NON-PROVABLE DEBTS IN BANKRUPTCY:

A CASE NOTE ON AUTRALIAN SECURITIES AND INVESTMENT COMMISSION V KING [2021] FCA 1610

MATTHEW BRADY QC

Introduction

Can a creditor with a debt which would not be provable in a bankruptcy nonetheless present a creditor's petition based on a failure to pay that non-provable debt?

The Federal Court of Australia squarely considered this question for the first time in *Australian Securities and Investment Commission v King* [2021] FCA 1610, a decision of Downes J delivered on 20 December 2021.

In summary, her Honour held that the Court has jurisdiction to make a sequestration order based on a creditor's petition which relied on non-compliance with a bankruptcy notice which sought the payment of a non-provable debt. Further, her Honour considered and rejected a submission that, consistent with English authority, the discretion to make a sequestration order in such circumstances should only be exercised if the creditor shows "special circumstances".

As well as its considerable precedential value, the decision is a useful consideration of the sorts of discretionary factors that the Court will take into account in deciding when it may be appropriate to make a sequestration order on the basis of a debt which is not provable in the bankruptcy.

Facts

The decision is the latest chapter in long-running litigation between the Australian Securities and Investments Commission (**ASIC**) and Michael King.

Mr King was the chief executive officer of a listed public company known as MFS Limited. MFS Limited was the parent company of an empire of hundreds of other companies (**MFS Group**) which conducted a wide array of businesses.

In 2016, the Queensland Supreme Court after a 60-day trial found that Mr King (amongst other officers) had breached various civil penalty provisions of the *Corporations Act* 2001 (**Corporations Act**) in relation to his conduct of the affairs of the MFS Group.[1]

In 2017, the Queensland Supreme Court made orders in consequence of the findings of breach of the civil penalty provisions, including (so far as it concerned him) that Mr King pay:

1. A civil penalty of $300,000 pursuant to s.1317G *Corporations Act*;
2. Compensation to the Premium Income Fund (**PIF**) in an amount exceeding $177 million; and
3. 60% of ASIC's costs of and incidental to the proceeding on the standard basis.[2]

---

1 *ASIC v Managed Investments Ltd & Ors (No 9)* (2016) 308 FLR 216; (2016) 112 ACSR 138

2 *ASIC v Managed Investments Ltd & Ors (No 10*) [2017] QSC 96

Following an appeal by Mr King to the Queensland Court of Appeal, then an appeal by ASIC to the High Court and an application for special leave to the High Court by Mr King, the High Court reinstated the orders made in 2017 by the trial judge.[3]

The ultimate effect of the High Court's orders is that Mr King was ordered to pay, in addition to the civil penalty and compensation to PIF, ASIC's costs of the proceedings at first instance (being the trial costs order) and ASIC's costs on appeal to the Court of Appeal and in the High Court.

In February 2021, ASIC served a bankruptcy notice on Mr King claiming a debt of $379,723 which comprised the $300,000 civil penalty, together with interest. Mr King failed to pay the debt in the bankruptcy notice.

ASIC filed a creditor's petition seeking a sequestration order against Mr King's estate.

It was common ground that Mr King had not paid any part of the compensation order in favour of PIF (exceeding $177 million) nor any part of ASIC's recoverable costs of the proceedings (which on the evidence was between $4 million and $6 million). ASIC had not taken any steps to have its costs assessed or taxed because ASIC, as a statutory body with an obligation to fulfil the objects of the ASIC Act and administer relevant laws efficiently, considered that the costs of the assessment of its costs would likely be significant and were ultimately not expected to be recovered.[4]

In addition to these orders, Mr King had a further potential liability exceeding $4 million to his former insurer who funded (in part) the earlier proceedings. Because of the Court's findings that Mr King had acted dishonestly, the insurer funding his defence under a Directors and Officers policy sought recovery of the defence costs that it had incurred.

Mr King adduced no evidence that he was able to pay his debts within the meaning of s.52(2)(a) *Bankruptcy Act* 1966 (**Bankruptcy Act**) being a matter on which he bore the onus.

Did the Court have jurisdiction to make a sequestration order?

It was common ground between the parties that the debt which ASIC relied upon in its bankruptcy notice (i.e., the civil penalty) was not provable in Mr King's bankruptcy by operation of s.82(3AA) *Bankruptcy Act*.

The first question that the Court had to consider was whether it had jurisdiction to make a sequestration order on the application of ASIC in reliance upon non-compliance with a bankruptcy notice which sought payment of a non-provable debt.

