SUPREME COURT OF QUEENSLAND

CITATION:	*Crossroads Fashions P/L (in liq) & Anor v Gavin & Anor* [2002] QSC 179
PARTIES:	**CROSSROADS FASHIONS PTY LTD (ACN 076 892 450) (IN LIQUIDATION)** (first applicant) **JOHN LETHBRIDGE GREIG AND ROBERT JOHN DUFF** (second applicant) **v** **SAW KIM GAVIN** (first respondent) **KIM SUSAN GAVIN** (second respondent)
FILE NO:	S870 of 2002
DIVISION:	Trial Division
PROCEEDING:	Application
DELIVERED ON:	20 June 2002
DELIVERED AT:	Brisbane
HEARING DATE:	27-29 May 2002
JUDGE:	Muir J
ORDER:	**Order that the respondent pay to the second applicants the sum of $135,094.49.** **Further that the respondent pay the second applicants' costs of and incidental to the application (including reserved costs) to be assessed on the standard basis, including the costs which the applicants were ordered to pay to the first respondent.** **Order that the respondent pay interest on the sum of $135,094.49 at the rate of 9 percent per annum for 18 months, namely $18,237.76.**
CATCHWORDS:	CORPORATIONS LAW – INSOLVENCY – where application made for payment of amount of loss or damage as a result of alleged insolvent trading – where respondent owned a chain of retail women's clothing stores – where failure to provide financial record documents to liquidator – where alleged evidence of insolvency – whether respondent was insolvent at relevant times *Corporations Act* 2001 s 588 *Russell Halpern Pty Ltd v Martin* (1983) 10 ACLR 539

Tourprint International Pty Ltd (in liq) v Bott (1999) 32 ACSR 201

COUNSEL: Mr A W Duffy for the applicants
Mr K A Barlow for first respondent
Second Respondent in person

SOLICITORS: Freehills Solicitors for the applicants
Macrossans Lawyers for the respondents

[1] This application is made by Crossroads Fashions Pty Ltd (In liquidation) and its liquidators John Lethbridge Greig and Robert John Duff under section 588M of the *Corporations Act* 2001 for orders for payment by the respondents of the amount of loss and damage allegedly suffered by creditors as a result of insolvent trading by the company.

The Dismissal of Claims against the First Respondent

[2] The second respondent, to whom I shall refer as "the respondent", was shown in the records of the company as a director from 12 October 1998. From the date of the company's registration on 24 December 1996 until 12 October 1998, the first respondent, the second respondent's mother, was shown as the company's sole director. It is accepted by the respondent that she was the person in sole control of the affairs of the company at the date of its registration until winding up and that the first respondent had little, if any, participation in the company's affairs. At all material times, the respondent was a "director" of the company within the meaning of section 9 of the Act. When the matter came on for trial on 27 May 2002, the applicants and the respondent consented to proceedings being dismissed as against the first respondent.

The Company's Trading History

[3] The company has an issued share capital of $1. It commenced trading in a retail women's clothing business under the name "Sequel" in early 1997. The first store opened was at Broadway on the Mall in February/March 1997. Further, stores were opened at Logan Hyperdome, the Grand Central Shopping Centre, Toowoomba and Toowong Village Shopping Centre respectively in August, October and November 1997. In all cases, the company operated from leased premises. It ceased trading between November 1998 and January 1999. The applicants are unable to fix that date with precision because the financial records of the company made available to them contain insufficient information.

[4] The respondent, who appears in person, did not attempt to place before me a great deal of factual information. Her efforts were largely directed towards attempting to show that a number of the debts claimed by the applicants related to periods prior to the onset of insolvency.

The Basis of the Applicant' Claims

[5] The applicants' relied on section 588E(4) of the Act to found a presumption that the company had been insolvent since July 1997. That subsection provides –

> "Subject to subsections (5) to (7), if it is proved that the company:
>
> (a) has failed to keep financial records in relation to a period as required by subsection 286(1); or
>
> (b) has failed to retain financial records in relation to a period for the seven years required by subsection 286(2);
>
> the company is to be presumed to have been insolvent throughout the period."

