

35/02; [2002] VSC 541

## SUPREME COURT OF VICTORIA

**QUARRY QUIP ENGINEERING PTY LTD v STARR**

Byrne J

27 November, 13 December 2002

**CIVIL PROCEEDINGS – CORPORATIONS LAW – COMPANY INSOLVENCY – CLAIM BY CREDITORS FOR LOSS AND DAMAGE AGAINST DIRECTORS OF INSOLVENT COMPANY – EVIDENCE THAT COMPANY HAD FUNDING AGREEMENT FROM ANOTHER COMPANY – WHETHER DIRECTORS BELIEVED ON REASONABLE GROUNDS THAT COMPANY WOULD REMAIN SOLVENT WHEN DEBT INCURRED – DEFENCE UPHOLD BY MAGISTRATE – WHETHER MAGISTRATE IN ERROR: CORPORATIONS ACT, S588G, H, M(3).**

At all material times, S. were directors of Rodas which in 2000 was ordered to be wound up in insolvency. In 1999, Brevtex placed an order on Rodas for the supply of tools and agreed to provide funding on a progress basis. In order to complete the Brevtex order, Rodas placed an order on QQ. for the supply of certain goods. The project fell into difficulties and Rodas failed to pay the supplier QQ. A claim by QQ was brought in the Magistrates' Court pursuant to s588M(3) of the *Corporations Law* which entitles a creditor to recover the amount of its loss as a consequence of a director's contravention of s588G(2). S. relied on the defence in s588H(2) that they had reasonable grounds to expect that Rodas would remain solvent because of the funding agreement with Brevtex. The magistrate upheld the defence and dismissed the claim. Upon appeal—

**HELD: Appeal dismissed.**

**There was evidence before the magistrate of the funding agreement between Rodas and Brevtex and that S. had confidence in the ability of Brevtex to provide the necessary funds as required. Accordingly, there was evidence upon which the magistrate might reasonably have acted to conclude that S. did in fact have reasonable grounds for their expectation of solvency.**

**BYRNE J:**

1. The respondents, Roger Starr and Mavis Janet Starr, were in 1999 and at all material times the directors of Rodas Developments Pty Ltd ("Rodas"), a company which, on 20 September 2000, was ordered by this Court to be wound up in insolvency.

2. By proceeding No. PO1781309 in the Magistrates' Court of Victoria at Melbourne, Quarry Quip Engineering Pty Ltd ("Quarry Quip"), a creditor of Rodas, sought, pursuant to s588M(3) of the *Corporations Act*, to recover from the Starrs as directors of Rodas the amount of its loss and damage suffered by reason of their involvement in the insolvent trading of Rodas in contravention of s588G. The amount sought was \$12,911.39. On 10 July 2002, the Magistrates' Court dismissed the claim and ordered Quarry Quip to pay the Starrs' costs fixed at \$5,370. Quarry Quip appeals to this Court pursuant to s92 of the *Magistrates' Court Act* 1989.

3. The evidence before the Magistrate showed that Rodas was a small company engaged in mechanical engineering. On 12 July 1999, Brevtex Machine Tools Pty Ltd ("Brevtex") placed an order on Rodas for the supply of four Marksman MK160 hydraulic steelworker tools for a total price of \$114,000. This order was placed following discussions between Mr Starr and Geoffrey Leslie of Brevtex. Mr Starr said that when he raised with Mr Leslie the difficulty of Rodas funding such an expensive order, Mr Leslie said that Brevtex "would provide funding on a progress basis [and that] as work was done we would collect funds from him".

4. For the purposes of completing this order, Rodas on 4 November 1999 placed an order on Quarry Quip for the supply of certain plates in the sum of \$18,276 and on 29 October 1999 it placed an order on another supplier, MG Hydraulics Sales and Service Pty Ltd ("MG Hydraulics"), for the supply of cylinders in the sum of \$24,340. The evidence showed the Rodas did not have the ability to pay for these supplies as and when they became payable otherwise than by using funds from Brevtex. There was no evidence otherwise of insolvency of Rodas at the time of the placing of these orders. The project fell into difficulties and Rodas failed to pay either of the suppliers.

Quarry Quip, having received a dividend of \$5,364.61 upon the liquidation of Rodas, sued the directors for the balance of its debt, namely, \$12,911.39.

