SUPREME COURT OF QUEENSLAND

CITATION:	*Chan & Ors v First Strategic Development Corporation Limited (in liq) & Anor* [2015] QCA 28
PARTIES:	**SING CHUK CHARLES CHAN** (first appellant) **WAI LAP VICTOR CHAN** (second appellant) **WAI TAK KWOK** (third appellant) **v** **FIRST STRATEGIC DEVELOPMENT CORPORATION LIMITED (IN LIQUIDATION)** ACN 128 309 651 (first respondent) **JONATHAN PAUL MCLEOD AS LIQUIDATOR OF FIRST STRATEGIC DEVELOPMENT CORPORATION LIMITED (IN LIQUIDATION)** (second respondent)
FILE NO/S:	Appeal No 4102 of 2014 SC No 7838 of 2012
DIVISION:	Court of Appeal
PROCEEDING:	General Civil Appeal
ORIGINATING COURT:	Supreme Court at Brisbane
DELIVERED ON:	6 March 2015
DELIVERED AT:	Brisbane
HEARING DATE:	25 September 2014
JUDGES:	Gotterson and Morrison JJA and Boddice J Separate reasons for judgment of each member of the Court, each concurring as to the orders made
ORDERS:	**1. Appeal dismissed.** **2. The appellants are to pay the respondents' costs of and incidental to the appeal, to be assessed on the standard basis.**
CATCHWORDS:	APPEAL AND NEW TRIAL – APPEAL GENERAL PRINCIPLES – INTERFERENCE WITH JUDGE'S FINDINGS OF FACT – FUNCTIONS OF APPELLATE COURT – WHERE INFERENCES OF FACT INVOLVED – WHERE FACTS IN DISPUTE – where on appeal the appellants challenged three central factual findings which led to the primary judge's conclusion – where these facts are firstly that First Strategic was insolvent at the time certain

debts were incurred, as the only means of meeting those debts was the willingness of one of the directors to pay – where the second finding was that each of the directors (the first and second appellants) and the third appellant had reasonable grounds for suspecting that Frist Strategic was insolvent – where the third finding what that the second and third appellant were unable to establish defences under s 588H(2) and s 588H(4) of the *Corporations Act* 2001 (Cth) – where the preparedness of the director to fund the company was dependent upon the on-sale of the companies tenements and shares to another company – whether the learned primary judge erred in finding that the arrangement was sufficiently certain to result in a finding of insolvency – whether the other directors were aware of the conditional nature of the funding – whether the third appellant was excluded from the management of the company – whether the trial judge applied the correct test for insolvency in the circumstances that applied – whether the trial judge's findings were open

Corporations Act 2001 (Cth), s 95A, s 588E(4), s 588H(2), s 588H(4), s 588M(2)

First Strategic Development Corporation Limited (in liq) and Anor v Chan and Ors [2014] QSC 60, related
International Cat Manufacturing Pty Ltd (in liq) & Anor v Rodrick & Ors (2013) 97 ACSR 200; [2013] QCA 372, considered
Lewis v Doran (2004) 184 FLR 454; [2004] NSWSC 608, considered
Lewis v Doran (2005) 219 ALR 555; [2005] NSWCA 243, considered
Mulherin v Bank of Western Australia Ltd; *McCann and Ors v Bank of Western Australia Ltd* [2006] QCA 175, applied
Soundwave Festival Pty Ltd v Altered State (WA) Pty Ltd (No 2) [2014] FCA 562, applied
Williams (as liquidator of Scholz Motor Group Pty Ltd (in liq)) v Scholz [2008] QCA 94, considered

COUNSEL: P A Hastie QC for the appellants
M D Martin QC, with C A Wilkins, for the respondents

SOLICITORS: McBride Legal for the appellants
Shand Taylor Lawyers for the respondents

[1] **GOTTERSON JA**: I agree with the orders proposed by Morrison JA and with the reasons given by his Honour.

[2] **MORRISON JA:** On 4 April 2014 judgment was given against the defendants, ordering them to pay the plaintiff, First Strategic Development Corporation Limited (in liq) (**First Strategic**) various sums pursuant to s 588M(2) of the *Corporations Act* 2001 (Cth). The first and third appellants were ordered to pay $1,349,131.03, and the second appellant was ordered to pay $1,322,867.35.