[6] In reliance on this provision, the applicants point to a failure to keep and/or retain financial records. The report of the liquidators prepared in January 2000 discloses that no financial accounts or management accounts for 1998 were prepared and that the documents of the following description were not delivered up to them -

(a) invoices and correspondence from creditors regarding outstanding accounts for 1998;
(b) management accounts for the period 1 July 1997 to 31 December 1998;
(c) general ledger accounts for 1998;
(d) a detailed cash book for 1997/1998;
(e) a creditors' ledger for 1997/1998;
(f) source documents for payments to creditors.

[7] I find that the above documents were not provided to the liquidators and that no final management accounts or profit and loss statements and balance sheets for the year ended 30 June 1998 were prepared as a result of the company's accountant ceasing work due to non-payment of accounts rendered for preparation of the 1997 accounts and other work.

Deemed Admissions by Operation of Rule 189(2) of the Uniform Civil Procedure Rules

[8] The applicants also relied on deemed admissions by operation of Rule 189(2) of the *Uniform Civil Procedure Rules*. Notices to admit were served on the former solicitors for the respondent on 9 and 10 May 2002 and not responded to. In consequence of the lack of response, there are deemed admissions that on and from 1 July 1997 the company did not keep or maintain the documents and books to which reference has just been made. These are also other deemed admissions.

[9] There is some doubt about when the respondent first saw the notices to admit.

[10] On 22 May 2002, a solicitor employed by the applicants' solicitors telephoned the respondent and told her that she could pick up the notices to admit and accompanying documents from her former solicitors. The respondent informed the solicitor that she was driving to the Gold Coast where her former solicitors had their office and would pick them up on her way. On Monday morning, shortly after the

trial commenced, she told me that she had not done so and I adjourned the matter until 11am on Tuesday to give her time to obtain and consider the documents.

The company's trading pattern and indicia of insolvency

[11] The company's accounts for the period ending 30 June 1997 reveal that the company made a net profit of $4,369 on sales of $364,199. The cost of goods sold was $175,172 and expenses $171,790.

[12] It seems that the financial position of the company deteriorated fairly quickly after commencement of trading. The evidence discloses that creditors totalled $69,411 as at 27 October 1997, but had increased to $139,117 as at 27 November 1997. Much of that increase is attributable to a debt of $65,000 owing to Glasswood Pty Ltd for a shop fit out at the Logan Hyperdome. As at that date, 63% of the creditors' debts were outstanding for 30 days or over, 7.1% for 60 days or over, and 26.9% for 90 days or over. Even as at 20 November 1997, 62% of debts were outstanding for 90 days or more. That compares with a figure of 4.5% as at 27 October 1997. Trading terms were usually "net 30 days".

[13] The company made weekly payments of $3,000 to Glasswood in part payment of the debt until 23 February 1998. Glasswood obtained judgment against the company for the balance of the debt on 17 May 1999.

[14] The applicants pointed to the following indicia of insolvency –

(a) A deficiency of liabilities over assets of some $294,000 as at 31 August 1999;
(b) As early as November 1997 the majority of the debts owing to creditors were outstanding for 90 days or more;
(c) Legal demands for payment were made by various creditors and legal proceedings were commenced against the company throughout 1998, particularly in the latter half, in respect of debts incurred in 1998;
(d) Compositions were entered into with creditors under which the company agreed to pay debts by instalments;
(e) The dishonouring of seven cheques between May 1998 and October 1998, including cheques in favour of the Australian Taxation Office;
(f) For the period prior to 1 July 1998, the company had arrears of insurance of $7,805.25.
(g) As at 30 June 1998 group tax outstanding totalled $37,555 and that included arrears for October and November 1997.
(h) Some employee superannuation contributions were not made in 1997.

[15] At times unstated but, it would seem in 1998, a number of suppliers would only deal with the company on a cash on delivery basis.

The commencement of insolvency

[16] In the liquidators' report, the opinion is expressed that "It is arguable that the company may have been insolvent since December 1997". Reasons for that opinion are then given. In one of Mr Greig's affidavits he swears to like effect. That evidence is inadmissible as it swears to the issue, but the facts sworn to in support of the opinion are admissible. It is significant for present purposes that no opinion is expressed that the company was or may have been insolvent at an earlier date. The explanation for this put forward by Mr Duffy, who appears for the applicants, is that the applicants had insufficient books and records to enable the applicants to state a concluded view.

