Legal and other professional fees – clawing them back as preferences

Foleys List

Presenter:

Jonathan Evans QC

ADVISING DIRECTORS AND COMPANIES UNDER THREAT OF INSOLVENCY

JOSHUA KOHN
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WHO IS THE CLIENT?

- Need to identify the client
  - Company
  - Director
  - Shareholder
  - Investor
- Advice may be different depending on the client. For example, the advice you give a company may be different to the advice you give a director who has personally guaranteed the company's debts. Such issues sometimes arose when dealing with voidable transaction claims and ATO liabilities.

- Professional
- Ethical and legal obligations
  - Act honestly and fairly in clients' best interest and maintain clients' confidence.
  - Not act as a mere mouthpiece and must exercise forensic judgment.
  - Not engage in conduct which is dishonest, prejudicial to the administration of justice, diminish public confidence or adverse to these rules
- Advisor
- Know your limitations
- Sometime may need to refer the client to an insolvency expert or tax expert or a barrister
- If you overstep your role, you may expose yourself to liability pursuant to the Corporations Act 2001 or the common law

DEFINITION OF DIRECTOR

- Section 9 of the *Corporations Act* 2001 **(Act)**

Director of a company or other body means:

(a) a person who:
(i) is appointed to the position of a director; or
(ii) is appointed to the position of an alternate director and is acting in that capacity;
regardless of the name that is given to their position; and

(b) unless the contrary intention appears, a person who is not validly appointed as a director if:
(i) they act in the position of a director; or
(ii) the directors of the company or body are accustomed to act in accordance with the person's instructions or wishes.

Subparagraph (b)(ii) does not apply merely because the directors act on advice given by the person in the proper performance of functions attaching to the person's professional capacity, or the person's business relationship with the directors or the company or body.

- A person who is not validly appointed as such if that person "act[s] in the position of a director".
- Objectively ascertained.
- A person may be a director even without any purported appointment of that person to that position at any time.
- Applies to a person who:
  - usurpers the functions of a director: *Re Valleys Rugby League Football Club Ltd* [1997] 2 QdR 645.
  - takes "an active part in directing the affairs of [a] company" with the acquiescence of de jure directors: *Austin & Partners Pty Ltd v Spencer* (unreported, NSWSC, 1 Dec 1998); *International Cat Manufacturing Pty Ltd v Rodrick* [2010] QSC 30.

- Example A:
  - Accountant.
  - Reviewed financial records.
  - "Advised" about restructure and tax savings.
  - Actually instructed the directors how to phoenix the company.
  - Told the directors:
    - Which creditors to pay.
    - Which employee to retain.
    - How to transfer the assets from Old Co to New Co.
  - Told the directors which solicitor to engage to draft the "sale" of business agreement.
  - Accountant and possibly the solicitor may be liable.

- Example B:
  - Transportation industry.
  - "Business advisor".
  - Worked with a group of other professionals – lawyer, accountant, insurance broker etc. Described as a "referral network".
  - "Advised" about how to resolve a dispute between two directors.
  - In practice, instructed and effected:
    - The splitting of the company between the two directors.
    - The transfer of assets to new entities.
    - The payment of some trade creditors and no others.
    - Breach of director duties.
    - Voidable transaction.

REPUTATION

- Important matters to consider.
- Reputation impacted.
  - Life time to build seconds to lose.
  - Judges talk, barristers talk and lawyers talk.
  - Reputation will spread.
- Does not mean only act for creditors or debtors or liquidators.
- Act honestly, ethically and within the law.

WHAT IS THE CLIENT TRYING TO ACHIEVE?

- Crucial question.
- Advice needs to be tailored to what the client wants to achieve.
- Sometimes the client's "wants" cannot be achieved.
- Need to be up front with what can and cannot be achieved.
- Realistic.
- Advice in writing.
- If you believe you cannot act:
  - Speak to your colleagues.
  - Speak to a barrister.
  - You might need to obtain an ethics ruling.
  - May need to withdraw / cease acting.

