178]

It is submitted, with respect, that Oliver J quite unequivocally stated that a single transaction could not amount to carrying on of a business, irrespective of any question of loss to creditors. By introducing the element of loss to creditors, Templeman J is adding a gloss to Oliver J's definition which the latter clearly did not intend. It is submitted that the two definitions are irreconcilable. Templeman J drew a distinction between a fraud on a customer and a fraud on a creditor, and confined Oliver J's example to the former. This enabled him to conclude:

> "It does not matter for the purposes of [section 320] that only one creditor was defrauded, and by one transaction, provided that the transaction can properly be described as a fraud on a

> creditor perpetrated in the course of carrying on business."[179]

It is respectfully submitted that both Murray Watson and Gerald Cooper are unsatisfactory decisions. It is submitted, with respect, that a single transaction should amount to the carrying on of a business, and to that extent Murray Watson is wrongly decided and Gerald Cooper should be preferred. Secondly, it is submitted that the basis on which Templeman J sought to distinguish Murray Watson is unsatisfactory, and to that extent Templeman J's decision should not be accepted.[180] The distinction between a fraud on a customer and a fraud on a creditor drawn by Templeman J is incorrect for two reasons, which have been cogently stated as follows:

> "First, the section covers the carrying on of business 'for any fraudulent purpose'; this is surely wide enough to cover the purpose of defrauding customers as well as creditors. Secondly, acceptance of Templeman J's suggested interpretation would have the strange result that controllers of a company could procure it to carry on business fraudulently with complete impunity under the fraudulent trading provisions, provided they kept the business on a strictly cash basis."[181]

The intention behind the enactment of section 320 originally was to prevent all manner of fraudulent trading and to bring perpetrators to account in a speedy manner through the procedural mechanism of the section.[182]

The customer-creditor distinction in Gerald Cooper is contrary to that intention.

Cessation of trading

One other aspect of the definition of 'carrying on of any business of the company' arose in Re Scarflex Ltd.[183] The respondent argued that once the company had passed the resolution to cease trading, its subsequent activities could not amount to a carrying on of business; the company had ceased trading and over the next two years was merely collecting and distributing its assets. Oliver J rejected that argument in these words:

> "[It cannot be said that] the expression 'carrying on any business' in the section is necessarily synonymous with actively carrying on trade or that the collection of assets acquired in the course of business and the distribution of the proceeds of those assets in the discharge of business liabilities cannot constitute the carrying on of 'any business' for the purposes of the section."[184]

What must be looked at is not the passing of the resolution or the cessation of trading, but the nature of the company's activities subsequent to those events. Normally a company has outstanding debts to collect and to pay, and while it was engaged in pursuing the various rights and discharging its various obligations, it was still carrying on business within the meaning of section 320. It would appear that even if a formal

resolution for voluntary winding up were passed, the company would still be carrying on business within the meaning of section 320, and it would not be until the actual presentation of the petition that it could be said the company had ceased to carry on business.[185]

The Scarflex approach is supported by certain comments of the Court of Appeal in Re Nimbus Trawling Co. Ltd.[186] It was argued that the alleged fraudulent transactions were not carried on in the usual course of the company's trading business. It was argued that the sale of the trawler, the company's major asset, was a disposition of a capital asset which could not amount to a carrying on of business. That argument was accepted by Richardson J, who agreed that the business of the company - trawling for fish - had ceased and the sale of the trawler was merely the realisation of a capital asset quite independent of, and not incidental to, the company's previous business. Nor did it constitute a new business. Richardson J distinguished Scarflex on the basis that in that case there were a series of transactions, including the sale of revenue assets, over a two year period. A company which was still collecting trade debts, realising trading stock and paying off creditors could be said to be carrying on business. That was the position in Scarflex and it

would appear that Richardson J would have decided Scarflex as Oliver J did.

But the majority of the Court of Appeal rejected the respondents' narrow interpretation of the section. Cooke P, referring to section 320, said:

> "The legislation is meant to protect creditors. If transactions of the company are in fact undertaken with the intention of defrauding creditors, it is difficult to suggest any reason why Parliament would have wished to insist on the fraud having occurred in the course of trade before the statutory remedy would be available."[187]

The President adopted the ordinary meaning of 'business' which he stated as "dealings and commercial activities."[188] That broad definition quite clearly covered the transaction in the instant case. A fortiori it covered the series of transactions over the two year period as occurred in Scarflex. It is further submitted that Cooke P's broad language covers the single transaction over a short period of time as occurred in Gerald Cooper. The advance payment order in that case was in relation to the very product the company was dealing in, and that clearly amounted to a commercial activity of the company. Further, as Cooke P expressly said in relation to section 320:

> "... the provision covers any dealing or transaction of the company performed, carried out or conducted with the intention of defrauding creditors."[189]

Somers J did not use language as wide as that used by Cooke P. However, he expressly agreed with the conclusion in Scarflex, since as in Scarflex, what had occurred on the facts before him was "a continuous course of active conduct in the collection and distribution of the business assets"[190], as well as a discharge of debts. According to Somers J, a company does not have to operate in the normal commercial sense of trading for a profit before it can be said to be carrying on business; the getting in of assets, paying of creditors and discharging of staff were activities amounting to a carrying on of business.

It is submitted, with respect, that the broad approach adopted in Scarflex and Nimbus is consonant with the intention behind the enactment of section 320. A company does not merely defraud creditors during the normal course of business. As the facts of Nimbus show, and as Prichard J in the High Court recognised, the versatility of company directors must not be underestimated.[191]

PROCEDURAL ISSUES

Introduction

So far this paper has discussed the basis upon which liability under section 320(1) is incurred; the elements which have to be established before one can prove negligent, reckless or fraudulent trading. This part of the paper looks at some of the procedural issues involved in bringing an application pursuant to section 320 in the first place, and at the consequences of the success of any such application.

Locus Standi

Subsection (1) of section 320 restricts the potential applicants under that section to four classes of persons: the Official Assignee, the liquidator, a creditor and a contributory of the company. For practical purposes the Official Assignee and the liquidator may be treated as one.

'Contributory' is defined by section 212(1) of the Companies Act 1955 essentially as "every person liable to contribute to the assets of the company in the event of its being wound up." But generally the term is used

to refer to the members of the company.[192] One reason for giving members standing is this. The members will only have their capital returned if there is a surplus of assets over liabilities after all the creditors of the company have been satisfied. If, instead of the company, the directors are made personally liable for the debts of the company, then the members stand a better chance of receiving part, or all, of their investment back. In practise, however, there do not appear to be any reported cases of a contributory exercising his right pursuant to section 320.