[17] The strongest evidence of insolvency at this time is provided by the company's failure to pay superannuation for employees as early as June 1997 and the commencement of instalment payments to creditors in July/August 1997. I note that no cheques were dishonoured prior to December 1997 and that there is no evidence of unsatisfied demands by creditors before that time.

[18] The above matters in my view demonstrate insolvency as at December 1997 but not before that date. It will be recalled that a trading profit was made for the period before 30 June 1997. What appears to have happened is that the company pursued an over-enthusiastic policy of expansion which led to liquidity problems which were beyond the respondent's power to rectify through improved profitability or an injection of additional capital.

Availability of defences under ss 588E and 588H of the Act

[19] Although affidavit material was prepared on the respondent's behalf whilst she had legal representation, it did not address any defence to a deemed insolvency pursuant to section 588E or any defence potentially available under section 588H. Matters referred to by her in the course of submissions suggested to me the possibility of such a defence and I adjourned the matter to allow the respondent to adduce sworn evidence in that regard. She has done so, swearing in effect that the documents the applicants identified as missing were lost through actions of landlords and their agents without any complicity or fault on her behalf.

[20] The respondent's evidence in this regard is uncorroborated and I find it unconvincing. I am not satisfied, on the balance of probabilities, that the respondent has established the facts necessary to satisfy the requirements of s 588E.

[21] The presumption under s 588E on which the applicants rely operates "except so far as the contrary is proved". In my view, the contrary has been proved in relation to the period prior to December 1997 by inferences able to be drawn from the evidence adduced by the applicants and the respondent. The applicants' investigations have been unable to cause them to form an opinion that the company was unable to pay its debts as they fell due prior to December 1997. As I have said, the company in fact traded at a small profit at the outset. There is really fairly slender evidence of insolvency in 1997. For instance, there is no evidence of dishonoured cheques, actions by suppliers and only a couple of isolated examples of payment of creditors

by instalment. Four debts incurred in 1997 remain outstanding but three of the four seem to have been incurred in or after August 1997.

[22] This leaves for determination the question of whether the respondent had reasonable grounds to expect and did expect that the company was solvent in and after December 1997 and would remain solvent even if it incurred any debt the subject of the liquidator's claims and "any other debts that it incurred at that time".

[23] As Austin J observed in *Tourprint International Pty Ltd (in liq) v Bott* (1999) 32 ACSR 201 –

> "The defence requires an actual expectation that the company was and would continue to be solvent, and that the grounds for so expecting are reasonable. A director cannot … hide behind ignorance of the company's affairs which is of their own making or, if not entirely of their own making, has been contributed to by their own failure to make necessary enquiries."

[24] The cumulation of indicia of insolvency in and after December 1997 in my view makes it impossible for the respondent to sustain this defence for debts incurred after November 1997. I find however that the defence has been made out in respect of debts incurred prior to December 1997. I give leave to the respondent to withdraw such of the deemed admissions as are inconsistent with this finding and with the finding that insolvency prior to December 1997 has not been established.

Quantification of the Applicants' Claims

[25] The respondent argued that some of the alleged debts incurred for supply of stock totalling $54,932 were in respect of stock repossessed by suppliers "on or about the date that the company ceased trading". She swore that "much" of the subject stock "was subject to a retention of title clause". I regard the respondent's evidence about the stock as unreliable. There is hearsay evidence that in respect of all, or virtually all, of the sums claimed by the plaintiff there was either no retention of title clause or that the stock was not recovered. That evidence was, unlike the respondent's evidence, quite specific. The evidence is admitted under rule 394 of the *Uniform Civil Procedure Rules*. Also admitted under that rule is the evidence in paragraph 8 of Mr Greig's affidavit filed on 25 January 2002. It seems to me that there is no serious dispute about the great bulk of the matters sworn to in that paragraph and to require the matters the subject of that paragraph and in respect of stock recoveries to be formally proved would be to involve the parties in additional expense for no good purpose.