LEGAL ISSUES

- Identify the problem
  - For example, the conduct of the director may be challenged, the transaction(s) may be set aside because it is avoidable transaction
- Common law
  - Duty of care
  - Fiduciary duties
- Statute
  - *Corps Act*
  - *Property Law Act*
  - *Income Tax Assessment Act*
  - *Bankruptcy Act*

COMMON LAW

- Two categories
  - Good faith
  - Skill and care
- Duties of good faith (fiduciary duties)
  - To act honestly in the best interests of the company
  - To exercise powers for a proper purpose
  - To act with an unfettered direction
  - To avoid conflicts of interest
- Duties of care and skill (negligence)
  - Directors must bring an independent mind in exercising their judgment
  - Not sufficient to merely delegate to others
  - Greater vigilance and attention

"KNOWING RECIEPT" AND "KNOWING INVOLVEMENT"

- *Barns v Addy* (1874) LR 9 Ch App 244
- First limb – "knowing receipt"
- Second limb – "knowing assistance"
- *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* (2007) 230 CLR 89
- Knowledge
  - *Baden v Societe Generale* [1993] 1 WLR 509
  - 4 types:
    - Actual knowledge
    - Willfully shutting one's eyes to the obvious
    - Willfully and recklessly failing to make such inquiries as an honest and reasonable man would make
    - Knowledge of circumstances which would indicate the facts to an honest and reasonable man

CORPORATIONS ACT

- Relevant sections – Corps Act
  - Section 9 – definitions
  - Section 180 – care and diligence
  - Section 181 – good faith
  - Section 182 – use of position
  - Section 588FA – unfair preference
  - Section 588FB – uncommercial transactions
  - Section 588FC – insolvent transactions
  - Section 588FDA – unreasonable director related transactions
  - Section 588FP – security interest in favour of company officers void
  - Section 588G – trading whilst insolvent
  - Section 588FE – void transactions
  - Section 588FF – orders about void transactions

  - Section 79 – involvement in contraventions
  - Section 1317H – compensation orders
- Bankruptcy Act
  - Section 120 – undervalue transactions
  - Section 121 – transfer to defeat creditors
  - Section 122 – avoidance of preference

CONSEQUENCES OF BREACHING A DUTY

- Number of avenues of financial recovery

Breach of common law duties:

- Recover property
- Account of profits
- Damages
- Injunction to prevent further defaults
- Declaration as to a constructive trust
- *Barnes v Addy*

Breach of Corps Act:

- Breach of ss180-183 is a civil penalty
- ASIC may apply for a civil penalty or a disqualification order
- A liquidator may bring an application for compensation or for recovery of compensation
- Section 598(2) allows an "eligible applicant" which includes a liquidator to apply for an order against a person "guilty of fraud, negligence, default, breach of trust or breach of duty in relation to a corporation" which has or is likely to suffer loss and damage as a result.
- Criminal liability (s 184)

ADVISING A DIRECTOR

- Must make the director aware of their duties
  - Common law; and
  - Statutory duties
- Advice you give the company may be different from the advice you give the director.
- Example:
  - The director gave personal guarantees and been served with a DPN.
  - Director's best interest for the company to pay the personal guarantee debts and the ATO liabilities the subject of the DPN
  - Company's best interests to enter DOCA or pay each creditor on a pro-rata basis or be wound up.

ADVISING THE COMPANY

- What are the best interests of the company?
- Options:
  - Pay all creditors on a pro-rata basis?
  - What about refinancing?
  - What about equity raising?
  - What about putting the company into liquidation?
  - What about voluntary administration?
  - What about selling company assets?
  - What about selling the business as a going concern?

ADVISING RECIPIENTS OF PROPERTY

- Example:
  - Lawyer has been approached to advise a purchaser of property from an insolvent or near-insolvent company
  - Consideration payable
  - Arms length transaction
  - What are the intentions of the parties?
  - Is the purchaser doing anything wrong?
  - Could he property be clawed back? Uncommercial transaction
  - Personal liability
  - Advice would change depending on whether act for the vendor or purchaser and if the recipient of the property was a related entity

ADVISING SECURED CREDITORS

- Validity of the security interest
- PPSA
- PPSR
- Assignment of security
- Appointing receivers
  - Value of security
  - Amount of the debt
  - Costs of the receiver
- The client needs to make a commercial decision
- If the company goes into external administration the secured creditor may be prevented from enforcing the security
- Lawyers can only give legal advice

ADVISING PARTIES IN THE WINDING UP PROCESS

- Process usually begins with a statutory demand
- Prior to the hearing often negotiate a resolution
- Often problems arise
- Creditors
  - Should I accept the payment?
  - What are the ramifications?
    - Preference
    - Uncommercial transactions
  - Deed of settlement
  - Personal guarantee from director

- Debtor
  - If money is paid will the director be breaching any duties?
  - What are the options?
    - Voluntary winding up?
    - Appoint an administrator?
      - Is a DOCA going to be proposed?
      - What is the utility of appointing an administrator?
      - Winding up application on foot – it the administration in the best interests of the company?
        - No such thing as a "friending liquidator"
        - Liquidators are officers of the court