The Court held that there were two key reasons why it had jurisdiction to make such an order on ASIC's application:

1. The statutory scheme supports a finding that the Court has jurisdiction; and
2. The decision of the Full Federal Court in *O'Mara Constructions v Avery* (2006) 151 FCR 196 (***O'Mara***) relied upon by Mr King as authority that no jurisdiction existed could be distinguished and did not have the consequences submitted by Mr King.[5]

---

3 *ASIC v King* (2020) 270 CLR 1; See note on this important case about the meaning of an "officer" for the purposes of the *Corporations Act* 2001 by the author included in Higgins Chambers "Insights" dated 19 June 2020

4 *ASIC v King* [2021] FCA 1610 at [13]

5 *ASIC v King* [2021] FCA 1610 at [33]-[35]

In relation to the statutory scheme, her Honour started by noting that the Full Court had determined in *ASIC v Forge*[6] (***Forge***) that ASIC was permitted to serve the bankruptcy notice based on a non-provable debt.[7] That was not in dispute between the parties.

Accordingly, it was accepted that ASIC was a "creditor" who was able to serve a bankruptcy notice for the purposes of s.40(1)(g) *Bankruptcy Act.* It also followed that Mr King's failure to comply with ASIC's bankruptcy notice in this case was an act of bankruptcy.

It is notable that whilst the Full Court in *Forge* had considered the question of whether a non-provable debt could found a bankruptcy notice, each member of the Court said that the question of whether a court can or should set aside a bankruptcy notice raised quite different considerations to those that arise in relation to the question of whether a court can or should make a sequestration order based on non-payment of a non-provable debt. Their Honours expressly declined to make any findings about whether non-compliance with such a notice could found the presentation of a creditor's petition.[8]

Section 43(1) *Bankruptcy Act* relevantly provides that, subject to the Act, where a debtor has committed an act of bankruptcy and otherwise meets the statutory residence requirements, the Court "may on a petition presented by a creditor" make a sequestration order against the state of the debtor. The term "creditor" is not defined in the *Bankruptcy Act* for these purposes.

Having regard to the context and purpose of s.43, Downes J held that the words in s.43 should be read together with the words of s.40(1)(g). The reference to an "act of bankruptcy" in s.43 is necessarily a reference back to s.40.[9] Her Honour found that if, as accepted in *Forge*, ASIC is a "creditor who has obtained against a debtor a final judgment" for the purposes of s.40(1)(g) and so is permitted to serve a bankruptcy notice, it would be incongruous if ASIC was not also "a creditor" who may present a petition in reliance on an act of bankruptcy arising from non-compliance with the bankruptcy notice that ASIC was legally permitted to serve.[10]

Her Honour held that "creditor" within s.40(1)(g) should be given the same meaning as "creditor" in s.43 of the *Bankruptcy Act*.[11]

Downes J held that such a finding was consistent with the text of the *Bankruptcy Act*.

Section 44 contains further conditions which must be satisfied before a creditor's petition may be presented, including the existence of a debt or debts which is or are owing to the petitioning creditor. The term used in s.44 is "debt" and not "provable debt", both of which are defined terms in the *Bankruptcy Act*. The broader term debt is therefore not to be confined to provable debts, but rather encompasses all debts and liabilities.[12]

In other parts of the *Bankruptcy Act*, where it is necessary to draw a distinction between creditors with provable debts and creditors with non-provable debts, the language of the Act makes that distinction plain: eg. s.81(1)(a).

---

6 (2003) 133 FCR 487
7 *ASIC v King* [2021] FCA 1610 at [37]
8 (2003) 133 FCR 487 at 490 [12] (per Branson and Stone JJ); at 494 [33] per Emmett J
9 *ASIC v King* [2021] FCA 1610 at [38]
10 *ASIC v King* [2021] FCA 1610 at [39]
11 *ASIC v King* [2021] FCA 1610 at [40]
12 *ASIC v King* [2021] FCA 1610 at [42]

Unless there is some reason lying within the clear terms of the *Bankruptcy Act*, the word "creditor" in each of the provisions in s.40(1)(g), 43 and 44 should be interpreted consistently.[13]

Despite this statutory scheme, Mr King relied upon the Full Court decision in *O'Mara*[14] in submitting that the Court had no jurisdiction to make a sequestration order. *O'Mara* concerned a judgment debt obtained in 1992. More than 12 years expired from the date of the judgment debt before a bankruptcy notice was served in 2004. The *Limitation Act* 1969 (NSW) (***Limitation Act***) provided, relevantly, that an action on a cause of action on a judgment is not maintainable if brought after the expiration of 12 years running from the date on which the judgment first becomes enforceable.

The Full Court proceeded first to consider whether the creditor had the capacity to present and prosecute the petition by reference to the *Limitation Act*. Their Honours found that the effect of s.17 *Limitation Act* was that the subject debt was not enforceable, whether against the putative debtor or against his trustee in bankruptcy. Section 17 barred the creditor from recovering the debt from the debtor and thus the debt could not be relied upon to present a petition.