Undoubtedly, the persons primarily intended to be benefited by section 320 are the creditors.[193] The liquidator occupies a fiduciary position in relation to the company as well as the creditors.[194] In discharging his functions he has to keep the interests of both groups in mind. It may be that in the course of winding up he discovers an instance of, say, fraudulent trading in relation to a particular creditor. But, keeping in mind the interests of both the company and the other creditors, he may decide not to pursue those responsible because the proceedings cannot be afforded in monetary terms. He may perhaps conclude that the chances of proving liability are less than even and that it would be more prudent to distribute the funds available rather than risk losing more in a

litigation which may prove unsuccessful. However, the particular creditor who was defrauded may wish to proceed against the delinquent director in any event. He is therefore given standing in a section which is, after all, creditor - protection legislation. That this was an appropriate measure is evidenced by the cases where the creditor, rather than the liquidator, is the applicant.[195]

While the desirability of such a position may not be doubted, the cases reveal that this position poses certain difficulties as well. The crucial question is whether the successful creditor in a section 320 application may retain the sum recovered from the respondent as his own or whether that sum should become part of the general assets of the company under the administration of the liquidator and be distributed pari passu amongst all creditors. The problem may arise, for instance, in the case where prima facie only the applicant creditor has suffered a loss but during the course of the proceedings it transpires that other creditors have also suffered loss. That issue in turn gives rise to the even more basic issue of whether a court ought to prevent a creditor from making an application pursuant to section 320 if the liquidator wishes to make, or has made, an application.

In other words, does the liquidator's application take precedence.

In Re Gerald Cooper Chemicals Ltd[196] Templeman J suggested that the liquidator would be given preference. His Lordship directed the applicant creditor to ask the liquidator whether he wished to intervene, and whether he wished to argue that any sums recovered from the respondents should go to the company rather than to the applicant creditor. Earlier, Templeman J had said:

> "An application by a creditor [under section 320] must be carefully regulated if injustice is not to result. The respondents to this summons must not be placed in double jeopardy by the possibility of further proceedings by the liquidator."[197]

Although Templeman J did not expressly indicate whether the liquidator would be made the substitute applicant if he did decide to intervene, his Lordship's approach is open to the interpretation that, all things being equal, that would be the case. However, such an interpretation would appear to be contrary to what was said by the English Court of Appeal in Re Cyona Distributors Ltd.[198]

In that case a company went into liquidation owing the Commissioners of Customs and Excise a large sum in unpaid taxes. The Commissioners sought an order pursuant to the United Kingdom equivalent of

section 320(1)(c). They also instituted criminal proceedings against the respondents. The section 320 application was not then proceeded with. When the criminal action came for trial the respondent paid the Commissioners most of what was owing. The liquidator then claimed that the amounts received by the Commissioners should go towards the general assets of the company.

Lord Denning MR and Dankwerts LJ had no doubt that the Commissioners were entitled to exercise their rights pursuant to the section. While the liquidator did not attempt to substitute himself for the Commissioners as the sole applicant, it would appear that even if he had tried, he would not have been successful. Lord Denning said:

> "But no doubt the liquidator should always be made a party to the proceedings, so that the interests of the other creditors can be safeguarded."[199]

It is submitted that if the liquidator were to apply, he would simply be made a party to the creditor's application, and not replace the creditor as the sole applicant. Any suggestion in Gerald Cooper to the contrary, therefore, is, with respect, incorrect. This course of action will adequately protect the interests of other creditors while at the same time ensuring that the individual creditor's efforts in bringing an action,

where the liquidator had previously refused, is not simply disregarded.

Although the liquidator may be given notice of the application, he may not be ordered to become a party; there is no suggestion in either Gerald Cooper or in Cyona to that effect. The liquidator may, however, be estopped from instituting fresh proceedings later if he refuses to become a party when initially notified. In Gerald Cooper Templeman J said:

> "[The liquidator] should be informed [by the applicant] that if he does not choose to intervene now he will not be able successfully to institute [section 320] proceedings against the respondents in the future."[200]

It is submitted that this is not an unreasonable approach. While the interests of the creditors are important, the respondent must not be placed in double jeopardy. Nor should the particular creditor applying later be suddenly faced with a challenge by the liquidator. Upon any application by a creditor, the court may easily adjourn proceedings for an appropriate period to enable the liquidator to make an election as to whether he wishes to join the application or not. Generally he will be acting on the views of all the creditors, and if, after consulting them, a decision is taken not to intervene, then the application should proceed and the respondent should not later be faced with fresh proceedings.

Before leaving the position of standing, it should be noted that an application pursuant to section 320 may only be brought once the company in question has actually gone into liquidation. This is apparent from the opening words of the section.[201] Hence if a creditor believes he has been the subject of improper conduct on the company's part, he cannot avail himself of section 320 unless he first winds the company up. His only remedy otherwise is to proceed by way of an ordinary proceeding in the courts.

The Distribution of any Sums Recovered

Perhaps a more important issue is whether a creditor who individually brings a section 320 application, and does so successfully, is entitled to personally retain any sums recovered from the respondent. Prima facie the answer is yes. But the position may be more difficult if the liquidator becomes a party to the creditor's application.

In Cyona Dankwerts LJ stated his opinion in unequivocal terms:

> "The situation seems to me to be quite different where a creditor begins proceedings at his own expense under the section. The creditor should be entitled to his reward. I do not think that he is acting as a trustee for the general body of creditors."[202]

Although his Lordship did refer to the court's discretion in this matter, as provided for under section 320 itself, he did not place as much emphasis on it as Lord Denning did. Lord Denning agreed that in a creditor's application the creditor acted on his own account, free from any control by the liquidator. Hence he was in no way a trustee for the other creditors. To that extent the court would probably make an order in his favour rather than in favour of the liquidator. However, the court did have a discretion in the matter. Russell LJ disagreed; in his opinion the section required that any sums recovered accrue to the assets of the company for distribution to all creditors.

It should be noted that their Lordship's opinions on this issue were obiter only. The Commissioner's appeal was unanimously upheld by the Court of Appeal on the basis that the sums received by the Commissioners were not received pursuant to the section 320 application (since it had not been proceeded with) but by way of a mitigation plea in the concurrent criminal proceedings.[203]

However, it is submitted that Lord Denning's approach is the preferable one. Section 320 gives the court a wide discretion to determine in whose favour the order should be made, and if in more than one person's favour, in what proportions should the sums recovered be divided.

