Creditors awarded damages after director's breach of duty

First award under s.1324(10) of the *Corporations Act*

By PETER HARKIN *and* GRAZIA ALTIERI

In the first reported decision of its kind, the Supreme Court of Queensland has awarded damages to a creditor under s.1324(10) of the *Corporations Act 2001* (Cth) (the Act) in the case of *Phoenix Constructions (Queensland) Pty Limited v Coastline Constructions (Aust) Pty Limited and Ors.*[1] The decision has caught the attention of commentators because never before has a creditor been awarded damages under the section.[2]

The Supreme Court considered s.1324 and, in particular, an application for an injunction and/or damages by a creditor. The decision draws on previous comments that give the section a wide interpretation and that suggest that creditors probably have standing to bring applications under s.1324.[3] *Phoenix Constructions* firmly cements this suggestion.

In advising their director clients, practitioners will have to consider the impact of this decision on the particular circumstances of their client's case. While the general rule is still that directors usually do not owe a duty directly to creditors,[4] directors may be personally liable to creditors in exercising their statutory duties under the *Corporations Act*.

The parties

The proceedings were originally commenced by Phoenix Constructions (Queensland) Pty Limited (Phoenix) against Coastline Constructions (Aust) Pty Limited (Coastline) only. During the course of the matter, Mr McCracken, being the sole director and secretary of Coastline, and his wife were joined as the third and second defendants respectively.

Mrs McCracken was joined in the proceedings because she had been a party to a joint venture agreement with Coastline. This agreement is a key element in the factual background to the proceedings.

Background

In August 2004, Mrs McCracken entered a joint venture agreement (the agreement) with Coastline. The purpose of the agreement was to develop land that Mrs McCracken had acquired some years earlier.

In September 2004, Phoenix entered a construction management agreement with Coastline.

In June 2006, Phoenix issued a statutory demand to Coastline. Shortly after, Phoenix commenced proceedings against Coastline for breach of the construction management agreement.

The parties attempted to settle the matter at mediation. However, this was unsuccessful. During the course of the mediation, Mr McCracken allegedly made a comment that he would "not be paying anything and I can close the company down if I need to".

In February 2007, the agreement was amended. The effect of the amendment was to remove certain parcels of land from the definition of "joint venture land", and to allow Mrs McCracken to retain ownership over six units, valued at $7,385,000. Under the agreement, these units would be excluded from proceeds of the development available to Coastline.

Coastline went into liquidation in mid-2010. In early 2011, Mrs McCracken became bankrupt. As a result, the proceedings continued against Mr McCracken only.

The court's construction of the agreements

Phoenix successfully argued that the agreement gave Coastline a substantial contractual interest. In his role in the amendment of the agreement, Mr McCracken caused Coastline to abandon this interest in relation to the six units that were subject of the February 2007 amendment. More importantly, the amendment meant that Phoenix, which at this stage was owed money by Coastline, could not have recourse to these six units to satisfy the debt owed to it.

Peter Harkin is a partner and insolvency expert and Grazia Altieri is a solicitor in the commercial dispute resolution team at CBP Lawyers, with experience in insolvency and construction, email gxa@cbp.com.au.

Mr McCracken's conduct and the *Corporations Act*

Phoenix argued that Mr McCracken's conduct resulted in a breach of directors' duties under s.182 of the Act, which provides that "(1) A director, secretary, other officer or employee of a corporation must not improperly use their position to: (a) gain an advantage for themselves or someone else; or (b) cause detriment to the corporation".

Justice Cullinane agreed. He considered the effect of the amendment to the agreement and the comment made by Mr McCracken during the mediation and concluded that, when taken together, there was clearly a breach of s.182. Not only was the conduct improper, Mr McCracken had used his position to gain an advantage for his wife and he caused detriment to Coastline. This, in turn, affected Phoenix's ability to seek repayment of the debt owed to it.

The application for injunctive relief

Section 1324(1) of the Act allows a court to issue an injunction in circumstances where there has been, or will be, a breach or threatened breach of the Act. Applications can be made by the Australian Securities and Investments Commission, or a person whose interests have been affected by the breach or threatened breach.

Under s.1324(10), the court also has the power to award damages to the person making the application, either in addition to or in substitution for an injunction.

Phoenix sought an injunction under s.1324(1) of the Act which required Mr McCracken to obtain a transfer from his wife (the effect of which would be to transfer certain property to Coastline), and/or requiring his wife to transfer certain real property to Coastline. Phoenix also sought, in addition to the injunction, or as an alternative, damages in the sum of $1,230,614.79 under s.1324(10) of the Act.

Phoenix made the application as a person "whose interests have been, or would be affected" by Mr McCracken's conduct.

Justice Cullinane noted that Phoenix was clearly such a person: Phoenix was a creditor of Coastline and, therefore, its interests were affected by Mr McCracken's conduct.