[26] Apart from the debts in respect of stock allegedly repossessed, the respondent mounted a detailed challenge to a number of other debts. The respondent's contentions in that regard were addressed in considerable detail by Mr Greig in his affidavit filed on 11 April 2002. I accept Mr Greig's evidence.

[27] After some discussion in the morning on the third day of the trial, Mr Duffy produced an amended schedule of debts (Ex 6) which I will now address. I find that the debts in the schedule were all incurred on or after December 1997 while the company was insolvent except as now discussed.

[28] Exceptions to the foregoing are items 3, 9, 10 and 29. In those cases it has not been shown that the subject debt was incurred after 30 November 1997.

[29] A number of the applicants' claims are for rent which has occurred under instruments of lease. Item 10 in the amended schedule of debts concerns the rent accrued in respect of the company's Logan Hyperdome tenancy and is for $53,200. Although the company went into possession in about August 1997 the lease is dated 4 February 1998. The probabilities are, having regard to the date of commencement of the lease, that there was at least an agreement for lease in existence prior to 1 December 1997 with obligations in respect of rental payments commensurate with those subsequently contained in the lease.

[30] $50,009 is claimed in item 9 in respect of rent accrued in relation to the Grand Central Toowoomba tenancy. No lease has been able to be located but I infer that one exists and that it pre-dated the entering into of possession by the company.

[31] $27,600 is claimed, by item 29, in respect of the Toowong Village tenancy. No lease has been located for that tenancy either but there is in existence a document signed by the respondent on behalf of the company dated 1 November 1997 entitled "offer to lease". I infer that the company went into possession under that document or under an agreement for lease and further that the rent was payable pursuant to such instrument.

[32] In *Russell Halpern Pty Ltd v Martin* (1983) 10 ACLR 539 it was unanimously held by the full court of the Supreme Court of Western Australia (in relation to s 556(1) of the Companies Code W.A.) that where rent accrues after insolvency under a lease entered into before insolvency the debts which thereby come into existence are not incurred for the purposes of the section as the rent falls due.

[33] Mr Duffy submits that, as the Logan Hyperdome lease postdated insolvency, rent falling due after insolvency gives rise to debts incurred after insolvency. The submission is not without substance but I do not accept it. It is inconsistent with the reasoning in *Russell Halpern Pty Ltd*. Although the rent, as a matter of law, became payable under a lease when it superseded a pre-existing agreement for lease, the company on entering into the agreement for lease did the act which committed it to incurring liability for future rent as and when it fell due. By executing a lease the company incurred no additional liability for rent. It is thus inappropriate to regard the company as having "incurred a debt" for the purposes of s 588G at the time the lease was entered into.

[34] It is also difficult to in such circumstances to regard the respondent as having failed "to prevent the company from incurring the debt" (s 588G(2)). Furthermore, in such

circumstances it is doubtful that the persons "to whom the debt is owed" would have "suffered loss or damage in relation to the debt" (s 588M).

[35] For the above reasons, it is ordered that the respondent Kim Susan Gavin pay to the applicants the sum of $135,094.49 being the total of the amounts in exhibit 6 less the total of the amounts in excluded items 3, 9, 10 and 29.

[36] It is further ordered that such respondent pay the second applicant's costs of and incidental to the application (including reserved costs) to be assessed on the standard basis, including the costs which the applicants were ordered to pay to the first respondent.

[37] The applicants also sought interest on the sum claimed at the rate of 9.5 percent per annum on the amount claimed in the application ($299,221.15) from 1 July 1997 to the date of payment or judgment. These proceedings were commenced on 25 January 2002. The liquidators' report was prepared in January 2000. Although there is a suggestion in it of wilful destruction of documents by the respondent, I am not satisfied that this occurred or that she failed to co-operate appropriately. It is the case, however, that the respondent bears responsibility for the loss of the company's records and for the failure to keep appropriate records. That loss and failure made the liquidators' task a difficult and time consuming one. In the exercise of my discretion, I order that the respondent pay interest on the sum of $135,094.49 at the rate of 9 percent per annum for 18 months, namely $18,237.76.