The section provides that upon liability being established under any one of paragraphs (a), (b) or (c), the court may "declare that the person shall be responsible, without any limitation of liability, for all or any part of the debts and other liabilities of the company as the court may direct". Prima facie the phrase 'as the court may direct' refers back to the extent of the order that may be made. However, the Court of Appeal (including Russell LJ[204]) construed that phrase as referring to the persons in whose favour the order may be made. Assuming that that is the case, the court has a discretion, in Lord Denning's words, to do one of three things:

> "... order the sum to go in discharge of the debt of any particular creditor; or that it shall go to a particular class of creditors, or to the liquidator so as to go into the general assets of the company".[205]

It follows from this that if the application is by a single creditor, the court may make an order in his favour. If the liquidator decides to intervene and proves that all or an ascertained group of creditors have suffered loss, then an order in favour of those other creditors may also be made. It is submitted that such an approach is in accordance with the intention behind the legislation, which was to indemnify those creditors who were actually the victims of the directors'

or officers' improper conduct. As Dixon CJ recognised in Hardie v Hanson[206], the purpose of the enactment "surely must have been to enable the court to remove the protection of the no liability system ... and to require [delinquent] directors to indemnify the creditors defrauded to any extent left to the discretion of the court."[207]

However, Dixon CJ's words do not apply in the case where the applicant is the liquidator on his own. It will be recalled that in In re William C. Leitch Bros. Ltd[208] the proceedings were instituted by the liquidator. An order against the respondent was made by Maugham J, but he left open the question of how the monies recovered, if any, should be applied. In a subsequent hearing Eve J held that all monies recovered should go towards the general assets of the company and be distributed amongst all the creditors of the company.[209]

Eve J's decision was dealt with in three different ways by the Court of Appeal in Cyona. Lord Denning MR sought to lay down a broad rule when he said that the court's discretion to direct the destination of any funds recovered included the case where the applicant was the liquidator, although in such a case the court would invariably make an order in favour of the general assets of the company. Eve J's decision, according to

Lord Denning, was simply an example of that approach. It is submitted, with respect, that the Master of the Roll's approach is incorrect. His remarks were purely by way of dicta while Eve J's decision was given following arguments by counsel, and was in respect of the precise point in issue. Dankwerts LJ distinguished Leitch (No. 2) on the basis that the application there was by the liquidator; his Lordship therefore confined his dicta to the case of an application by a creditor. Russell LJ, on the other hand, agreed with Eve J's decision, and saw it as being of general application.

It is submitted that, in light of the way Leitch (No. 2) was dealt with by the Court of Appeal[210], it is open for a subsequent court to adopt one of three approaches. It may hold Leitch (No. 2) to be of general application (as Russell LJ did); it may draw a distinction between the case where the applicant was the liquidator and the case where the applicant was a creditor (as Dankwerts LJ did); or it may decline to follow Leitch (No. 2). It is submitted that the second alternative would result in an undesirable and unnecessary distinction. The issue is not in respect of who the applicant is, but in respect of whether the particular creditors who have suffered loss only should be compensated; who the applicant is is an irrelevant consideration.

It is submitted that the preferred alternative is in effect to adopt Lord Denning's approach, with the qualification that that would necessitate not following Leitch (No. 2).[211] Section 320(1), as has been recognised, gives courts wide powers to make delinquent directors and officers personally liable to those whom they have caused loss. If a particular creditor, or a particular group of creditors, can be identified as having specifically suffered losses, then the court should make an order in their favour. That was the approach envisaged by the section. Where, however, there are difficulties in ascertaining which creditors in fact have suffered loss, and if such difficulties would unduly prolong the process of winding up[212], then no doubt it would be in the interests of all creditors if the court made an order in favour of the general assets of the company. This approach, it is submitted, makes it irrelevant whether the applicant is the liquidator or a creditor in the first place, and if the latter, whether the liquidator does in fact become a party to the application subsequently.

Extent of the Order - Is Section 320 a Penal Provision

The issue under this head is to what extent, following the establishment of liability under section 320(1),

the court may make an order against the respondent. The section states that the court may declare that the person liable should be responsible "without any limitation of liability, for all or any of the debts and other liabilities of the company".

Generally the court will be able to establish the extent of loss suffered by creditors and will accordingly be able to make an order for a specific sum. In some cases, however, when the application comes on for hearing, the quantum of loss may still be a question to be finalised. The issue then arises, as it did in <u>In re William C. Leitch Bros. Ltd</u>[213], whether the court in such a case should make a general declaration rather than an order for a specific sum. In <u>Leitch</u> it was held that any order had to be for a specific sum. Maugham J pointed out that an order under section 320 was, pursuant to subsection (4), deemed a final judgment for the purposes of the bankruptcy legislation[214] and formed the basis for possible bankruptcy proceedings against the respondent. His Lordship accordingly made an order for 6000 pounds, which was the debt due in respect of stock purchased during the period the company was trading fraudulently. It is respectfully submitted that this decision was correct, and the quantum of the order quite reasonable in the circumstances and clearly within the court's discretion.[215]

Maugham J's conclusion follows from the phrase "all ... of the debts and other liabilities of the company". That phrase prima facie enables the court to make a delinquent director or officer personally liable even for those debts of the company which were contracted during the proper, bona fide period of trading. But the cases have not been at one on the meaning of the phrase. Some cases have said that the phrase makes section 320 a punitive or penal provision; other cases have given it a more restrictive interpretation.

In Leitch Maugham J had no doubt about the meaning of the phrase. He said:

> "[Section 320] is in the nature of a punitive provision, and it is in the discretion of the court to make an order without limiting the order to the amount of the debts of those creditors proved to have been defrauded by the acts of the director in question, though no doubt the order would in general be so limited."[216]

It should be noted that in general Maugham J would not exercise the discretion to penalise, and in Leitch itself he did not do so. But he did not indicate what circumstances or factors would lead him to exercise the discretion. In Cyona Lord Denning MR added his authority to this interpretation when, referring to the order that may be made, he said:

> "The sum may be compensatory. Or it may be punitive."[217]

The position, however, is not entirely settled. In Re Maney and Sons De Luxe Service Station Ltd[218] the New Zealand Court of Appeal cast doubt on the position as stated above. In doing so the court also disagreed with Myers CJ in Re J. E. Hurdley and Son Ltd[219] where the learned Chief Justice had relied upon Leitch in holding that a predecessor of section 364 of the Companies Act 1955 was a penal provision. In Maney North P, referring to the English authorities, said that their Lordships' opinions "meant no more than that the damages may be 'punitive' in the sense in which that word is used in actions to recover damages at common law".[220] Turner J said that he was not persuaded by their Lordships' opinions and Haslam J dismissed them as being obiter.