ADVISING PARTIES IN THE LIQUIDATION PROCESS

- Company
  - Consent to winding up
    - What are the ramifications?
      - Directors and third parties may be exposed to liabilities
      - Might be able to purchase the business from the liquidator
      - Post winding up DOCA
  - To oppose a winding up application need to prove solvency
    - Audited accounts
    - Expensive
    - Best interests of the company
  - Winding up on just and equitable grounds

- Directors
  - Obligations
    - Provide documents to the liquidator
    - Assist the liquidator
  - Increasing number of cases where ASIC have issued criminal charges or sought fines to be imposed for none compliance with liquidator's requests
- Creditors
  - Lodge proof of debt
  - Attend meetings – committee of creditors
  - Fund the liquidator to undertake investigations
  - Purchase a cause of action from the liquidator

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PRACTICAL CONSIDERATIONS

- Debt restructuring
  - Approach creditors early
  - Speak to the bank
  - Be open and honest with your creditors
  - Provide all relevant information to the ATO, bank and creditors
- Equity raising
  - Be open and honest
  - All books and records up to date
- Lodge all tax documents
- Make sure all transactions are properly documented. For example, if money was loaned to the company make sure the loan is properly reflected in the financial statements and loan agreement

- Selling the business when the company is insolvent or near insolvency
  - Valued
  - Independent professional. Often accountants are not the best people to value businesses.
  - Assets – auction value, bulk sale or individual items
  - Partially completed contracts have a value
  - Goodwill
  - Trade debtors
  - Employees
  - Intellectual property
  - Don't act for the vendor and purchaser

- Ask the administrator or liquidator if they are willing to sell the business, intellectual property etc.
- Power of sale pursuant to the Corps Act
- Example:
  - ATO issued a winding up application
  - Company appointed administrators
  - DOCA proposed
  - DOCA withdrawn before the 2nd creditors meeting
  - Administrator sold the asset to director
  - Asset independently valued
  - Asset would be worthless if the company went into liquidation

- Before putting a company into administration make sure a DOCA is going to be proposed and it is likely to be accepted by the creditors
- Often there is no point putting the company into administration if a DOCA is not going to be proposed or the creditors are likely to reject the proposal. May be different when served with a DPN
- Lawyers
  - Payment up front and in trust
  - Avoid your fees being an unfair preference
  - Keep good file notes
  - Provide your client will written advice
  - Confirm your oral advice in writing

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Unfair preferences

Available to both liquidators and bankruptcy trustees:

Bankruptcy Act 1966, s. 122

Corporations Act 2001, section 588FA

Applies to payments made by insolvent entity

Unfair preferences

3 further elements:

(1) transaction (payment or something more?);

(2) debtor-creditor relationship;

(3) ultimate effect: “unfair”.

Unfair preferences

Monies in trust before work performed:

VR Dye & Co. v Peninsula Hotels

[1999] 3 VR 201

Unfair preferences

Nexus between performance of work and time of payment? – “transaction”: *Beveridge v Whitton* [2001] NSWCA 6; *Mann v Sangria* (2001) 38 ACSR 307.

Unfair preferences

Attempts to recover existing debt through future work:

Re Employ (No. 96) Pty Ltd (in liq)

(2013) 93 ACSR 48

Risks of an uncommercial transaction under s. 588FB

Commerciality of recovery of preferences

Costs to estate/company of proceeding in smaller claims.

Insolvency Practice Schedules, section 100-5: power of external administrators to assign preference claims

WINDING UP PROCEEDINGS: ISSUES FOR LAWYERS

Notes for presentation given Tuesday, 17 October 2017 at 8 am

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Introduction

1. My presentation this morning focuses on the most common foundation for winding up proceedings: the unsatisfied statutory demand. I will structure my presentation in three parts:

2. First, I will address 4 practice points relevant to the issue of a statutory demand.

3. Second, I will address service under s 109X the *Corporations Act 2001* (Cth) (**Act**).

4. Third, and tying in to the two other topics in this morning's presentations, I will address two species of debt which are less susceptible to genuine dispute under s 459H of the Act: assessed tax debts, and construction debts pursuant to security of payment legislation.

Some practical points

Take care before signing demand

5. Under s 459E(2)(f) of the Act, a statutory demand must be signed by or on behalf of the creditor. It is commonplace for a solicitor to sign the demand, and indeed, note 1 to Form 509H, states the form may be signed by the creditor's solicitor. The traditional view is that the statutory demand process should not be used as a debt-collection mechanism. This has been qualified somewhat by the decision of the High Court in *Deputy Commissioner of Taxation v*

Broadbeach Properties Pty Ltd,[1] which I discuss later, but in any event, the best view is that a demand should only be signed by a solicitor in relation to debts that are not subject to a genuine dispute. It is prudent therefore to obtain fulsome instructions in regard to the nature and circumstances of the debt. If there is any indication of a genuine dispute, it is preferable to commence curial proceedings in a Court or Tribunal. This is because it is inefficient from a time and cost perspective to issue a demand, only to lose in an application to set aside. Also, in more egregious examples, the Court has jurisdiction under the Court Rules, or the *Civil Procedure Act 2010* (Vic) in the Supreme Court, to make costs orders personally against a solicitor.