[3] The appellants' appeal involves a challenge to three central factual findings which led to the learned primary judge's conclusion. The first finding was that First Strategic was insolvent at the time certain debts were incurred, because its only means of meeting those debts was the willingness of one director, the first appellant (**Charles Chan**) to fund First Strategic. His Honour found that Charles Chan's degree of commitment to meeting the debts of the company was low, and his willingness to do so was conditional at all times. The second finding was that each of the directors (Charles Chan, the second appellant (**Victor Chan**) and the third appellant (**Mr Kwok**)) had reasonable grounds for suspecting that First Strategic was insolvent, as Charles Chan's willingness to fund the debts was an insufficiently reliable source of funds, and that would have been apparent. Thirdly, findings were made that Victor Chan and Mr Kwok were unable to establish defences under s 588H(2) or s 588H(4) of the *Corporations Act*. The first defence related to their contention that they were able to rely upon the ability and willingness of Charles Chan to fund First Strategic. The second, which applied only to Mr Kwok, related to a contention that he was effectively ousted from the company's affairs from early May 2010, and therefore could not be held liable for debts incurred thereafter.

Relevant background and history of First Strategic

[4] Much of what follows was uncontroversial. It is reflected in paragraphs [7] to [42] of the learned primary judge's reasons[1] but there are matters to which I will draw attention that make it necessary to set these matters out.

[5] Macarthur Minerals Limited (**MMS**) is an Australian company. At all relevant times Mr Alan Phillips (**Alan Phillips**) was a director of MMS, and its Chief Executive Officer.

[6] From about 2007 MMS was seeking to attract investors to develop an iron ore project, called the Lake Giles Project. In the course of that process Mr Kwok began to have dealings with MMS. He introduced potential Chinese investors to MMS, one of whom was Charles Chan. Mr Chan conducted business through a number of companies in a group, the holding company being Continental Holdings Limited (**Continental**). He also introduced a company called China Minmetals Ltd (**Minmetals**), which became shareholder of MMS. One of Mr Kwok's roles was to act as an intermediary between MMS and Minmetals, negotiating long term off-take agreements for the Lake Giles Project, and assisting in capital raising.

[7] In September 2009 Charles Chan, Mr Kwok and Alan Phillips visited the Lake Giles Project and discussed the possible exploration of tenements which were adjacent to those held by MMS, and held by a Mr Dalla-Costa (**Dalla-Costa**).

[8] Dalla-Costa was interested in selling his tenements, and willing to grant an option to purchase them at a price which would be calculated by reference to the value of the mineral resources on the tenements. At that point the tenements were unexplored and the extent of their resources was unknown. Dalla-Costa's proposal was that the grantee of the option would be required to explore the tenements and establish the extent of the resource. In that way the price could be established. His proposal was that the grantee would be required to spend A$2.5 million in exploring the tenements, as a condition of the exercise of the option.

---

1 *First Strategic Development Corporation Limited (in liq) and Anor v Chan and Ors* [2014] QSC 60. (**Reasons**).

[9] At that time MMS did not have sufficient funds of its own to explore the Dalla-Costa tenements. However, MMS considered those tenements to be attractive, given that they were adjacent to its own tenements. MMS therefore proposed to Charles Chan and Mr Kwok that they should take the option to purchase those tenements, and fund the exploration, with the ultimate aim of on-selling those tenements to MMS. The on-sale would be at a substantial profit and in consideration of MMS issuing shares to them.

[10] Shortly afterwards MMS emailed Mr Kwok to summarise the discussion to that point, dealing with matters that went beyond the Dalla-Costa tenements. The proposal was for a "Newco" to hold the option over the Dalla-Costa tenements for 12 months, expending A$2.5 million in the exploration and production of an independent resource report, and taking about six months to do so. Proposals were made as to how the equity in the Newco would be held.

[11] Discussions between MMS and Mr Kwok continued into late October 2009, at which point a proposal was emailed by Alan Phillips, containing a number of elements:

(a) first, the grant of an option by Dalla-Costa to First Strategic, which by then had been identified as the appropriate vehicle to take the option and to pursue the exploration of the Dalla-Costa tenements; at that point First Strategic was simply a shell company with Alan Phillips and a Mr Taplin as the directors; 90 per cent of the shares were to be transferred to Charles Chan and Mr Kwok, who were also to be its directors;

(b) secondly, MMS would manage the exploration project on behalf of First Strategic;

(c) thirdly, MMS would hold a call option, enabling it to purchase the Dalla-Costa tenements within 60 days of the exercise by First Strategic of its option over the Dalla-Costa tenements;

(d) fourthly, the prices to be paid for the Dalla-Costa tenements (by First Strategic to Dalla-Costa, and by MMS to First Strategic) were identified, resulting in a large profit to First Strategic; MMS was to pay First Strategic "in the form of equity".