With respect, the opinion of the court in Maney was also clearly obiter. The issue in that case was the issue in respect of which the question of whether section 320 is a penal provision generally becomes important viz. whether the limitation period for a section 320 proceeding is two or six years.[221] Counsel in Maney proceeded upon the basis that section 320 was not a penal provision and the limitation period was accordingly six years. It was, therefore, strictly unnecessary for the court to discuss the issue.

The Court of Appeal referred to the fact that Myers CJ's endorsement of the English position was a minority opinion. However, the issue in Hurdley was not in relation to section 320, but in relation to section 364. The majority in Hurdley[222] held that section 364 was not a penal provision; they did not, however, express any opinion about section 320. It is submitted that the Court of Appeal could have, and should have, distinguished Hurdley on the basis that the court's discretion to make an order under section 364 is expressed in different terms from the court's discretion under section 320.

Section 364 states that if a member of a company acts or omits to act in a certain way then:

> "the court may, if it finds that the act or omission has in fact prejudiced the creditors or any creditor of the company, order any such member to pay to the liquidator of the company such sum in addition to the amount for which he may be liable under the constitution of the company as to the court may seem just."

This section may be distinguished from section 320 on two grounds: the incurring of liability, and the extent of liability.

The first ground is based specifically on the phrase 'the act or omission has in fact prejudiced the creditors'. The majority of the Court of Appeal in Hurdley placed

much emphasis on this phrase. Ostler J said:

> "It is to be noted that no action will lie against the directors ... notwithstanding that they have done the prohibited actions unless and until such actions have caused prejudice to one or more creditors."[223]

There must be a causal relationship between the member's improper act and the creditor's loss before the former may be held liable at all. If the member has acted improperly but it cannot be shown that such acts led to any losses on the part of the creditor, then liability is not established.

The phrase in question does not, however, appear in section 320. There is no suggestion at all that a causal link between the respondent's improper acts and the creditor's loss is a prerequisite to imposing liability. On the contrary, it has been held[224] that a director who participated in a fraudulent transaction but whose acts did not in fact cause any loss to creditors was liable for fraudulent trading. Liability under section 320, unlike that under section 364, does not, therefore, depend on the fact of loss to creditors due to improper trading; it depends upon whether the respondent has acted in an improper manner. If he has, he is liable.[225]

The second ground of difference between sections 320 and

364 follows from the first. Assuming that the respondent is in fact liable, the next issue is as to the extent of his liability. The language of section 364 is, in relation to this issue, in fact somewhat ambiguous. The section may be interpreted as giving the courts a discretion to impose liability to any extent they see fit, or it may be interpreted as restricting the courts' powers to imposing liability up to, but not exceeding, the actual loss suffered by creditors as a consequence of the member's improper acts. In Hurdley the majority of the Court of Appeal adopted the latter interpretation. Fair J said:

> "However grave the misconduct of the officer, the amount of the order must, I think, be limited to the extent to which the creditors are proved in fact to have been prejudiced."[226]

Consequently, section 364 was held to be a merely compensatory, as opposed to punitive, provision.

That position must be compared with the position under section 320, where no ambiguities in relation to the issue of the extent of the order exists. The position is quite clear; the court may make an order in respect of "all ... of the debts or other liabilities of the company". The amount payable by the delinquents here is not limited to the amount of the loss suffered by creditors, but extends to all the debts and liabilities of the company, whether incurred during the period of

improper trading or not. If the court's order is limited to the debts incurred during the period of improper trading, then it may be termed compensatory; if the order extends to debts incurred outside that period, then it may be termed punitive.[227]

It is submitted that the decision in Maney does not necessarily settle the issue of whether section 320 is a penal provision. As noted above, the court's comments were obiter only. Further, a recent High Court decision adopted the Leitch approach as correctly stating the law.[228] It is true that the actual decision in Maney in respect of the period of limitation for section 320 proceedings is in favour of the creditor. However, it is submitted that when one examines section 320 in detail, and compares it with section 364, one may conclude that section 320 is in the nature of a penal provision. Such a conclusion would appear to be within the intention behind the section.[229]

Enforcement Provisions of Section 320

One difficult and time consuming problem which successful litigants often face is the enforcement of judgments against the unsuccessful parties. In the context of a section 320 application, if one bears in

mind the type of improper activity the section was originally primarily directed against, the problem may sometimes prove more difficult than usual.

It is no use making a director or other officer of the company personally liable if one cannot in fact obtain from him within a reasonable period of time the sum for which judgment has been entered against him. The section 320 procedure was intended to be a relatively expedient one. In accordance with that object, the Greene Committee recommended[230], and Parliament accepted, that the liability of the director be made a charge on any debt due from the company to him. This recommendation was directed in particular to the prevalent practice of the time whereby directors 'filled up' their debentures before putting their insolvent companies into liquidation. The Greene Committee's recommendation, now enacted as section 320(2) meant that the director could no longer take the benefit of the debenture. Instead, the assets over which the debenture was held in effect became available for the benefit of creditors (and contributories). Subsection (2), in fact, is expressed in very wide terms; where the court makes a declaration against the director "it may give such further directions as it thinks proper for the purpose of giving effect to that declaration ...". The court has the power to charge the debenture even if it has been transferred to a third

party, unless it was to "an assignee for valuable consideration ... given in good faith and without notice of any of the matters on the ground of which the declaration is made." The courts have utilised their power under subsection (2) and the provision would appear to be a useful enforcement mechanism in practice.[231]

Subsection (4) of section 320 further provides that a declaration under subsection (1) is deemed to be a final judgment within the meaning of section 19(d) of the Insolvency Act 1967. This enables the applicant (as judgment creditor) to commence bankruptcy proceedings against the respondent (now the judgement debtor) if the latter does not, or is unable to, discharge the liability.

Mention has already been made of the criminal penalties associated with section 320. Prior to the passing of the Companies Amendment Act 1980 they were contained in subsection (3) of section 320; they are now to be found in section 461D. Two points may be noted about section 461D. It only applies to a breach of section 320(1)(c); it does not apply to a breach of sections 320(1)(a) or (b). Secondly, the words "If in the course of the winding up of a company" in section 320(1) do not appear in section 461D. It has been held, however, in relation to the former section 320(3), that that provision only applied where the company was in fact being wound up.[232] It is submitted that the repeal

of section 320(3) and its re-enactment as section 461D makes no difference to that position; the change brought by the amendment is merely procedural, not substantive.