Have client swear affidavit in support at the time the demand is signed

6. Under s 459E(3), the demand must be accompanied by an affidavit that verifies that the debt is due and payable. The affidavit should be sworn at the time the demand is signed. If the affidavit is sworn before the demand is signed, as a matter of evidence, it is unclear whether the debt is still outstanding.

Solicitors: reconsider swearing the affidavit in support

7. As a general rule, a solicitor should only swear the affidavit in support in exceptional circumstances. The affidavit should only be sworn by the person who has knowledge of whether the debt is still due. Unless for some reason, such as under a deed of settlement, the debt is payable by way of payment directly to a solicitor, the client is in the best position to say whether the debt is due. Further, where the creditor is a company, the prescribed form for the affidavit contains the statement that the deponent has inspected the business records of the creditor. Unless the solicitor holds all of the books and records of the company, and has in fact inspected them, it is best practice for a director, or senior employee, to give this evidence.

Commence proceedings within 3 months

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1 (2008) 237 CLR 473, [58] (Gummow A-CJ, Heydon, Crennan and Kiefell JJ).

8. Under s 459C, the statutory presumption of insolvency disappears 3 months after the expiry of the demand. If winding up proceedings are not commenced within that time, the statutory presumption is not available in the proceeding. It can be easy to lose track of this point particularly where negotiations with the debtor are ongoing. However, it is important to avoid issuing proceedings on a stale demand. Unfortunately, once the evidentiary presumption has been lost, it cannot be recovered. The plaintiff cannot rely on any future failure to comply with any other demand in that proceeding.[2]

Service

9. Timing in the context of statutory demands, and winding up proceedings, is therefore incredibly important. The 3 month limit just mentioned is one example. Another example is the 21 day limit in which to apply to set aside a demand under s 459G. This time limit is immutable, and cannot be extended under s 1322: *David Grant & Co Pty Ltd v Westpac Banking Corporation.*[3][4] In that landscape, the principles concerning service, and presumed service of documents are fundamental.

10. The usual manner of service on a company is by s 109X(1)(a) of the *Corporations Act 2001* (Cth), which provides:

> (1) For the purposes of any law, a document may be served on a company by:
>
> (a) leaving it at, or posting it to, the company's registered office.

11. Other relevant provisions include s 160(1) of the *Evidence Act 2008* (Vic), which provides:

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2 See *Woodgate v Garard Pty Ltd* [2010] NSWSC 508, and *Surdex Steel Pty Ltd v GB Manufacturing Pty Ltd* [2012] VSC 90.

3 (1995) 184 CLR 265.

4 (1995) 184 CLR 265, 278 (Gummow J, with whom Brennan CJ, Dawson, Gaudron, McHugh JJ agreed).

> It is presumed (unless evidence sufficient to raise doubt about the presumption is adduced) that a postal article sent by prepaid post addressed to a person at a specified address in Australia or in an external Territory was received at that address on the fourth working day after having been posted.

and s 29(1) of the *Acts Interpretation Act 1901*:

> (1) …service shall be deemed to be effected by properly addressing, prepaying and posting the document as a letter and, unless the contrary is proved, to have been effected at the time at which the letter would be delivered in the ordinary course of post.

12. The question of service under s 109X turns on delivery, and not receipt. That is, it is irrelevant whether the recipient company in fact received the document. The question is whether the document was delivered to the registered address. The leading case on this point is *Fancourt v Mercantile Credits Limited*, where the High Court said:[5]

> The consequence is that where it is necessary to establish service at a particular time, proof of non-delivery is as effective as proof of non-service, notwithstanding that service by post is in the circumstances permitted and the requirements of the *Interpretation Act* are observed.

13. Australia Post currently offers three main methods of post: Ordinary Post (or Parcel Post), Express Post, and Courier Post. Each of those posting methods includes tracking. In my view, Courier Post, which includes signature on delivery, is not suited to service under s 109X. This is because the document will not be delivered unless signed for, and it is therefore, possible to avoid

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5 (1983) 154 CLR 87, 96-97 (Mason, Murphy, Wilson, Deane, Dawson JJ).

service. In circumstances where personal service is desirable, the best course is to engage a process server.