[12] Alan Phillips explained in that email how the various elements of the proposal fitted together. It was, in essence, that after about 18 months First Strategic would end up acquiring 36.6 per cent of the shares in MMS. In round terms the price to be paid for the Dalla-Costa tenements would be about A$40 million, and the price paid by MMS to First Strategic would be about A$60 million, satisfied by the issue of shares in MMS. Whilst the end result was profitable to First Strategic, the proposal meant that First Strategic would have to find the funds for the acquisition of the Dalla-Costa tenements, as the on-sale was going to be satisfied by an equity issue, not cash.

[13] The matters recited above demonstrated, as the learned primary judge found,[2] that First Strategic's

> "exploration and acquisition of the Dalla-Costa tenements was intended to be for the ultimate benefit of MMS, in that there was no proposal either for the development by [First Strategic] (or anyone

[2] Reasons at [16].

> behind it) of the tenements or for the sale by [First Strategic] of the tenements to anyone other than MMS".

[14] It was eventually agreed that First Strategic would be wholly owned by Charles Chan and Mr Kwok. They were First Strategic's initial directors, being joined by Victor Chan in March 2010.

[15] On 28 November 2009 Joe Phillips (Alan Phillips' son) sent a further email explaining the proposal to acquire the Dalla-Costa tenements. The ultimate end was that they would be owned by MMS, and paid for by the issue of shares to First Strategic, with the consequence being that more than 70 per cent of MMS would be held by "our group", as he described it.

[16] The call option was granted by Dalla-Costa to First Strategic on 3 December 2009. The purchase price was to be calculated by reference to the exploration program, but capped at A$40 million. First Strategic covenanted to act with all reasonable expedition in order to satisfy the conditions of the exercise of the option. One of those conditions was that First Strategic would expend A$2.5 million on the exploration of the Dalla-Costa tenements, of which at least 85 per cent had to be expended on geological investigation of the resource. The option granted to First Strategic had to be exercised no later than 12 months from 3 December 2009, but upon its exercise First Strategic would be able to extend the date for completion to a period of 90 days. Charles Chan and Mr Kwok signed on behalf of First Strategic.

[17] The following day Joe Phillips, emailed Mr Kwok, attaching a budget for the exploration. He also stated that he would submit a management contract to First Strategic.

[18] A few days later Joe Phillips emailed Mr Kwok again, reiterating that First Strategic had to have funds at hand to meet the exploration commitments, and that contractors had to be paid directly after approval by MMS that the work was completed appropriately. As Joe Phillips put it:

> "Macarthur Minerals is the manager of the exploration tasks and will in effect redirecting (sic) invoices to [First Strategic] for the geological tasks performed."

[19] The evidence of Charles Chan, Victor Chan and Mr Kwok made it clear that all of the funds to meet the A$2.5 million expenditure was to come from Charles Chan, and no one else. There was no question at the trial that Charles Chan had the ability to meet that amount (and greater), nor that Mr Kwok believed Charles Chan to be a wealthy and trustworthy man, and a prominent entrepreneur and businessman in Hong Kong, well able to afford the required expenditure.

[20] By 20 January 2010 some work had been done on the Dalla-Costa tenements, resulting in invoices totalling about $16,000. These were sent by Joe Phillips to First Strategic, and were paid promptly. Then, in early March 2010 a further sum of about $21,000 was paid for further work.

[21] On 25 February 2010 Alan Phillips wrote to Victor Chan and Mr Kwok, raising the question of the execution of the option agreement and management agreement between First Strategic and MMS. The board of MMS had resolved to execute those documents, but First Strategic had not responded. In addition the exploration work did not proceed quite as planned. This led to a number of complaints being

made by Joe Phillips on 28 March 2010, that MMS had not received the direction to undertake the next round of exploration on the Dalla-Costa tenements, and there was no finalised management agreement. Charles Chan responded, saying that he had overlooked those matters and instructing MMS to "catch it up immediately".