Procedure for bringing Application under Section 320(1)

The method of instituting proceedings under section 320(1) was until recently quite simple. Rule 49 of the Companies (Winding Up) Rules 1956 is the starting point. It states that all section 320(1) applications are to be made by motion to the court.

Under the former Code of Civil Procedure the practice was to make an originating application pursuant to Part VI of the Code. But with the coming into force of the new High Court Rules the procedures have changed. The position is not entirely satisfactory because the Rules do not thoroughly deal with (inter alia) the question of proceedings under the Companies Act. Further procedures to reconcile the Companies Act procedures and the High Court Rules, particularly in relation to winding up, are still under consideration. For present purposes, however, the procedure is that contained in Part IV of the High Court Rules. By rule 448(1)(c) the Companies Act falls to be dealt with under Part IV. That

Part abolishes the former originating applications procedure and introduces instead a uniform originating process by way of statement of claim and notice of proceeding.[233] There would also normally be filed an affidavit in support.

Rule 49(2) of the Winding Up Rules requires the application to be on notice. The notice is to be served on the respondent not less than eight days before the hearing. Any affidavits and reports intended to be used in support are to be served at least four days before the hearing. Where the applicant is not certain as to who exactly should be served, he may, pursuant to rule 451 of the High Court Rules, apply to the court for directions. Normally this would be done as a matter of course. Pursuant to rule 455 evidence is given either by means of a statement of facts as agreed to by the parties, or by means of affidavits. In the latter case either party may, pursuant to rule 508, cross-examine witnesses. Generally the court has a discretion as to the procedures involved, and will usually act so as to make the proceedings acceptable and expedient for all parties involved.

CONCLUSION

Section 320 is, without doubt, a complex section. The various inter-relationships between the different parts of the section are not always easy to establish or construe. Part of the difficulty arises from the rather obscure structure of the section; and that situation has not been helped by the lack of any comprehensive global judicial consideration of the section.[234] All the cases deal with particular aspects of the section only, without considering the relationship of that aspect with other aspects of the section.

Professor Gower at least is in no doubt as to the efficacy of section 320.[235] However, one would, with respect, find it hard to support his view if one considers that there are relatively few reported decisions on the section in spite of the fact that it was first enacted almost sixty years ago. The section has been universally criticised (including in New Zealand, at least prior to its amendment in 1980) as imposing too high a standard of proof. But the enactment of paragraphs (a) and (b) of section 320(1) in 1980 does not appear to have made any difference to the position.

It has been argued[236] that the difficulty with section 320 is not, and never has been, one in relation

to the question of the standard of proof, but rather one in relation to the question of enforcement. The problem, it is argued, lies in the high costs involved in instituting and completing proceedings against delinquent directors and other officers. On the one hand the assets of the company may not be adequate to cover the cost of proceedings, and on the other hand the respondent "may have made arrangements against that contingency".[237] It is accordingly argued that the remedy lies not in broadening the scope of section 320 (as New Zealand has done) but in establishing a fighting fund for creditors to bring into account those behind the many 'fly-by-night' companies who, according to one article[238], defraud innocent members of the public in New Zealand of about $100 million each year. The options suggested include a legal aid fund established and maintained by increased charges at the Companies Office; the setting aside of a proportion of all secured creditors' claims; and the abolition of the concept of an order of priority upon a winding up, and in particular of the Revenue's privileged position.

The arguments referred to above would appear to have support in New Zealand. The Head of the Justice Department's Corporate Fraud Unit has been reported as confirming that the major problem in bringing fraudulent

company directors to account was the high cost of proceedings.[239] And the Minister of Justice has been reported as suggesting the implementation of a "suitors fund":

> "The source of such funds could be unclaimed dividends on the introduction of a reserve liability so that shareholders contribute to the cost of the liquidator's proceedings."[240]

It is unlikely, however, that any particular measures will be implemented in the near future. For the moment creditors will have to continue relying on section 320 (and the related creditor-protection provisions in the Companies Act 1955) and their own resources and determination to safeguard their interests. They have the support of the courts; in recent decisions[241] the courts have indicated that they are prepared to give section 320 a wide and liberal interpretation so as to give effect to the intention behind the section.

FOOTNOTES

1 Re Maney and Sons De Luxe Service Station Ltd [1969] NZLR 116, 128 per North P.

2 Nicholson v Permakraft (NZ) Ltd [1985] 1 NZLR 242, 255 per Richardson J.

3 Ibid. 250 per Cooke J.

4 Re Horsley and Weight Ltd [1982] Ch. 442, 454-455 per Cumming-Bruce LJ and Templeman LJ.

5 Walker v Wimborne (1976) 137 CLR 1, 7 per Mason J.

6 Nicholson v Permakraft (NZ) Ltd [1985] 1 NZLR 242, 249-250 per Cooke J.

7 [1985] 1 NZLR 242.

8 Ibid. 250.

9 Ibid. 255.

10 See, for example, Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Services Ltd [1983] 1 Ch. 258, 288 per Dillon LJ.

11 L. C. B. Gower The Principles of Modern Company Law (4 ed. Stevens and Sons, London, 1979) 115.

12 Report of the Company Law Amendment Committee (1926; Cmd 2657).

13 Ibid. para.61.

14 Today such a transaction may be set aside pursuant to section 311C of the Companies Act 1955.

15 [1932] 2 Ch. 71.

16 See text accompanying n.2.

17 Infra p.111.

18 Infra pp 23 and 111.

19 As opposed to 'any persons'. See text accompanying n.20.

20 Report of the Committee on Company Law Amendment (1945; Cmd 6659)

21 Now consolidated and re-enacted as section 630 of the Companies Act 1985 (UK).

22 Report of the Company Law Committee (1962; Cmnd 1749).

23 Ibid. para.497.

24 Ibid. para.503(b).

25 Final Report of the Special Committee to Review the Companies Act (1973 Wellington).

26 This is evident from the speech of the Minister of Justice (Hon. J. K. McLay) during the First Reading of the Bill: see NZ Parliamentary Debates Vol. 427, 1979; 4518.

27 Section 320(1)(c) was retained unaltered: see Appendix.

28 In In re William C. LeitchBros. Ltd [1932] 2 Ch. 71, 77 Maugham J. described the issue as 'a question of great difficulty'.