5. Quarry Quip contended before the Magistrates' Court that the indebtedness of Rodas which arose as a result of the order of 4 November 1999 arose at a time when Rodas was insolvent or became insolvent by incurring that debt or by incurring that debt and the MG Hydraulics debt. It contended further that there were at the time reasonable grounds for suspecting this to be the case. Accordingly, s588G applies. Sub-section (2) of that section provides that a person, that is a director, contravenes s588G in the following circumstances.

**"588G(2) [Contravention]** By failing to prevent the company from incurring the debt, the person contravenes this section if:

(a) the person is aware at that time that there are such grounds for so suspecting; or

(b) a reasonable person in a like position in a company in the company's circumstances would be so aware."

6. The claim before the Magistrates' Court was brought pursuant to s588M(3) which, broadly speaking, entitles a creditor to recover the amount of its loss suffered as a consequence of a director's contravention of s588G(2). For present purposes, Mr and Mrs Starr relied upon the following defence which was available to an allegation of such a contravention:

**"588H(2) [Reasonable grounds to expect company solvent]** It is a defence if it is proved that, at the time when the debt was incurred, the person had reasonable grounds to expect, and did expect, that the company was solvent at that time and would remain solvent even if it incurred that debt and any other debts that it incurred at that time."

7. What was put by the directors was that they had reasonable grounds to expect and did expect that Rodas was solvent at the time the Quarry Quip debt was incurred and that it would remain solvent because Rodas had a funding agreement with Brevtex which they believed on reasonable grounds would be able to provide funds in accordance with its terms to pay the debts to Quarry Quip and MG Hydraulics as they fell due.

8. The parties have agreed and I ordered that the questions of law certified by the Master on 20 August 2002 should be amended so that they read as follows:

"1. Whether the Magistrate made an error of law in finding on the evidence that there was an agreement made between Rodas Developments Pty Ltd ('Rodas') and Brevtex Machine Tools Pty Ltd ('Brevtex') to fund the works that Rodas engaged Quarry Quip Engineering Pty Ltd to perform ('the agreement'). 2. Whether the Magistrate made an error of law in finding that the Respondents had reasonable grounds to expect that Rodas would remain solvent for the purposes of Section 588G(2) based on the agreement."

9. In order to understand question 1, as a question of law, it is necessary for the appellant to show that there was no evidence upon which such an agreement could have been found.

10. I put to one side, therefore, arguments which depended upon inferences to be drawn from the failure of the directors to call as a witness Mr Leslie, the other participant in the conversation which was said to have given rise to the funding agreement. Likewise, I put to one side arguments based on the surprising failure of Mr Starr to mention the funding agreement in much of the correspondence. These are matters which might be marshalled in support of an argument that the Magistrate should reject Mr Starr's evidence that the funding agreement existed. My task is entirely different. I am not concerned with Mr Starr's reliability. I am not asked to express any views upon the Magistrate's findings of fact. I am not asked to substitute my view of the evidence from his Worship's view. I put to one side, too, the argument based on the great caution with which the Court should approach evidence of a director of the making of an agreement such as the present. These are all part of the fact finding process with which this appeal on a question of law is not concerned.

11. The difficulty which the appellant must overcome is that Mr Starr swore on a number of occasions before the Magistrate that Mr Leslie of Brevtex agreed to fund the work of Rodas for which Quarry Quip provided some material. He did not resile from this in cross-examination. This

is sufficient to dispose of the first question in favour of the respondents. I should add that the Magistrate in his reasons made it clear that he approached this question of fact with caution but that, on the balance of probabilities, he was satisfied that a funding agreement was made out. I find no error of law in his conclusion.

12. The second question faces similar difficulties. It does not put in issue the Magistrate's finding that the directors in fact held the expectation in terms of s588H(2). The appellant must establish that there was no evidence before the Magistrate upon which he could have found that the directors had reasonable grounds for their expectation that Rodas would remain solvent in terms of the sub-section. Mr Starr swore that the funding agreement was entered into and, further, that he had confidence in the ability of Brevtex to provide the necessary funds. There is, therefore, evidence upon which the Magistrate might find those facts. It was not contended before me that these facts were not capable in law of providing the reasonable grounds. Accepting that the Magistrate was entitled to act upon the evidence of Mr Starr on this matter, there seems to me no doubt that there was some evidence upon which he might reasonably have acted to reach the conclusion that the directors did in fact have reasonable grounds for their expectation of solvency. Accordingly, this ground, too, must fail.

13. I propose, therefore, that the appeal be dismissed with costs including reserved costs.

**APPEARANCES:** For the appellant Quarry Quip: Mr T North, counsel. Middletons, solicitors. For the respondents: Mr MD Dean, counsel. KCI Lawyers.

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