14. In respect to Ordinary Post, and Express Post, there is no relevant difference, save the delivery time. Importantly, both services include tracking information.

15. In this regard, it is wise to check the tracking information on the Australia Post website in the following days. This is because although the evidentiary presumption of service will apply, the tracking information constitutes evidence that tends to show delivery, or non-delivery, as the case may be. The tracking information is available to all of the world, so long as the tracking number is known. This provides a recipient company with a means to adduce evidence in respect of non-delivery, in the right case.

16. For example, assume a company has forgotten to update its registered address, and the new occupant is in no way connected with the company. A serving party is entitled to rely on the ASIC search record as proof of the registered address for the purposes of s 109X. Presume, that the document is posted to the registered address, and then returned to sender marked "Not at this address." There might be two ways in which this occurred.

17. First, the postman attended the address and handed the envelope to the receptionist. The receptionist looked at the envelope and either at that time, or some time later, returned the envelope to post marked "Not at this address." In that situation, there is delivery at the registered address and therefore service under s 109X.

18. The second possibility is that for some reason the postman attended the address, saw that it had no relation to the recipient company, and without delivering it at the registered address, marked the envelope "Not at this address" and returned it to sender. In that situation there is no delivery at the registered address and therefore no service under s 109X.

19. This was the situation in *NRA Developments ty Ltd v Longmuir*[6] a case that I appeared in for the recipient company. Although we had no other way of proving non-delivery, we accessed the tracking information on the Australia Post website and used it to prove non-delivery on the balance of probabilities.

Setting aside statutory demand

20. A common application in the context of statutory demands is an application to set aside a demand under s 459G. There are four grounds upon which a demand may be set aside:

> "there is a genuine dispute between the company and the respondent about the existence or amount of a debt to which the demand relates:" s 459(1)(a)
>
> or
>
> "the company has an offsetting claim:" s 459H(1)(b)
>
> or
>
> "because of a defect in the demand, substantial injustice will be caused unless the demand is set aside:" s 459J(1)(a).
>
> or
>
> "there is some other reason why the demand should be set aside:" 459H(1)(b)

Graywinter

21. The first point to be aware of in applying to set aside a demand, is the *Graywinter* principle. The application and the affidavit in support must be filed

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6 [2016] VSC 585, [1]-[8] (Efthim AsJ).

and served within the 21 day period. In addition, the affidavit in support must raise the grounds upon which the application is based.

22. In *Graywinter Properties Pty Ltd v Gas & Fuel Corporation Superannuation Fund*, Sundaberg J considered whether an affidavit filed in support was sufficient and said:[7]

> In order to be a 'supporting affidavit' an affidavit must say something that promotes the company's case. An affidavit which merely says 'I am a director of the company but am too busy at present to make a full affidavit, and I will do so later' would not support the application. It would in no way advance, further or assist the company's cause, which is to have the notice set aside. At the other extreme, the affidavit need not detail, in admissible form, all the evidence that supports the contention of a genuine dispute…
>
> In a s 459H(1)(a) case, the affidavit must in my view disclose facts showing there is a genuine dispute between the parties. A mere assertion that there is a genuine dispute is not enough. Nor is a bare claim that the debt is disputed sufficient. It follows from the fact that the affidavit need not go into evidence, which is the customary function of an affidavit, that it may read like a pleading.

23. Recent cases have modified the principle slightly. In *Financial Solutions Australasia Pty Ltd v Predella Pty Ltd*[8] Parker J, with whom Anderson and Scott JJ agreed, refused to accept that the reasons in *Graywinter* reveal a "settled and universal principle" and said:[9]

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7 (1996) 14 ACLC 1703, 1708-1709 (Sunaberg J).
8 (2002) 26 WAR 306.
9 (2002) 26 WAR 306, 316 [34] (Parker J, with whom Anderson and Scott JJ agreed).

> The statutory yardstick remains that the affidavit should support the application. The precise nature of the application may well influence what this requires.

24. Thus in *POS Mediate v B Family,*[10] Austin J stated that "the *Financial Solutions* case has reduced the *Graywinter* 'principle' to a more fact-specific inquiry."[11]

Genuine dispute prevented by statute

25. The second point to be aware of in applying to set aside a statutory demand is that there are some debts which are not susceptible to genuine dispute because of the operation of statute. There are at least two types of debts that have this character: assessed taxation debts, and construction debts pursuant to Security of Payment legislation.

Assessed Taxation Debts

26. Section 350-10 of Schedule 1 to *Taxation Administration Act 1953* (Cth) provides that a notice of assessment under a taxation law is conclusive evidence that:

(a) the assessment was properly made; and

(b) …the amounts and particulars of the assessment are correct.