29 The courts have not generally been specifically concerned with the phrase 'fraudulent purpose'. That phrase is very wide and may include fraudulent activity of a type not within the scope of 'with intent to defraud', for example a fraud on a customer: see text accompanying n.181. But no case has defined the limits of 'fraudulent purpose'. In In re Patrick and Lyon Ltd [1933] 1 Ch. 786 Maugham J. saw the issue as being one of fraud generally, rather than 'fraudulent trading' (or 'with intent to defraud') specifically.

30 [1932] 2 Ch. 71.

31 Ibid. 77.

32 [1933] 1 Ch. 786

33 Ibid. 790.

34 So as to avoid invalidating the debentures pursuant to what are now sections 309 and 311 of the Companies Act 1955.

35 But see infra p.34.

36 105 CLR 451.

37 Ibid. 460.

38 Ibid. 469 per Menzies J.

39 Ibid. 458.

40 Ibid. 467.

41 Ibid. 463.

42 Idem.

43 Eg. see text accompanying n.53 and n.58.

44 Infra pp 59-65.

45 Hardie v Hanson 105 CLR 451, 463.

46 Ibid. 461 (emphasis added).

47 Ibid. 462.

48 Ibid. 467.

49 See Companies Amendment Act 1980, section 32.

50 (1986) 3 NZCLC 99646.

51 [1968] NZLR 624.

52 Even if not 'a carrying on of business with intent to defraud creditors', this transaction would be a 'fraudulent purpose' within the meaning of section 320.

53 (1983) 1 NZCLC 95074.

54 Supra n.50.

55 Supra n.30.

56 (1983) 1 NZCLC 95102

57 (1986) 3 NZCLC 99646, 99650.

58 Ibid. 99656.

59 Ibid. 99658.

60 Idem.

61 See Companies Amendment Act 1980, section 32.

62 (Unreported) 30 June 1960, Ch.D; referred to in R v Grantham [1984] 1 QB 675, 682.

63 Text accompanying n.31.

64 Supra n.62. Buckley J. continued in rather picturesque language: "However, there is nothing to say that directors who genuinely believe that the clouds will roll away and the sunshine of prosperity will shine upon them again and disperse the fog of their depression are not entitled to incur credit to help them get over the bad time."

65 Palmer's Company Law Vol. 1 (23 ed. Stevens and Sons, London, 1982) para.85-84, p.1192.

66 [1984] 1 QB 675.

67 Ibid. 681.

68 Ibid. 682.

69 Supra pp 11-12.

70 R. C. Williams "Fraudulent Trading" (1986) 4 C. & S. L. J 14, 25.

71 105 CLR 451.

72 75 Cr.App.R. 291; [1983] BCLC 169.

73 [1981] 1 WLR 355.

74 Ibid. 365.

75 See John H. Farrar "The Meaning of Intent to Defraud in Section 332 of the Companies Act 1948" [1984] JBL 357.

76 Supra n.24.

77 Supra p.8.

78 [1979] 1 Ch. 592.

79 Ibid. 612.

80 Idem.

81 (1986) 3 NZCLC 99646.

82 Although the Court of Appeal did not explicitly distinguish Scarflex their treatment of that case is only explicable upon that basis.

83 An argument which Cooke P. described as "more of a quibble": (1986) 3 NZCLC 99646, 99650.

84 Cf. the conclusion reached on similar facts in Dorklerk Investments (Pty.) Ltd v Bhyat 1980 (1) SA 443 (South Africa).

85 [1933] 1 Ch. 786. For facts see supra p.13.

86 [1932] 2 Ch. 71. For facts see supra p.5.

87 This is quite clear from the Greene Committee's Report (see supra p.4) and from Somers J judgment in Re Nimbus Trawling Co. Ltd (1986) 3 NZCLC 99646, 99654. And in the High Court in the same case Prichard J., referring to the instances of fraudulent trading, said: "This, I venture to say, is one of those categories which will never close": (1983) 1 NZCLC 95102.

88 [1975] 1 NZLR 172.

89 105 CLR 451.

90 Recklessness is discussed infra p.52 et. seq.

91 See Appendix.

92 Supra n.22.

93 Ibid. para.503(b).

94 'Officer' is defined by section 2 of the Companies Act 1955 as including a director, manager or secretary. "The word 'officer' is not to be confined to a person who has in some way or other control over the assets of the company." Buckley on the Companies Act Vol. 1 (14 ed. Butterworths, London, 1981) 779. A solicitor who agreed to do all work at a fixed salary was held to be an officer: Liberater Permanent Benefit Building Society 71 LT 406. But a receiver and manager appointed by a debenture holder is not an officer: In re B. Johnson and Co. (Builders) Ltd [1955]Ch. 634.

95 Eg. the director's spouse who is not normally engaged in the company's day to day activities.

96 I.e. pursuant to section 320(1)(a); see infra p.40 et. seq.

97 The consequence of this is that a person, not being an officer, who is not fraudulent but who might be negligent or reckless escapes liability altogether.

98 Supra p.11 et. seq.

99 (1984) 2 NZCLC 99102.

100 [1932] 2 Ch. 71. discussed supra p.11 et. seq.

101 (1984) 2 NZCLC 99102, 99109.

102 The liquidator commenced the application on 29 January 1981 whereas section 320, as amended, came into force on 1 April 1981 (see section 51(9) of Companies Amendment Act 1980); hence applying section 20(g) of the Acts Interpretation Act 1924, the matter fell to be decided under the former section 320: ibid. 99107.

103 Supra p.15.

104 Infra p.52.

105 Section 374C has been replaced by section 556 of the Companies Act 1981 (Cth).

106 See B. H. McPherson The Law of Company Liquidations (2 ed. The Law Book Co. Ltd., Sydney, 1980) 296-297.

107 See Appendix.

108 Thompson v Innes (1982) 2 NZCLC 99463, 99470 per Bisson J.

109 148 CLR 72; 34 ALR 417.

110 Ibid. 85; 426.

111 Ibid. 86; 427. (original emphasis).

112 In R v Tustin (1908) 27 NZLR 506 the Court of Appeal held that the phrase 'any reasonable or probable ground of expectation' in section 137(2) of the Bankruptcy Act 1892 gave rise to an objective test; the intention of the defendant was irrelevant.

113 Dunn v Shapowloff [1978] 2 NSWLR 235, 243.

114 148 CLR 72, 78; 34 ALR 417, 421.