[22] At this point in the chronology, disagreements between Mr Kwok, Alan Phillips and Joe Phillips were occurring. The source of the disagreement was MMS' intention to issue a private placement of shares which Mr Kwok considered would have the effect of diluting the interests of existing shareholders. Mr Kwok instructed solicitors in respect of that matter, and they wrote a number of letters to MMS complaining about the placement and other differences which had arisen between the board of MMS and the "Hong Kong shareholders", a phrase which included Mr Kwok and Charles Chan.

[23] The relationship between Alan Phillips and Mr Kwok broke down once the solicitors' letters had been sent. Alan Phillips said that he was not prepared to have further dealings with Mr Kwok because of the threatened proceedings against MMS. In April or May2010 Alan Phillips told Charles Chan that he (Alan Phillips) would not do business with Mr Kwok. He insisted that Mr Kwok be removed as a director and cease to be a shareholder of First Strategic. That demand was also evident in the draft management agreement between MMS and First Strategic, with MMS requiring a condition that it be satisfied that it was Charles Chan who owned all the capital in First Strategic.

[24] Some steps were put in place to remove Mr Kwok as a director. In May 2010 Mr Kwok executed a power of attorney appointing a Mr Yeung

> "to represent me and sign document on my behalf in all corporate matters, including but not limited to the transfer of shares or change of share holding structure, relating to me … being a member of [First Strategic]".

[25] Soon thereafter Charles Chan emailed Alan Phillips telling him he was in effective control of First Strategic. Mr Yeung gave some instructions for Mr Kwok's shares to be transferred to Charles Chan. Those documents were prepared and signed by Mr Yeung, as Mr Kwok's attorney. They were also signed by Charles Chan. However, the transfer was not registered and as a consequence Mr Kwok remained a shareholder and a director.

[26] On about 26 May 2010 a management agreement was signed between MMS and First Strategic. The management agreement was conditional upon MMS being satisfied that Charles Chan was the holder of, or entitled to, all of the share capital in First Strategic. Under the agreement MMS was authorised to make expenditure in accordance with an approved program and budget, to explore the Dalla-Costa tenements. Under the agreement MMS was to be paid a fee, accruing on a daily basis, but payable in equal monthly instalments. That fee was calculated at 15 per cent of the project's budget, which was defined to mean the amount of A$2.5 million identified for the exploration of the Dalla-Costa tenements. However, the fee was to form part of the project budget, and therefore came within the A$2.5 million.

[27] Whilst the management agreement was signed, the option agreement, under which MMS would be entitled to purchase the Dalla-Costa tenements from First Strategic, was never signed.

[28] A deposit of $20,000 was required, and paid. Charles Chan signed the acceptance of that quotation, and made the payment of the deposit.

[29] On 9 June 2010 Charles Chan accepted a quotation from Orbit Drilling, to do drilling work on the Dalla-Costa tenements. Orbit Drilling's debt made it the largest of the unpaid creditors of First Strategic. It was owed just over $448,000. At the trial it was common ground that Orbit Drilling's debt was incurred on 9 June 2010, upon acceptance of its quotation. However, the actual drilling work did not commence for about one month.

[30] On 8 July 2010 Charles Chan emailed Alan Phillips, saying that he wished to discuss the "317 MMS contract" and the "317 extension with the original mill operator", for the purpose of providing some assurance to Charles Chan so that he could "move forward". The "317 MMS contract" was a reference to the draft call option to be granted to MMS by First Strategic. The "317 extension with the original mill operator" referred to a proposed extension of time for First Strategic to exercise its own call option in respect of the Dalla-Costa tenements.

[31] Correspondence then followed between the representatives of MMS on one side, and First Strategic on the other. There was also internal correspondence in First Strategic and Continental, with Mr Yeung (an advisor to Charles Chan) referring to the interval of the time between when payment had to be made to Dalla-Costa by First Strategic, and the receipt of any payment by First Strategic from MMS. This was referred to as a "cash flow consideration". He told Victor Chan that he had discussed the issue with Charles Chan, and understood that "neither [First Strategic] nor MMS had the cash to complete the transaction". The consequence was that a site visit was made to the Dalla-Costa tenements, and Charles Chan, Victor Chan and Mr Yeung were introduced to Dalla-Costa. An additional participant at the meeting was a Mr Betts, who represented another potential investor if the Dalla-Costa tenements were proved and acquired. Inconclusive discussions took place about an extension of the option period.

