INSOLVENCY - A GROWTH AREA
- Philip Davenport

In the next few years, we can expect a flood of interesting cases on insolvency. Many will serve as a warning.

In *Jeffree v National Companies and Securities* (1990) WAR 183 the Full Court of the Supreme Court of Western Australia considered the duty of a director of a company to prospective creditors. In *Marson Pty Ltd v Pressbark Pty Ltd* (1990) 1 QdR 264, the Full Court of the Queensland Supreme Court considered the liability of directors to account for benefits received. In the third case discussed in this article, *Starkey v Australian Guarantee Corporation Limited,* the Full Court of the Supreme Court of Queensland (16 December 1988) considered the obligation of a creditor to repay moneys received from a company after the commencement of winding up proceedings. The fourth case, *Cater-King Pty Ltd v Westpac Banking Corporation* (1990) WAR 225 considers the power of a receiver to repudiate a contract.

The *Jeffree* case arose out of a contract by Leighton Contractors Pty Ltd to construct a pool at Cottesloe Pool Centre for Wanup Pty Ltd. A dispute arose and arbitration proceedings commenced. "A" was a director of Wanup. He feared that Leighton would win the arbitration and he sought legal advice. Acting on that advice, "A" as a director of Wanup authorised a sale of the assets of Wanup to another company. With the proceeds of sale, creditors of Wanup were paid, with the exception of Leighton, which eventually obtained an award of approximately $40,000 in the arbitration.

"A" was charged and convicted of an offence under S.229 of the Companies (Western Australia) Code. That section requires directors to act honestly and not to make improper use of their position as directors to gain advantage for themselves. The section provides for a fine of up to $20,000 or imprisonment for five years or both. Jeffree was fined $5,000 and appealed to the Full Court of the Supreme Court.

It was not disputed that "A" had acted on legal advice and the assets were sold for their full value. The proceeds of sale were lawfully used to pay trade creditors. The business of Cottesloe Pool Centre was still conducted by "A", but it was now owned by the new company. The magistrate said:

> "Aware as he was that his company faced probable liquidation it was improper of (A) to protect himself from the consequences of the liquidation in a way which jeopardised the pool funds that would have been available for a liquidator. It was not consistent with the proper discharge of his duties, obligations and responsibilities. It fell short of the standards of propriety that one expects of company directors."

Brinsden J referring to cases dealing with the meaning of "improper" said:

> "A purpose therefore may be improper even though it is not illegal and indeed it may be improper even though those officers of the company authorising the act believe it to be in the overall interest of the company ... The duty of directors is a fiduciary duty and their rights and powers are to be exercised for the benefit of the company ... The duty of directors also extends to creditors ... And that duty also extends to prospective creditors."

The court rejected the appeal by "A". It found that he had gained an advantage for himself in that he was able to keep working for the business. Brinsden J said:

> "The offence is committed even though the advantage is not, in fact, gained."

The Queensland case of *Marson Pty Ltd v Pressbark Pty Ltd* concerned contracts for the sale of land, but its relevance extends to the situation that frequently occurs when a small construction company is financially unable to complete a contract and directors or officers of the company offer to the Principal to complete the work under a separate contract.

In the *Marson* case, Pressbark Pty Ltd had contracted to purchase land and did not have the funds to complete the purchase. The vendor terminated the contract and forfeited the deposit which Pressbark had paid. A director of Pressbark arranged for another company to purchase the land and, as part of the new contract, $30,000 of the deposit forfeited by Pressbark was treated as part of the purchase price under the new contract.

There was no suggestion that the director of Pressbark had any blame whatsoever for the loss by Pressbark of its deposit. However, as the company which ultimately bought the land was financed by the director, the arrangement for crediting $30,000 meant that the director did not have to finance the purchase price to the extent of the $30,000. The director had acquired a benefit and the Court held that the director was accountable to Pressbark for this benefit even though Pressbark could not have recovered back its deposit. The obligation arose both in equity and by a statute.

In the instance where a director of an insolvent company agrees with the principal to complete the work in place of the insolvent company, the director would be liable to account to the insolvent company for any benefit received from completing the work.