115 [1978] 2 NSWLR 235, 243.

116 Ibid. 244.

117 Ibid. 240. Glass JA agreed with Reynolds JA.

118 Ibid. 244 per Mahoney JA.

119 Morison's Company Law Vol. 2. (4 ed. Butterworths, Wellington, 1985) para.40.55 n.(d). p.1455.

120 [1932] 2 Ch. 71.; see text accompanying n.31.

121 Supra p.12.

122 Supra pp 7-10.

123 (1985) 2 NZCLC 99463.

124 Ibid. 99470.

125 Section 320(1) may be seen as a punitive provision in that the court has a discretion as to what the respondent's liability in any particular instance should be. The court may, therefore, state the liability of a person guilty of fraudulent trading at a higher level (eg. for all the debts of a company), and that of a person guilty of reckless trading at a lower level (eg. only those debts incurred during the period of reckless trading). See further infra p.103 et. seq.

126 [1982] AC 510.

127 Ibid. 521.

128 [1952] 2 All ER 842.; 36 Cr.App.R. 175.

129 Donovan J. noted that he was not constrained to follow Derry v Peek (1889) 14 App.Cas. 337 and hold that 'recklessness' as it appeared in the statute before him connoted dishonesty. Derry v Peek was an action in deceit, and it was held that fraud was an essential ingredient in establishing deceit. It was held that a statement made recklessly i.e. without belief in its truth, was fraud for the purposes of establishing deceit: ibid. 843; 178.

130 [1982] AC 510, 525.

131 Ibid. 526.

132 (1985) 2 NZCLC 99463, 99472.

133 See, for example, Lord Diplock's test in R v Lawrence at 526 where he uses the phrase 'obvious and serious risk'.

134 See Glanville Williams Textbook of Criminal Law (Stevens and Sons, London, 1978) 72.

135 This proposition gains support from the decision of the Irish High Court in In re Hunting Lodges Ltd (Unreported 1984, Carroll J.) where the respondent was held liable for fraudulent trading (under the Irish equivalent of section 320(1)(c)) even though her acts did not in fact cause creditors any loss, since she was found to have been a party to the carrying on of the company's business with intent to defraud creditors. The case is discussed by Michael M. Collins (1984) 6 D.U.L.J. 138.

136 There is no indication on the facts of the case that the earlier slump was merely temporary or short-term; on the contrary it was quite clear that the business would not be able to pull through the difficulties.

137 (1985) 2 NZCLC 99463, 99472.

138 Commission of Inquiry into the Companies Act: Main Report (Pretoria 1970) para.44.24(b) p.78.

139 Following the recommendation of the Jenkins Committee: supra, text accompanying n.22.

140 Supra n.22.

141 Supra n.25.

142 Supra p.55.

143 [1952] 2 All ER 842, 844; 36 Cr.App.R. 175, 180.

144 [1982] AC 341.

145 [1982] AC 510.

146 See, for example, the rather scathing criticisms of Professor J. C. Smith [1981] Crim. LR 392 and of Professor Glanville Williams "Recklessness Redefined" 40 CLJ 252, especially at 282-283.

147 Smith and Hogan Criminal Law (5 ed. Butterworths, London, 1983) 56.

148 Another basis for rejecting the R v Caldwell and R v Lawrence definition of reckless is this: paragraphs (a) and (b) of section 320(1) were enacted in 1980, prior to the decisions in R v Caldwell and R v Lawrence, hence it may be inferred that Parliament intended to distinguish between paragraphs (a) and (b) in the manner submitted, which was the law prior to those two cases.

149 Supra pp 15 and 23.

150 105 CLR 451.

151 Supra p.14.

152 Supra n.125.

153 [1971] 1 WLR 1085.

154 Ibid. 1092.

155 Cf. R. C. Williams op.cit. 28, n.93, where it is suggested that on the facts the respondent could be seen as having taken a positive step.

156 (1985) 2 NZCLC 99463.

157 Ibid. 99470.

158 [1978] 1 Ch. 262.

159 Ibid. 268.

160 Idem.

161 Idem.

162 The case proceeded upon the basis that the company's business had been carried on fraudulently.

163 See [1971] 1 WLR 1085, 1087.

164 The Times, Dec. 7, 1985. Ch.D (Hoffmann J.).

165 It would appear that Hoffmann J.'s comments in this respect were confined to the case where no fraudulent trading charge was laid against the directors. It is submitted that his Lordship's comments should not be extended to the question of intention generally; it is unlikely that he intended to lay down any broad rule.

166 Supra n.94.

167 As was the case in Re Maidstone Buildings Provisions Ltd [1971] 1 WLR 1085; for facts see supra p.67.

168 (1985) 2 NZCLC 99463, supra p.56.

169 [1941] NZLR 686.

170 Discussed infra p.107.

171 [1941] NZLR 686, 734.

172 Cf. S v Parsons 1980 (2) SA 397, where the South African Supreme Court, in relation to the South African equivalent of section 320(1), held that 'knowingly' meant "with full knowledge of the facts".

173 As is suggested in Morison's Company Law Vol. 2, op.cit. para.40.55, p.1454.

174 [1978] 1 Ch. 262; for facts see supra p.70.

175 (Unreported) April 6, 1977 Ch.D. (Oliver J.).

176 See [1978] 1 Ch. 262, 267.

177 Idem.

178 Idem.

179 Ibid. 268.

180 The intention behind section 320 was to prevent all forms of fraudulent trading: supra, text accompanying n.87.

181 R. C. Williams op.cit. 26.

182 As to procedural mechanisms, see infra p.113.

183 [1979] Ch. 592; for facts see supra p.30.

184 Ibid. 599.

185 Assuming a winding up order was made upon the petition, in which case the winding up is deemed to commence from the time of the presentation of the petition for winding up: Companies Act 1955, s 224(2).

186 (1986) 3 NZCLC 99646.

187 Ibid. 99649.

188 Idem.

189 Idem.

190 Re Scarflex Ltd [1979] 1 Ch. 592, 599 per Oliver J.

191 See (1983) 1 NZCLC 95102, 98767.

192 See McPherson op.cit. 251 et. seq.

193 "The legislation is meant to protect creditors": per Cooke P. in Re Nimbus Trawling Co. Ltd (1986) 3 NZCLC 99646, 99649.

194 McPherson op.cit. 188.

195 Eg. In re Patrick and Lyon Ltd [1933] 1 Ch. 786; In re Casual Capers Ltd (1983) 1 NZCLC 95074 and Re Nimbus Trawling Co. Ltd (1986) 3 NZCLC 99646.