27. Further, s 14ZZM of the *Taxation Administration Act* provides:

> The fact that a review is pending in relation to a taxation decision does not in the meantime interfere with, or affect, the decision and

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10 (2003) 21 ACLC 533, [35] (Austin J).

11 See also *Re Scahill & Co Pty Limited* [2016] NSWSC 566, [19]; *Pravenkav Group Pty Ltd v Diploma Construciton (WA) Pty Ltd (no 3)* (2014) 46 WAR 483, [43], [56]-[57]; *Infratel Networks Pty Ltd v Gundry's Telco & Rigging Pty Ltd* (2012) 297 ALR 372, [30] (Young AJA, with Hoeben JA and Ward J agreeing); *Hansmar Investments Pty Ltd v Perpetual Trustee Co Ltd* (2007) 61 ACSR 321; *Saferack Pty Ltd v Marketing Heads Australia Pty Ltd* (2007) 25 ACLC 1392

> any tax, additional tax or other amount may be recovered as if no review were pending.

28. Section 14ZZF contains an identical provision in relation to appeals:

> The fact that an appeal is pending in relation to a taxation decision does not in the meantime interfere with, or affect, the decision and any tax, additional tax or other amount may be recovered as if no appeal were pending.

29. These provisions, and their predecessors have been criticised as harsh in their operation. But, as the High Court has said, they are "impervious to criticism for Parliament has not seen fit to amend…"[12]

30. By operation of those provisions, an assessed tax debt is not susceptible to a genuine dispute. In *Deputy Commissioner of Taxation v Broadbeach Properties Pty Ltd,*[13] Gummow A-CJ, Heydon, Crennan and Kiefel JJ, said:[14]

> …the operation of the provisions in the taxation laws creating the debts and providing for their recovery by the Commissioner cannot be sidestepped in an application by a taxpayer under s 459G of the *Corporations Act* to set aside a statutory demand by the Commissioner.
>
> …The use by the Commissioner of the statutory demand procedure in aid of a winding up application is in the course of recovery of the relevant indebtedness to the Commonwealth by a permissible legal avenue. The phrase "may be recovered" in ss 14ZZM and 14ZZR of the Administration Act applies to the statutory demand procedure. That state of affairs places the existence and amounts of the "tax debts" outside the area for a "genuine dispute" for the purposes of s 459H(1) of the *Corporations Act.*

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12 *Clyne v Deputy Commissioner of Taxation* (1982) 56 ALJR 857, 858-859.
13 (2008) 237 CLR 473.
14 (2008) 237 CLR 473, 496 [57] (Gummow A-CJ, Heydon, Crennan and Kiefel JJ).

31. Further, there was no other reason why the demand should be set aside under s 459J(1)(b):[15]

> The "material considerations" which are to be taken into account, on an application to set aside a statutory demand, when determining the existence of the necessary satisfaction for para (b) of s 459J(1) must include the legislative policy, manifested in ss 14ZZM and 14ZZR of the Administration Act, respecting the recovery of tax debts notwithstanding the pendency of Pt IVC proceedings.

32. *Broadbeach Properties Pty Ltd* was applied recently by the Full Court of the Federal Court in *MNWA Pty Ltd v Deputy Commissioner of Taxation.*[16] In that case, two companies, MNWA and Gucce Holdings owed the ATO significant tax debts. The Commissioner had commenced proceedings in the Supreme Court of Western Australia against Gucce, seeking a tax debt of about $10.5 million, and against MNWA seeking a tax debt of about $21.6 million. In settlement of those proceedings, Gucce and MNWA entered into separate deeds of agreement with the Commissioner. Under both Deeds, security was provided to the Commissioner, and the Commissioner agreed not to take any further steps to recover the tax debts unless an event of default occurred. Each Deed defined the assessments that were subject to the agreement.

33. Shortly prior to the execution of the Deed, the Commissioner had issued MNWA and Gucce with notices of assessment relating to further tax liabilities. In respect of Gucce, the notice of assessment was for a further $3.7 million. In respect of MNWA, the notice of assessment was for a further $9.8 million. Those further liabilities had not been included in the definition of the assessments the subject of the Deed. However, there was evidence that prior to the execution of the Deeds, representatives for Gucce and MNWA had discussions with representatives from the ATO in negotiation of the terms of the Deed. Gucce and MNWA alleged that in the course of those discussions,

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15 (2008) 237 CLR 473, 497 [61] (Gummow A-CJ, Heydon, Crennan and Kiefel JJ).
16 [2016] FCAFC 154.

the ATO had agreed, or represented that if Gucce and MNWA provided security ("This should resolve all the current outstanding debt recovery disputes.") It was alleged that the ATO's representative had called this a "global deal" and remarked that Gucce and MNWA would be "a born again taxpayer."

