

A creditor's right to seek damages under s.1324(10) revisited

By PETER HARKIN and GRAZIA ALTIERI

The Queensland Court of Appeal has overturned Justice Cullinane's primary decision in *Phoenix Constructions (Queensland) Pty Limited v McCracken* [2011] QSC 167 awarding a creditor damages under s.1324(10) of the *Corporations Act 2001* (Cth) (the Act) (see "Creditors awarded damages after director's breach of duty", *LSJ*, April 2012). In *McCracken v Phoenix Constructions (Qld) Pty Ltd* [2012] QCA 129, the court revisited the section and its connection to creditors.

The decision returns us to the general rule that a director does not owe a direct duty to creditors which would give creditors the right to seek damages under the Act. It does not mean that a creditor cannot

seek an injunction under s.1324(1) to prevent a director from acting in a particular way as the Court of Appeal acknowledged that the meaning of a person whose interests have been affected is quite broad. Practitioners will still need to warn their director clients of this potential.

Will a creditor ever have a direct cause of action against a director under the Act? The weight of authority says no. However, this does not mean that directors escape all liability to creditors. It remains the case that a liquidator can pursue a director to recover the loss suffered by a creditor or creditors. There is also room for the Australian Securities and Investments Commission (ASIC) to seek damages under s.1324 in



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the name of a creditor, as we saw in *Australian Securities and Investments Commission v Plymin and Others* (2003) 46 ACSR 126 and, dependent on the facts, under the representative provisions of the *Australian Consumer Law*.

The case

In the decision at first instance, Mr McCracken, a sole director of Coastline Constructions (Aust) Pty Limited (Coastline), was found to have breached s.182(1) of the Act in: allowing the company to enter a joint venture agreement with his wife, whereby

certain land was to be developed by Phoenix Constructions (Queensland) Pty Limited (Phoenix); and later authorising the company to enter an amendment to enable certain parcels of land to be removed so Mrs McCracken retained ownership over six units, valued at \$7,385,000, subsequently excluding them from the pool available to repay a debt owed to Phoenix.

Justice Cullinane decided that not only was Phoenix a person who had standing to make an application under s.1324(1), it also had standing to seek damages under

subsection 10. Phoenix was awarded damages of just under \$1.5 million.

The appeal

On appeal, Mr McCracken raised three issues:

in relation to the finding that he had breached his duties under s.182(1) of the Act, there was a question of whether certain, allegedly relevant, evidence had been wrongly excluded. He was not successful on this matter, but this was a relatively minor issue;

whether Phoenix had proven that it suffered loss; and

whether the court had power under s.1324(10) to award damages to Phoenix based on a breach of s.182(1).

Did Phoenix prove its loss?

At first instance, Phoenix was awarded damages in an amount which equated to its contractual claim against Coastline. Phoenix's claimed loss was merely derivative of Coastline's recoverable loss. The Court of Appeal went on to say that, in order to show the effect of the breach, Phoenix would have had to adduce evidence of Coastline's financial position, including the state of the accounts of its creditors. It was not enough to draw an inference from the fact that Mr McCracken did not give evidence on these matters, which Phoenix had attempted to do.

Ultimately, however, this was a minor point given the court's next finding in relation to Phoenix's ability to claim damages under s.1324(10).

The award of damages under s.1324(10)

The Court of Appeal found that s.1324(10) did not give the court power to award damages to a creditor for a director's breach of s.182(1) of the Act and, more broadly, any civil penalty provisions.

Phoenix raised the same arguments which it had raised at first instance, namely that damages could still be awarded, even though an injunction might be refused on discretionary grounds. Phoenix also argued that it was sufficient that a court had jurisdiction to grant an injunction, and that it was not determinative that

the circumstances in which an injunction might be granted only existed at a time earlier than the date of judgment.

In considering Phoenix's arguments, the Court of Appeal looked to Justice Perry's judgment in *Executor Trustee Australia Limited & Anor v Deloitte Haskins & Sells* (1996) 22 ACSR 270. In that case, Justice Perry considered the equivalent provision in the South Australian Companies Code. He also commented that the same interpretation would apply to s.1324 of the Act.

In Justice Perry's view, the principal focus of s.1324 is the granting of an injunction. Damages are a substitute or supplementary remedy. The statute could not have intended to give a person, such as Phoenix, a general right to damages. Justice Perry pointed out that, if this were the intention, there would be no need for a general right to be limited to situations where the court may have the ability to grant an injunction (at [279]). This view was embraced by the Court of Appeal.

There were a few other bases for the Court of Appeal's decision.

Nature of damages

The court noted that a meaning of damages is "a sum of money paid in compensation for damage suffered or vindication of a claimant's rights in contract and tort actions". The court went on to say that in a case such as the present, a creditor's claimed loss is merely derivative of the company's recoverable loss. To say, therefore, that Phoenix was able to claim damages under s.1324(10) would mean that there might be double recovery (meaning recovery by both the creditor and the corporation), or that the creditor might recover damages at the expense of a corporation.

Section 1324(10) and the wider Act

The court also looked at s.1324(10) in the wider context of the Act and the breach that was the focus of Phoenix's claim.

Part 9.4B of the Act sets out remedies for breaches of the civil penalty provisions, including s.182(1). In particular,

ss.1317E, 1317G and 1317H set out three remedies, namely:

- declarations;
- pecuniary penalty orders; and
- compensation orders.

Section 1317J then goes on to identify who is able to seek each of the remedies. Importantly, under the section, only ASIC and the company may apply for those remedies. The Court of Appeal noted that to construe s.1324(10) as giving any person whose interests are adversely affected by a breach of a civil penalty provision the ability to seek and be awarded damages, did not sit well with the words of part 9.4B. In fact it would render the specific provisions of part 9.4B rather pointless.

Damages and injunctions

For the Court of Appeal, the words of s.1324(10) had to be read in light of the rest of the section.

Standing under s.1324(1) is quite broad. However, this does not mean that there is a correlation between stand-

ing under subsection 1 and an entitlement to damages under subsection 10.

Damages are a substitute or supplementary remedy to an injunction under subsection 1. The court said that this is clearly indicated by the final words of subsection 10: "either in addition to or in substitution for the grant of the injunction".

There is a direct connection between the purpose of an injunction and the purpose of damages under the section. Damages will be awarded to remedy the adverse effect caused by the particular breach of the Act for which an injunction is sought. For example, in the current case, an injunction would have meant that property was returned to Coastline. If an injunction would not have been an effective remedy, damages could be awarded in favour of Coastline by way of compensation for the irretrievably lost property. Only in this way would damages be a substitute or supplementary remedy for the injunction.

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