The case of *Starkey v A.G.C.* also arose out of a construction contract. The contractor Allan Fitzgerald Pty Ltd had several large projects for Queensland Governmental instrumentalities. To carry out the work the contractor had items of constructional plant on lease from A.G.C. On 13 April 1987 an application for winding up of the contractor was filed by another creditor. On 16 July 1987 a provisional liquidator was appointed. Under the Companies (Queensland) Code the winding up of the contractor company is deemed to have commenced on 13 April 1987, when the application for winding up was filed.

Section 368(1) of the Code provides:

> "Any disposition of property of the company, other

> than a disposition made by the liquidator pursuant to a power conferred on him by this Act ... made after the commencement of the winding up by the Court is, unless the Court otherwise orders, void."

The contractor was behind in lease payments. When the winding up was deemed to have commenced, arrears of rental were approximately $100,000. On 24 April 1987, a payment of $40,000 was made. A.G.C. told the contractor that unless further payments were made, A.G.C. would repossess the equipment. On 29 April 1987, A.G.C. became aware that a petition for the winding up of the contractor had been filed. After further threats by A.G.C. to repossess the equipment unless $80,000 was paid, the contractor paid a further $30,000 on 13 May 1987. After further threats by A.G.C., a further $60,000 was paid on 3 June 1987. On 16 June 1987, a provisional liquidator was appointed and, on 23 June 1987, an order was made for the winding up of the contractor.

Since, by S.368(1) of the Companies (Queensland) Code, the winding up is deemed to have commenced on 13 April 1987 when the application for winding up was filed, the payments to A.G.C. since that date were void, unless the Court otherwise ordered. A.G.C. made an application to the Court for validation of the payments and the primary judge validated them, but the liquidator appealed to the Full Court which reversed the decision, with the consequence that A.G.C. must repay the $130,000 received since the 13 April 1987.

The Queensland Full Court placed considerable emphasis on the words of Mahoney J in the NSW Court of Appeal in *Tellsa Furniture Pty Ltd v Glendave Nominees Pty Ltd* (1987) 9 NSWLR 254. Mahoney J said that the basic consideration is the division of the assets of the company rateably amongst the unsecured creditors. If there is to be a departure from such a rateable distribution (in the exercise of the power under S.368(1)), there must be considerations which warrant that departure. He said that usually payments made by a company for goods honestly and in the ordinary course of business will be protected by an order of the Court. The delivery of the goods to the company after the date of the commencement of the liquidation increases the assets of the company and to provide properly for payment of them is not inconsistent with that principle.

The Queensland Court formed the view that there were no considerations which warranted departure from the principle that the company's assets should be distributed rateably among unsecured creditors. The Court found that A.G.C. enjoyed an advantage against other creditors.

The relation back of the commencement of a winding up which S.368(1) of the Companies Code effects is the reason why General Conditions of Contract (e.g. Cl.44.11 of AS2124-1986) usually make provision for the Contractor or the Principal to take over the work or suspend work upon an application being made by a creditor to the court for a winding up of the other party. If a winding up order were to be made, the liquidator of the insolvent party may recover any payment made or other disposition of property made after the date of the application to the court for a winding up order, unless the court otherwise orders. Similarly, a payment out of moneys due to the Contractor made by the Principal at the request of the Contractor directly to a subcontractor or supplier may be recoverable by a liquidator albeit that at the time of the payment the Contractor is not actually in liquidation.

The last case, *Cater-King Pty Ltd v Westpac Banking Corporation* deals with the powers of a receiver manager appointed under a debenture deed. Master White in the Supreme Court of Western Australia held that a company could not confer on a receiver manager power to do what the company could not lawfully do. A company cannot lawfully repudiate a contract and hence, notwithstanding an express power in deed of debenture, a receiver manager cannot by "repudiation" of a contract convert the company's contractual obligation into a liability for damages. In certain circumstances, a liquidator of a company can have such a power, but a receiver manager does not.

It was argued that, since the receiver manager exceeded the powers given to the receiver manager, the receiver manager was personally liable to the other party to the repudiated contract. Master White rejected this argument and held that a claim was only available against the company in receivership because at all material times, the receiver manager was agent of the company in repudiating the contract.

Whenever a receiver manager is appointed to a company, it will be very important to distinguish between agreements made by the receiver manager personally and agreements made with the receiver manager in the capacity of agent of the company in receivership.