In summary, the Full Court said that if a debt is statute barred, it will not be provable in the winding up of a company and cannot ground the presentation of a petition. The same approach applies in bankruptcy. To the extent that the debt was unenforceable, it could not be relied upon to present and prosecute a bankruptcy petition.[15] This passage was relied upon by Mr King to contend that a non-provable debt cannot ground the presentation of a creditor's petition.

Downes J rejected Mr King's submissions. Her Honour found that the statements in *O'Mara* were expressly limited to statute-barred debts, that is debts which are not recoverable by reason of the expiry of some relevant limitation period.[16] Further, the decision in *O'Mara* was premised on the debt being unenforceable, based on the *Limitation Act* barring recovery of the debt. Her Honour contrasted this position with the facts that she was considering, where there was no bar on recovery by ASIC of the civil penalty against Mr King.[17] Further, her Honour noted that the Full Court in *O'Mara* said nothing about a debt which *is* enforceable by the creditor against the debtor, but which is not provable in bankruptcy.[18] Nor did the Full Court say anything about the manner in which the Full Court in *Forge* had interpreted the meaning of "creditor" for the purposes of s.40(1)(g) *Bankruptcy Act*.[19]

For those reasons, Downes J held that *O'Mara* did not bind her to find that the Court had no jurisdiction to make a sequestration order based on a non-provable debt of the nature of ASIC's debt.

---

13 *ASIC v King* [2021] FCA 1610 at [44]
14 (2006) 151 FCR 196; [2006] FCAFC 55
15 *O'Mara* at [24]
16 *ASIC v King* [2021] FCA 1610 at [56]
17 *ASIC v King* [2021] FCA 1610 at [57]
18 *ASIC v King* [2021] FCA 1610 at [58]
19 *ASIC v King* [2021] FCA 1610 at [59]

Exercise of discretion to make sequestration order

Mr King submitted that if there was jurisdiction to make a sequestration order based on a non-provable debt, ASIC was required to demonstrate that there were "special circumstances" before the Court's discretion would be exercised in favour of making an order.[20] This submission was based on English jurisprudence to the effect that as a matter of discretion, it will not usually be appropriate to make a bankruptcy order based on a non-provable debt unless there are special circumstances present.[21]

Her Honour rejected the submission that ASIC had to demonstrate "special circumstances" because:

1. There is nothing in the language of ss.43, 44 and 52 *Bankruptcy Act* that would require the imposition of such a requirement;[22]
2. It is "quite inappropriate" to read s.52 as imposing limitations which are not found in the express words;[23]
3. The decision of the English Court of Appeal in *Levy v Legal Services Commission*[24] is inconsistent with that of the Full Court in *Forge,* where the Federal Court reached the opposition conclusion to the Court of Appeal as to whether a bankruptcy notice issued in reliance on a non-provable debt should be set aside;[25] and
4. The approach of the English Court of Appeal was not consistent with the scheme or the purpose of the Australian *Bankruptcy Act* which requires the Court to have regard not only to the rights of the parties to the proceedings, but to the community as a whole.[26]

Her Honour considered other discretionary factors, including:

1. The unchallenged evidence that Mr King was insolvent;[27]
2. ASIC's interest in the making of the sequestration order because it had the benefit of significant costs orders against Mr King which (whilst presently unassessed) would be provable in any bankruptcy;[28]
3. The strong public interest in the making of a sequestration order because of the evidence demonstrating both insolvency and the existence of substantial provable debts, as well as fair notice being given to the public in dealing with an insolvent person.[29]

The discretionary factors fell in favour of making a sequestration order.

---

20 *ASIC v King* [2021] FCA 1610 at]79]
21 *Russell v Russell* [1998] 1 FLR 936; [1998] BIPR 259*; Levy v Legal Services Commission* [2001]1 All ER 895 [2000] EWCA Civ 285
22 *ASIC v King* [2021] FCA 1610 at [85]
23 *ASIC v King* [2021] FCA 1610 at [86]
24 [2001] All ER 895
25 *ASIC v King* [2021] FCA 1610 at [87]
26 *ASIC v King* [2021] FCA 1610 at [88]
27 *ASIC v King* [2021] FCA 1610 at]64]-[70]
28 *ASIC v King* [2021] FCA 1610 at [71]-[72]
29 *ASIC v King* [2021] FCA 1610 at [74]-[75]

Conclusion

The decision in *ASIC v King* is an important precedent establishing:

1. The Court has jurisdiction to make a sequestration order based on a non-provable debt; and
2. In the exercise of the discretion whether to make a sequestration order based on a non-provable debt, the creditor is not required to prove "special circumstances", contrary to the English cases on this question.

The decision will be of particular interest to regulators who have achieved success in penalty proceedings, or indeed other creditors who may have the benefit of debts which would not be provable in any bankruptcy. The fact that debts are non-provable may be a discretionary factor against the making of a sequestration order, but the mere fact of non-provability is not, of itself, an insuperable obstacle to proceeding down the route of bankruptcy in appropriate cases.