196 [1978] 1 Ch. 262; for facts see supra p.70.

197 Ibid. 268.

198 [1967] Ch. 889.

199 Ibid. 902.

200 [1978] 1 Ch. 262, 269.

201 "If in the course of the winding up of a company it appears that ..."

202 [1967] Ch. 889, 904.

203 Ibid. 902 per Lord Denning, 904 per Dankwerts LJ, 909 per Russell LJ.

204 Ibid. 907. Russell LJ pointed out that the section did not, as it quite clearly could have, empower the court to order the persons liable to contribute to the assets of the company a sum equivalent to all or any of the debts of the company.

205 Ibid. 902.

206 105 CLR 451.

207 Ibid. 459 (emphasis added). Dixon CJ was speaking in the context of Eve J.'s decision in In re William C. Leitch Bros. Ltd (No. 2) [1933] 1 Ch. 261, a decision which he considered inevitable, but unfortunate. See also Menzies J. ibid. 472.

208 [1932] 2 Ch. 71; for facts see supra p.5.

209 In re William C. Leitch Bros. Ltd (No. 2) [1933] 1 Ch. 261.

210 And see also Dixon CJ's and Menzies J.'s comments supra n.207.

211 Cf. Re Casual Capers Ltd (1983) 1 NZCLC 95074 where Leitch (No. 2) was followed.

212 These were the difficulties which Eve J. and Russell LJ felt unable to overcome in, respectively, Leitch (No. 2) (at 266) and Cyona (at 907).

213 [1932] 2 Ch. 71; for facts see supra p.5.

214 Insolvency Act 1967, s 19(d); see infra p.112.

215 Cf. Re Casual Capers Ltd (1983) 1 NZCLC 95074 where Bisson J., following Leitch, made an order against the respondent in the sum of $9600, being the cost of the stock purchased while the business of the company was being carried on fraudulently.

216 [1932] 2 Ch. 71, 79.

217 [1967] Ch. 889, 902.

218 [1969] NZLR 116.

219 [1941] NZLR 686.

220 [1969] NZLR 116, 129.

221 By section 4(5) of the Limitation Act 1950, an action to recover any penalty or forfeiture, or any sum by way of penalty or forfeiture, recoverable by virtue of any enactment, shall not be brought more than two years after the accrual of the cause of action. An action to recover a sum not a penalty has a limitation period of six years: s 4(1)(d).

222 Ostler and Fair JJ.

223 [1941] NZLR 686, 741.

224 In re Hunting Lodges Ltd, supra n.135.

225 Although in general an action will, no doubt, be brought only if creditors have in fact suffered some loss.

226 [1941] NZLR 686, 752.

227 Cf. Lord Denning MR in Re Cyona Distributors Ltd [1967] Ch. 889, 902, supra p.105.

228 Re Casual Capers Ltd (1983) 1 NZCLC 95074. It should be noted, however, that Maney was not referred to.

229 Cf. Cooke P. and Somers J. in Re Nimbus Trawling Co. Ltd (1986) 3 NZCLC 99646, who referred to section 320 as being a 'remedial' provision: 99650 and 99655, respectively.

230 Supra p.4.

231 Eg. in In re William C. Leitch Bros. Ltd [1932] 2 Ch. 71 the liability of the respondent, which was fixed at 6000 pounds, was made a charge on his debenture.

232 R v Rollafson [1969] 1 WLR 815; Director of Public Prosecutions v Schildkamp [1971] AC 1.

233 See McGechan on Civil Procedure (Brooker and Friend Ltd, Wellington, 1985) p.3-501.

234 But see the judgment of Dixon CJ in Hardie v Hanson 105 CLR 451.

235 Text accompanying n.11, supra.

236 Patrick Ussher "Fraudulent Trading" (1984) 6 D.U.L.J. 58.

237 Ibid. 67.

238 Sunday Star, Auckland, New Zealand, 25 May 1986, section C, p.2.

239 Idem.

240 Idem.

241 Eg. Re Nimbus Trawling Co. Ltd (1986) 3 NZCLC 99646, especially Somers J. at 99654; Templeman J. in Re Gerald Cooper Chemicals Ltd [1978] 1 Ch. 262, 268: "But a man who warms himself with the fire of fraud cannot complain if he is singed."

APPENDIX

Companies Act 1955, section 320

Responsibility for fraudulent trading of persons concerned- (1) If in the course of the winding up of a company it appears that-

(a) Any person was, while an officer of the company, knowingly a party to the contracting of a debt by the company and did not, at the time the debt was contracted, honestly believe on reasonable grounds that the company would be able to pay the debt when it fell due for payment as well as all its other debts, (including future and contingent debts); or

(b) Any person was, while an officer of the company, knowingly a party to the carrying on of any business of the company in a reckless manner; or

(c) Any person was knowingly a party to the carrying on of any business of the company with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose,-

the Court, on the application of the Official Assignee or the liquidator or any creditor or contributory of the company, may, if it thinks it proper to do so, declare that the person shall be personally responsible, without any limitation of liability, for all or any part of the debts and other liabilities of the company as the Court may direct. On the hearing of an application under this subsection the Official Assignee or the liquidator, as the case may be, may himself give evidence or call witnesses.

(2) Where the Court makes any such declaration it may give such further directions as it thinks proper for the purpose of giving effect to that declaration, and, in particular, may make provision for making the liability of any such person under the declaration a charge on any debt or obligation due from the company to him, or on any mortgage or charge or any interest in any mortgage or charge on any assets of the company held by or vested in him, or any company or person on his behalf, or any person claiming as assignee from or through the person liable or any company or person acting on his behalf, and may from time to time make such further order as may be necessary for the purpose

of enforcing any charge imposed under this subsection. For the purpose of this subsection the expression "assignee" includes any person to whom or in whose favour, by the directions of the person liable, the debt, obligation, mortgage, or charge was created, issued, or transferred or the interest created, but does not include an assignee for valuable consideration (not including consideration by way of marriage) given in good faith and without notice of any of the matters on the ground of which the declaration is made.

(3) Repealed by s. 32(2) of the Companies Amendment Act 1980.

(4) The provisions of this section shall have effect notwithstanding that the person concerned may be criminally liable in respect of the matters on the ground of which the declaration is to be made, and every declaration under subsection (1) of this section shall be deemed to be a final judgment within the meaning of paragraph (d) of section 19 of the Insolvency Act 1967.

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