34. The ATO served statutory demands on MNWA and Gucce respectively pursuant to the further notices of assessment which were not covered by the Deed. MNWA and Gucce applied to set aside the demands under 459J(1)(b) on the ground that the discussions prior to the execution of the Deed constituted an agreement by the ATO not to pursue the further assessments, or alternatively, an estoppel. The ATO, MNWA and Gucce all filed affidavit material in respect to the discussions that occurred prior to the execution of the Deed.

35. Perhaps surprisingly, the primary judge allowed cross examination. After hearing the evidence, the primary judge found that Gucce and MNWA had not proved that the parties had entered into a contract that was a legally enforceable global settlement.

36. On appeal to the Full Court of the Federal Court, the decision of the primary judge was upheld 2:1. Farrell and Daviess JJ delivered the majority judgment and found that in light of the decision in *Broadbeach Properties Pty Ltd* and the provisions of the taxation legislation, the contention that the pre-Deed discussions gave rise to an enforceable contract, or an estoppel, did not constitute "some other reason" to set aside the demands under s 459(1)(b). Their Honours said:[1]

> *DCT v Broadbeach* establishes that in considering whether there is "some other reason" within the terms of s 459J(1)(b) of the Act the "material considerations" which are to be taken into account will include the statutory scheme that applies to the collection and recovery of tax liabilities. Given the statutory scheme for collection and recovery of tax, an arguable basis for disputing the

> Commissioner's right to take recovery action is insufficient to constitute "some other reason" within the terms of s 459J(1)(b) and does not support an exercise of power to set aside the statutory demands under that section.

Debts under security of payment legislation

37. Debts arising pursuant to the *Building & Construction Industry Security of Payment Act 2002* (Vic) are by analogy with the decision in *Broadbeach Properties Pty Ltd* also less susceptible to genuine dispute. Similar legislation is in force in New South Wales, Queensland, Western Australia, and the Northern Territory. In short compass, the Act applies to construction contracts. A person claiming a progress payment may serve a payment claim [s 14]. The respondent may then serve a payment schedule admitting or denying the claim [s 15].

38. If a respondent fails to serve a payment schedule, the claimant has two options: (1) recover the amount in any Court as a debt; or (2) make an adjudication application [s 16(2)].

39. Subsection 16(4)(b) then provides that if the claimant seeks to recover the amount in Court as a debt:

> …the respondent is not, in those proceedings, entitled –
>
> (i) To bring any cross-claim against the claimant; or
> (ii) To raise any defence in relation to matters arising under the construction contract.

40. Subsection 17(4)(b) contains an identical prohibition on a respondent in circumstances where the respondent has served a payment schedule agreeing to pay an amount, but fails to do so.

41. If the claimant chooses to adjudicate, and the respondent fails to pay the adjudicated amount, the claimant can request an adjudication certificate, and

then recover the amount of the adjudication certificate in any Court as a debt [s 28O].

42. The policy behind these provisions is "pay now, argue later."[17] That is, to ensure that progress claims are paid on time, with the primary aim of keeping the money flowing by enforcing timely payment.[18]

43. In *Diploma Construction (WA) Pty Ltd v KPA Architects Pty Ltd*[19], the Western Australian Court of Appeal considered the *Construction Contracts Act 2004* (WA) in the context of an application to set aside a demand. In that case, KPA Architects provided architectural services, rendered invoices (which were not paid) and then obtained a determination by an adjudicator of the payment dispute, and entered judgment upon which a statutory demand was issued. Following service of the statutory demand, *Diploma Construction* did two things: First, it commenced a proceeding against KPA alleging various breaches of contract, including failure to perform to work the subject of the adjudication. Second, it applied to set aside the statutory demand on the basis that there was a genuine dispute as to whether the adjudicated amount was payable, and that it had an offsetting claim.

44. An application was issued to set aside the demand based on genuine dispute. The Court of Appeal applied the decision in *Broadbeach Properties Pty Ltd* by analogy and dismissed the application. Pullin JA, with whom Newnes and Murphy JJA agreed, said:[20]

> Likewise in this case, the source of the debt is located in the statutory consequences given to a determination in the Act. The fact that the source of the debt is State legislation, whereas in the case of the tax debt, the source of the debt was Commonwealth legislation, does not make any difference. There is no question

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17 *Multiplex Constructions Pty Ltd v Lui Kans* [2003] NSWSC 1140, [96] (Palmer J).
18 *Perrinepod Pty Ltd v Georgiou Building Pty Ltd* [2011] WASC 217, [87].
19 [2014] WASCA 91.
20 [2014] WASCA 91, [61] (Pullin JA, with whom Newnes and Murphy JJA agreed).