[32] By August 2010 First Strategic was being pressured to pay creditors. On 6 August 2010 Charles Chan sent an email to Alan Phillips in these terms:

> ""…I feel uncomfortable with the immediate prospect of the Lake Giles E317 exploration program. I have to request you to suspend the exploration with immediate effect until further notice and until the concerns below are resolved.
>
> I have a few concerns. We have secured the buy option from the tenement owner but we cannot secure the sell option to MMS. This does not make commercial sense for me to proceed further. Given the uncertainty of the dispute regarding [Mr Kwok] vs MMS, I feel very unsecure [sic] to move forward.
>
> I understand [First Strategic] is responsible for the exploration costs and other expenses accrued so far. Please send me the most up to date account upon suspension. [First Strategic] shall settle the account in due course …"

[33] As a consequence MMS suspended all geological activity on the tenements. Alan Phillips told Charles Chan that he would compile a list of outstanding accounts for First Strategic. On 19 August 2010 he sent that list to Charles Chan. The total amount owing was $856,365.19, which included invoices from Orbit Drilling

totalling about $350,000. It also included two invoices, each dated 10 August 2010, from MMS, for management services totalling about $365,000.

[34] In the result, notwithstanding what Charles Chan had said on 6 August 2010, none of those outstanding accounts was paid.

[35] Mr Yeung emailed Joe Phillips (copying in Victor Chan and Charles Chan) on 16 August 2010. He said that First Strategic

> "hesitates to proceed further with this project since there is an important missing link for a valid sell option of the tenement to Internickel.[3] There will be an opportunity for meeting with Alan to resolve this issue at the upcoming AGM. Until this critical issue is resolved, hopefully at or before the AGM, we just cannot make a decision at this stage to apply to the Department of Mines and Petroleum for their consideration of an extension to the licence."[4]

[36] Charles Chan emailed Alan Phillips on 27 August 2010, to state his position:

> ""Given the missing link of a firm commitment from MMS … on buying the tenement … from [First Strategic] if [First Strategic] is to take up the option of buying the tenement from the tenement owner, [First Strategic] will not be able to raise funds for this project. Please be advised that [First Strategic] had to face the reality of cancelling and terminating this project.
>
> MMS as a manager to the exploration project should also immediately convey the same message to all parties concerned by this decision.
>
> Shareholders of [First Strategic] are considering disposing the company [sic] as an option to draw a conclusion to this project. Please let me know if any potential buyer is interested in taking up this offer before [First Strategic's] deciding on other options."

[37] On 17 November 2010, a meeting of the creditors of First Strategic appointed liquidators to the company. That was on a resolution signed by Victor Chan and Mr Kwok, as directors.

The approach of the learned primary judge - support of First Strategic?

[38] The appellants do not challenge the approach of the learned trial judge insofar as the application of legal principle is concerned. The challenge is entirely as to the factual findings.

[39] In terms of the insolvency of First Strategic, the learned primary judge identified that it had kept no financial statements at all and the liquidator reported that the source documentation from which such statements might be compiled was inadequate for the company to be able to produce true and fair financial statements.[5] That would lead to a presumption of insolvency under s 588E(4) of the

---

3 Internickel was a company to be introduced as a subsidiary of MMS, to exercise the call option.

4 This was a reference to the fact that part of the Dalla-Costa tenements was subject to a partial surrender and an extension of time was required.

5 Reasons at [64].

Corporations Act, but his Honour did not stop there. The central issue as to the solvency was summarised in the following way by the primary judge:

> "[65] At no time did the company have any assets. Nor had it arranged any line of credit or other financial support from a party with whom it was at arms length. It had no contractual entitlement to receive any funds at all, from which it could have paid the debts which it was incurring. Its prospects of paying its debts depended entirely upon the means and preparedness of someone who stood to benefit from the company's operations. According to the evidence, the only possibility was [Charles Chan]. There is no suggestion that [Mr Kwok], who on the face of things was a half owner of the company, was prepared to fund any part of its operations during any relevant time.
>
> [66] The plaintiffs concede that [Charles Chan] had the means to fund [First Strategic's] payment of the subject debts and any other debts, to the order of the amount of $2.5 million which had to be spent under the option agreement with Mr Dalla-Costa. But they dispute that there was a sufficient likelihood that [Charles Chan] would meet [First Strategic's] debts such that [First Strategic] was thereby able to pay its debts as they fell due."[6]

