Compulsory winding up

Legal information for community organisations

This fact sheet covers:

- when your organisation can be compulsorily wound up
- winding up in insolvency
- winding up on other grounds
- what happens if a court makes a winding up order

Compulsory winding up occurs when there is a court order that an organisation be wound up.

This fact sheet outlines the two circumstances in which this occurs and explains what happens if a court makes a winding up order.

When can our organisation be compulsorily wound up?

Compulsory winding up occurs when a person or company brings legal proceedings against an organisation and asks the court to order that an organisation be wound up. This usually happens in one of two circumstances:

- first, where a creditor has served a demand for payment of a debt that has not been answered or the organisation is otherwise unable to pay its debts when they become due. This is known as 'winding up in insolvency', and
- second, where there is a breakdown or failure in management of the organisation or where the organisation has become defunct or never started operating. This is known as 'winding up on other grounds'.

Winding up in insolvency

The organisation itself or (with the leave of the court) a director or member can apply to a court for an order that it be wound up in insolvency. However, in most cases the application will be made by a creditor. Whoever applies is required to prove to the court that the organisation is 'insolvent' (which means that the organisation is unable to pay all of its debts as and when they become due and payable, for more detail go to Not-for-profit Law's Changing or ending your organisation page).

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Usually, this happens when:

- a creditor that is owed money by the organisation sends by post or delivers to the registered office of the organisation a signed document called a 'statutory demand'
- the organisation doesn't pay the demand or bring a court proceeding to have the demand set aside within 21 days after the demand is received, which means the organisation will be presumed by a court to be insolvent, or
- the creditor brings legal proceedings for an order that the organisation be wound up and proves insolvency just by proving that the statutory demand was sent to the organisation and the organisation failed within 21 days to pay the demand or apply to a court to have the demand set aside.

NOTE

There are many other ways a company can be wound up in insolvency, but all of them begin with a statutory demand or legal proceedings (or both) and you will need to get legal or other professional advice about how best to deal with your particular situation.

What should we do if we receive a statutory demand or we are struggling to pay our debts?

If your organisation receives a statutory demand or you are concerned that your organisation may not be able to pay its debts when they become due, the consequences of doing nothing can be extremely serious. In either of these circumstances, your organisation should urgently seek legal advice or advice from an accountant who specialises in insolvency. One of the things your organisation might be advised to do is to appoint a 'voluntary administrator'. This is explained further below.

What is 'voluntary administration'?

One option for an organisation facing insolvency is for its board (directors) to hold a meeting and resolve that:

- in the opinion of the directors voting for the resolution, the organisation is insolvent or is likely to become insolvent at some future time, and
- an administrator of the company should be appointed.

A voluntary administrator must be a specialist accountant or lawyer who is registered by ASIC as a liquidator. For a list of firms that offer liquidation services go to, Australian Restructuring Insolvency & Turnaround Association. You can check if the person you are considering is registered by searching the ASIC database.

A voluntary administrator of an organisation takes control of the organisation a bit like a liquidator, but has much more flexibility in deciding what to do about the future of the organisation. In particular, a voluntary administrator can promote and endorse a restructuring of the organisation that will see it continue to exist, perhaps in a reduced form. It is also possible as part of this restructuring to ask creditors to agree to accept less than 100 cents in the dollar for their debts.

However, the entire process is ultimately dependant on the support of creditors and unless creditors can be persuaded that a form of restructuring is better for them than liquidation, they can resolve that

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the company should be wound up. If that happens, the organisation is then treated as if it has resolved to go into a creditors' voluntary liquidation.

The main advantages of a voluntary administration for your organisation are that:

- if they act quickly enough, a decision to appoint a voluntary administrator will protect the directors from getting into trouble for allowing the organisation to incur new expenses when it is insolvent, and
- it provides a chance for an organisation that is struggling financially to restructure and reduce its debts.

NOTE

But a decision to appoint a voluntary administrator also has very serious consequences and should not be taken before your organisation has obtained legal or other professional advice.

Winding up on other 'non-insolvency' grounds

An organisation can be wound up by a court when it has:

- resolved by special resolution to be wound up by the court
- not commenced any activities for a year after incorporation or has suspended its activities for a whole year
- has no members
- the directors have acted in the affairs of the organisation in their own interest rather than in the interests of the members as a whole, or in any other manner which appears unfair or unjust to members
- the affairs of the organisation are being conducted in a manner that is oppressive or unfairly prejudicial to, or unfairly discriminatory against a member
- or an act, omission or resolution of a class of members is oppressive or unfairly prejudicial, or
- the court believes it is 'just and equitable' that the company be wound up.

Who can apply?

An application to a court on any of these grounds can be brought by:

- the organisation itself
- a creditor of the organisation
- a member
- a liquidator, and
- various government bodies (e.g. ASIC)

In most cases, applications to court for winding up a company limited by guarantee will be made:

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- where the organisation has become defunct (although often it will be easier an cheaper to end a defunct organisation by deregistration or voluntary winding up followed by deregistration), or
- where there is a deadlock, serious dysfunction or significant dispute in or about the management of the organisation, and the organisation or a member (often a disgruntled member or group of members) decides that the only way to end the problem is to end the organisation.

What are the steps for applying to a court for winding up on non-insolvency grounds?

The process for bringing an application to a court relying on grounds other than insolvency requires the preparation of a form of court application or other court process setting out the grounds to be relied, supported by a sworn affidavit or affidavits verifying the grounds. In a simple uncontested case (for example, where the organisation has resolved by special resolution to be wound up by the court) the application will be reasonably straightforward and the affidavit in support will simply confirm that the resolution was validly passed.

However, in cases where the application is made in the context of some alleged management dysfunction or a dispute, the application will be much more complex and the proceedings can take on the scale of any contested litigation between parties.

In either case, the application and affidavits must be:

- filed with the court (either the Supreme Court of a State or the Federal Court), and
- served on various stakeholders (in particular, the organisation if it is not the one making the application).

In more difficult applications, the court registry will usually then allocate the application to a judge and set a date a few weeks later for the judge to hear from the interested parties and make directions for any further affidavits or other steps that need to be taken before a final hearing. It would be unusual for more complex applications to be finally heard and determined in less than a few months and they can take years. Simpler uncontested applications should be determined within a few weeks.

What happens if a court makes a winding up order?

With both winding up in insolvency or winding up on other grounds, if the court agrees with the application, the court will order that the organisation be wound up and a liquidator or liquidators be appointed to the organisation. Usually the party making the application will have arranged to obtain a form of consent from a suitable liquidator before the court finally decides the application.

The winding up process proceeds in much the same way as a creditors' voluntary winding up, with control of the organisation passing immediately to the liquidator and the liquidator proceeding to collect and sell the organisation's assets, pay off creditors, investigate the organisation, provide annual reports and so on.

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Resources

Related Not-for-profit Law Resources

Changing or ending your organisation

This Not-for-profit Law page on the Information Hub provides information on changes to an organisation's constitution, changes to an organisation's structure, the ending of an organisation and voluntary cancellation or deregistration.

Other Related Resources

Australian Securities and Investments Commission (ASIC)

This ASIC webpage provides information on closing down your company.

Australian Restructuring Insolvency & Turnaround Association (ARITA)

ARITA is the professional body for insolvency practitioners.

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