> of any conflict arising between the Act and the *Corporations Act.* The question is whether there is a debt. If there is a debt which is due and payable by reason of the State legislation, then there is no 'fictional state of affairs.'

45. Although it is generally not possible to raise a genuine dispute against a construction debt under the Security of Payment Act, it still possible to raise a true offsetting claim.

46. *In the matter of Douglas Aerospace Pty Ltd,*[21] concerned the New South Wales *Building and Construction Industry Security of Payments Act 1999*, which again, is very similar to the Victorian legislation. In that case, a payment claim was served, and the respondent failed to serve a payment schedule. The claimant then obtained an adjudication determination, and entered judgment in the District Court pursuant to the adjudication certificate. A statutory demand was then served. *Douglas Aerospace* applied to set aside the demand on the ground that there was a genuine dispute as to the existence of the judgment debt, that it had an offsetting claim, and that there was some other reason why the demand should be set aside. The offsetting claim comprised a claim for rectification of defects pursuant to the construction contract.

47. Brereton J agreed with the Court of Appeal in *Diploma Constructions*, but distinguished between "true offsetting claims" and other types of offsetting claims which merely seek to challenge the construction debt. Brereton J said:[22]

> While a "true" offsetting claim – for example, a cross-claim for damages for negligence or breach of contract, or the recovery by way of restitution of amounts already allegedly overpaid – may be relied on to set aside a statutory demand for a judgment debt founded on an adjudication certificate, the existence or pendency of an arguable claim that an adjudication does not reflect the true legal rights of the parties – involving no cross-claim for damages,

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21 [2015] NSWSC 167.
22 [2015] NSWSC 167, [101](5) (Brereton J).

> and where there has been no payment and thus no complete claim for restitution – cannot be an offsetting claim for the purposes of s 459H(1)(b). In this respect, I am not only unpersuaded that the decision in *Diploma* is plainly wrong, but I respectfully accept its correctness.

48. *In the matter of Douglas Aerospace* and *Diploma Constructions* were both cases in which the plaintiff had obtained an adjudication determination, and entered judgment. In that type of case, it is clear that no genuine dispute can be raised.

49. It is less clear however, whether a genuine dispute can be raised in circumstances where the dispute has not been adjudicated, and judgment has not been entered. In this regard, *In the matter of Douglas Aerospace*, Brereton J said:[23]

> It is difficult to see how a debt arising under s 14(4), which creates a statutory liability upon the failure to provide a payment schedule, could be the subject of a genuine dispute, if the conditions in s 15(1) are satisfied, regardless of any underlying dispute. As it seems to me, the only way in which a "genuine dispute" could be raised in respect of such a debt would be disputing whether the circumstances referred to in s 15(1) existed.

50. In other words, if a payment claim is served, and the respondent fails to serve a payment schedule, there can be no genuine dispute as to the existence of the debt (even without obtaining an adjudication certificate and entering judgment.) This is due to the operation of s 16(4) (under the Victorian legislation), which provides that the defendant cannot challenge the enforcement proceeding. The only way to raise a genuine dispute in those circumstances is to challenge the service of the payment claim.

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23 [2015] NSWSC 167, [76] (Brereton J).

51. This occurred in *Re Rockwall Homes Pty Ltd.*[24] In that case, four invoices were rendered for tiling work to the wrong corporate entity, and the payment claim was issued to "Rockwall Homes", without referring to any corporate title or ACN. Black J set aside the demand on the basis that the payment claim had not been served, and said:[25]

> [T]he SOPA is only capable of applying where a payment claim is served upon the party to the construction contract and does not exclude a dispute as to whether that requirement is satisfied…That result is consistent with the reasoning of Brereton J in *Re Douglas Aerospace Pty Ltd* above, so far as his Honour left open (at [77]) the possibility that a genuine dispute would be established where there was an issue as to whether the conditions of s 15 of the SOPA had been satisfied.

52. Last, in *SP Builders Pty Ltd,*[26] Efthim AsJ confirmed that the principles in *Diploma Constructions* apply equally to the Victorian legislation. I would submit the other cases discussed in this section are also applicable.

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24 [2017] NSWSC 223.
25 [2017] NSWSC 223, [30].
26 *SP Builders Pty Ltd* [2014] VSC 680, [25] (Efthim AsJ).