[40] The learned primary judge's consideration of that issue was in the context of the principles established in *Williams (as liquidator of Scholz Motor Group Pty Ltd (in liq)) v Scholz*[7] and *International Cat Manufacturing Pty Ltd (In Liquidation) & Anor v Rodrick & Ors*.[8] Those authorities deal with the question which arises when, under s 95A of the *Corporations Act*, the court has regard to "commercial reality" when assessing whether, as at the relevant date, a company is able to pay its debts as and when they become payable.[9] The company's position must be considered by reference, not only to its legal rights and obligations, but also to the relative likelihood that it will have funds available to it, albeit from sources in respect of which there is no formalised agreement or understanding.[10] Those sources might include consideration of the prospect of loans from related corporations or directors.[11]

[41] In *International Cat* it was held that "regard can be had to such financial support where the evidence establishes that the directors are likely to continue it".[12] In *Scholz* Muir JA held that "the most important consideration is the degree of commitment to the continuation of financial support",[13] a statement endorsed in *International Cat*.[14]

---

6 Reasons at [65]-[66].

7 *Williams (as liquidator of Scholz Motor Group Pty Ltd (in liq)) v Scholz* [2008] QCA 94. (***Scholz***)

8 *International Cat Manufacturing Pty Ltd (In Liquidation) & Anor v Rodrick & Ors* [2013] 97 ACSR 200. (***International***)

9 See *Lewis v Doran* (2004) 184 FLR 454, at 481; [2004] NSWSC 608; and on appeal at [2005] 219 ALR 555; [2005] NSWCA 243.

10 *Mulherin v Bank of Western Australia Ltd*; *McCann and Others v Bank of Western Australia Ltd* [2006] QCA 175.

11 *Scholz* at 110.

12 *International Cat* at 224.

13 *Scholz* at 110.

14 *International Cat* at 224.

[42] The learned primary judge also referred to the statement of Giles JA in *Lewis v Doran*[15] that "the key concept is *ability* to pay the company's debts as and when they become due". The learned primary judge went on:

> "That emphasis on "ability" is important here. The prospects of obtaining necessary funds from a party, which is not obliged to provide them, must be such as to give the company something more than a chance of paying its debts: the prospects must be sufficient to make the company **able** to do so. That does not mean that the provision of the funds must be free of any uncertainty or contingency. But there must be a sufficient likelihood for the company, and those directing it, to be able to rely upon the availability of those funds when incurring the relevant debts."[16]

[43] I agree respectfully with those observations. They reflect the need, in cases where the financial support is from a source which cannot be compelled by legal arrangement, for there to be a degree of assuredness that the financial support will be forthcoming and at such a level that one could say the company was **able** to pay its debts as and when they fall due, rather than being **possibly able** to do so. Just as a conclusion that the relevant financial support does not have to be absolutely certain in order to be sufficient to meet the test in *Lewis v Doran*, *Scholz* and *International Cat*, equally the financial support does not have to be absolutely uncertain in order to be insufficient to qualify. Between the two extremes the factual circumstances of each case will provide a variety of points at which one might conclude that the financial support was of such a degree of commitment that it was likely to continue, and with the result that the company was able to pay its debts, and therefore that it has sufficient financial support to draw the conclusion of solvency.

[44] However, in my view there is no benefit in attempting to achieve some precise formula as to likelihood, by reference to which the financial support qualifies or does not. To say that the likelihood of it being provided is "probable" or "improbable" adds no more to what has been said in the authorities to which I have referred. Given that the resolution of this issue will almost always depend upon an assessment of facts, in my view it is better to proceed on the basis that, where the financial support is being provided by a director or related entity, and in circumstances where there is no formalised agreement or understanding, what is required is cogent evidence which enables the court to conclude that there is such a degree of commitment on the part of the provider of the financial support to continue it, such that it can be said that at any point of time it was likely to be continued, with the result that, at any of those times, the company was able to pay its debts as and when they fell due.[17]

Findings on this issue by the learned primary judge

[45] The learned primary judge's consideration of Charles Chan's willingness to provide financial support proceeded upon a consideration of the objective evidence, rather

---

15 *Lewis v Doran* at 579.