His Honour went on to highlight a number of questions relevant to an application under s.1324 of the Act and Phoenix's application, which he considered to be unanswered by the case law:

- ☐ does a party have to seek an injunction in the proceedings?
- ☐ if the answer is yes, when must the injunction be sought?
- ☐ will damages be refused if the injunction would fail on discretionary grounds, or is it enough that the court has power to grant the injunction?

His Honour answered the questions in the following way:

Does a party have to seek an injunction in the proceedings?

Phoenix sought an injunction

when the third defendant was added as a party. After this, the original claim for an injunction was amended. Nothing further was added on this point.

When must the injunction be sought?

In this case, Phoenix had sought the injunction when Mr McCracken was added as a defendant. Although the substance of the injunction sought changed during the proceedings, Phoenix always had a claim for injunctive relief on foot. Justice Cullinane considered that this was enough to allow Phoenix to make a claim for damages.

Will damages be refused if the injunction would fail on discretionary grounds, or is it enough that the court has power to grant the injunction?

Phoenix argued that it was sufficient that the court had jurisdiction to grant the injunction – it was irrelevant that the injunction might have been refused on discretionary grounds.

His Honour agreed with this argument, drawing on comments made in *Wentworth v Woollahra Municipal Council and Ors*: "It is obvious that a discretionary defence to a claim for equitable relief does not, if made out, operate as a defence to a claim for common law damages for infringement of the legal right on which the case for equitable relief is based."[5]

His Honour also drew on comments made in *Equitable Remedies*, such as "the view which is most consistent with the authorities, and which accords more neatly with the words of the material enactments, is that the statutory power of awarding damages subsists whenever at the material time the contract in questions is susceptible of specific performance or the right in question is susceptible of protection or enforcement by injunction, whether or not relief might be refused on a discretionary ground".[6]

In Justice Cullinane's view, the court plainly had jurisdiction to grant the injunction under s.1324(6) and therefore, the court also had jurisdiction to grant damages.

The result was that Phoenix was awarded $1,495,208.71 in damages and other losses and liabilities, plus interest, instead of the injunction being granted.

The aftermath

Mr McCracken has appealed the decision. As well as questions in relation to the quantum of damage and the admissibility of evidence concerning Mr McCracken's breach of s.182, the appeal raises the following questions:[7]

"The court plainly had jurisdiction to grant the injunction under s.1324(6) and therefore, the court also had jurisdiction to grant damages."

Does s.1324(10) of the Act confer a right to damages upon a creditor who has suffered loss as a result of a contravention of s.182? Was Phoenix a "person affected" under s.182?

These two questions draw a link between the particular duty in question and a creditor's right to seek remedies under s.1324. Justice Cullinane did not take this approach at first instance – it was enough that there had been a contravention of the Act and that Phoenix's interests were affected by that breach. The nature of the duty in question was not considered.

Does the power to award damages in substitution for an injunction arise when there was no prospect of an injunction being granted?

As noted above, in Justice Cullinane's opinion, it was not relevant that the power to award damages was not dependent on the prospect of the injunction being granted. It was enough that the court had jurisdiction to award damages. This would not be a new concept for practitioners – authorities have recognised that equitable damages can be awarded where there is jurisdiction to do so but where an injunction would be refused on a discretionary ground.[8]

During a listing before the Queensland Court of Appeal which dealt with, among other things, an application by Phoenix for security of costs, Wilson AJA noted that an appeal was arguable.[9] If it is granted, the appeal is likely to raise some interesting points on s.1324 and the relationship between directors and creditors.

However, for the time being, Justice Cullinane's decision continues to represent the law in this area. Practitioners will need to keep Justice Cullinane's decision in mind when advising clients:

- ☐ directors must be warned that, if they breach a duty under the Act, they are opening themselves up to personal liability in the form of injunctive relief and/or damages. Regardless of the general rule, a direct link has now clearly been drawn between directors and creditors, with the effect that directors must consider the effect of their actions on creditors; and
- ☐ the nature of the duty in question is not relevant – any behaviour which falls within the scope of s.1324 may give rise to personal liability if a creditor is adversely affected. ☐

ENDNOTES

1. [2011] QSC 167.
2. Professor Bob Baxt AO, "Why directors should be 'scared'", *Australian Corporate News*, Issue 16, 19 August 2011.
3. *Allen v Atalay & Ors* 11 ACSR 753 per Hayne J, at 757-758; see also *Airpeak Pty Limited & Ors v Jetstream Aircraft Limited & Anor* [1997] 144 ALR 448 per Einfeld J, at 453-454.
4. *Spies v R (2000)* 35 ACSR 500.
5. (1982) 42 ALR 69, at 73 and 74.
6. I.C.F Spry, *Equitable Remedies*, 8th Ed, Thomson Reuters, 2009, at p.626.
7. *Phoenix Constructions (Qld) Pty Ltd v McCracken* [2011] QCA 259, BC201107818 per Wilson AJA, at 3.
8. J.D Heydon & P.L Loughlan, *Cases and Materials on Equity and Trusts*, 7th edition, LexisNexis Butterworths, 2007, at p.1062.
9. Above n.7, per Wilson AJA, at 4. ☐