16 Reasons at [69]. Emphasis added.

17 See *Lewis v Doran* at [113]; *Soundwave Festival Pty Ltd v Altered State (WA) Pty Ltd (No 2)* [2014] FCA 562, at [25].

than Charles Chan's evidence of what was in his mind. That was not a surprising approach given other findings by his Honour. First, his Honour noted that:

> "none of the defendants impressed as a credible witness, having regard to their conduct in falsifying the affairs of the company in an attempt to control the winding up of the company in a way which would avoid proceedings such as the present one".[18]

[46] This was a reference to the fact that when the liquidators' issued their report to creditors the liabilities to unsecured creditors totalled $1,894,405.98, which included claims by the directors and their associates in the amount of $982,667. His Honour found, and there was no challenge to it, that:

> "None of the claims by the directors or their associates was genuine. Each was made in an attempt to have the defendants control the outcome of the meeting for the purpose of having their selected candidates appointed as liquidators. About those facts there was no real contest at this trial."[19]

[47] Having reviewed some of the evidence of how the claims were manufactured, his Honour continued:

> "It is unnecessary to discuss further the details of this attempt to obtain control of the meeting. It could not be doubted that each of the defendants was a participant and made claims for debts which he knew were false. The evidence of these matters is clearly relevant to each defendant's credibility."[20]

[48] Secondly, his Honour's criticism of the credit of Charles Chan was also based upon the disparity between statements as to his preparedness to fund First Strategic's activity, when compared with what he did or did not do. In particular his Honour referred to the fact that Charles Chan "gave no credible explanation for not paying the debts which had been incurred to August 2010".[21]

[49] The respondent characterised the position, at least in oral submissions, as being that Charles Chan was wholly disbelieved and, at least in the learned primary judge's eyes, suffered a complete lack of credibility. That went further than the submission in the respondent's written outline, which was to the effect that the learned primary judge was "disinclined to give significant weight to [Charles Chan's] evidence of his intentions …".[22] However that may be, the appellants' argument proceeded upon the basis that they could not rely upon the oral evidence of Charles Chan, Victor Chan or Mr Kwok, as it had been effectively rejected by the learned primary judge. The whole approach of the appellants' argument was to focus on the objective evidence, and to eschew any suggestion that they were trying to overturn the primary judge's rejection of the appellants' evidence.

[50] The learned primary judge acknowledged that Charles Chan "had some inclination to provide funds for [First Strategic]",[23] based on the fact that some of the debts

---

18 Reasons at [81].
19 Reasons at [41].
20 Reasons at [45].
21 Reasons at [81].
22 Respondents outline, paragraph 7(a).
23 Reasons at [70].

were paid from funds which Charles Chan provided. However, his Honour found that in the context of what was required, those payments were comparatively small, totalling no more than about $80,000 prior to 6 August 2010. This was also reflected in the fact that there was no system in place for the timely provision of funds to facilitate payment of debts.

[51] His Honour held that, to the extent that Charles Chan was minded to fund First Strategic's operations, that was because of his interest in the prospective transactions going beyond the exploration and acquisition of the Dalla-Costa tenements. His Honour was referring to Charles Chan's interest in becoming a major shareholder in MMS. There was no evidence that First Strategic intended to develop the tenements itself, but rather to on-sell them to MMS in consideration for a share issue.[24] His Honour held that the potential for the profit to be made on the acquisition and on-sale of the Dalla-Costa tenements to MMS, and ongoing participation as a substantial shareholder of MMS "was sufficiently attractive to [Charles Chan] for him to transact as he did in 2009 and to cause some funds to be provided for the payment of [First Strategic's] debts".[25]

[52] However, his Honour found that Charles Chan's preparedness to fund the company

> "was qualified by the prospect that, for one or more reasons, the on-sale to MMS and the consequential acquisition of a substantial shareholding in MMS would not eventuate".[26]

His Honour pointed to the fact that First Strategic and MMS did not reach the point where the call option agreement was concluded, notwithstanding that the parties reached an advanced state of negotiation. However, even if the agreement had been concluded, it was nonetheless one simply granting a call option to MMS, rather than one which obliged MMS to acquire the Dalla-Costa tenements, or the shares in First Strategic.

[53] That meant that there must have been "other contingencies or uncertainties" which could affect the proposed transfer to MMS. His Honour identified a number of those contingencies or uncertainties as being:

(a) first, the level of MMS' share price at the time of any transfer of the tenements; since MMS was to pay A$60 million to First Strategic by the issue of shares in MMS, then obviously the number of shares which First Strategic would be issued would depend upon the then share price; if the share price was low enough, there was a prospect that the number of shares issued to First Strategic would result in First Strategic holding more than 50 per cent of MMS;

(b) secondly, the number of issued shares in MMS might vary by the time the tenements were transferred, with the result that the envisaged percentage shareholding by First Strategic in MMS could have been less than contemplated;

(c) thirdly, MMS itself operated in a business where its future was dependent upon the securing of sufficient capital or finance for the development of the

---

24 Reasons at [71].

25 Reasons at [72].

26 Reasons at [72].

Lake Giles Project; in turn those prospects would be affected by the chance of securing appropriate off-take agreements;

(d) fourthly, what his Honour called the "fragility of the relationship" between the controllers of MMS, and in particular Alan Phillips, and the controllers of First Strategic, had a potential impact upon whether MMS would continue to view First Strategic as a desirable major shareholder; the primary judge held that the commercial reality was that First Strategic and Charles Chan "had no protection against the possibility that the board of MMS would choose to deal instead with other parties to become the major shareholders of MMS";[27] and

(e) fifthly, there was a risk that First Strategic would have to fund not only the exploration of the tenements, but also the acquisition of them from Mr Dalla-Costa, at a sum of about A$40 million; that was connected with the fact that MMS was proposing to acquire the tenements from First Strategic with a consideration in the form of equity, and not cash; as his Honour recognised,[28] there was a difference between saying that Charles Chan was able to fund the expenditure required under the option agreement with Dalla-Costa, and being required to fund an acquisition of the tenements for A$40 million.[29]

[54] The learned primary judge's conclusion that Charles Chan's preparedness to pay First Strategic's debts, as and when they fell due, was not sufficiently reliable to meet the test of solvency, was expressed as follows:

> "[78] Therefore there were many circumstances which must have made [Charles Chan], at any point, reluctant to contribute anything to the exploration of these tenements and otherwise to the expenses of [First Strategic], to any extent beyond that which was required to be paid immediately in order to avoid the collapse of the entire proposal at that point. His "degree of commitment" was thereby low. It was dependent upon so many contingencies that, had there been an independent board of directors, they could not have considered [Charles Chan] to be a reliable source of funds.
>
> [79] The reliability or otherwise of [Charles Chan] is also indicated by the way in which he ultimately showed no sense of responsibility for the payment of debts which he had caused [First Strategic] to incur. In his letter of 6 August 2010, he asked for the outstanding accounts so that he could have them paid. But none of them was paid. He sought to explain this in his evidence by saying he felt that he had been "cheated". But that allegation, whatever its content, was apparently directed to the controllers of MMS and not to any other creditor."[30]

Discussion - challenge to those findings

---

27 Reasons at [76].

28 Reasons at [77].

29 Though his Honour did not expressly refer to it, the email from Mr Yeung to Victor Chan on 7 July 2010 raised that very issue: see Reasons at [35].

30 Reasons at [78] and [79].

[55] The appellants' approach in oral argument was to examine a number of steps in the relationship between MMS and its representatives, on the one hand, and First Strategic and its representatives, on the other. The evident purpose of that examination was to attempt to demonstrate that the risks referred to by the learned primary judge, and in particular the risk that MMS may not acquire either the tenements or the shares in First Strategic, were risks which were always present, and that Charles Chan's willingness to fund was not affected by them. It is therefore necessary to review the matters raised.

[56] From as early as September 2009 Joe Phillips discussed the essential nature of the proposed investment with Mr Kwok.[31] It was, in essence, that a newly incorporated company would obtain an option to acquire the Dalla-Costa tenements, and in the process expend A$2.5 million in exploration and production of a resource report. At that point it was proposed that an external investor would supply the A$2.5 million, and in that way earn 40 per cent equity in the new company. Upon establishment of the resource report the investor would then have the option to sell or deal with the tenements through the new company. Mr Kwok was interested, saying that the A$2.5 million funding was not the issue,[32] and in response Joe Phillips expressed the need for prompt action, because of the prospect that the tenement holder might deal with other parties.[33]

[57] By the end of September Joe Phillips was able to retain a solicitor[34] to draft the option and purchase agreement between the new company and Dalla-Costa,[35] and was in a position to assure Dalla-Costa that Mr Kwok's investors had the capacity to complete the initial funding along with the full take-out purchase.[36] Initially the new company was to be the manager of the project,[37] but by 16 October 2009 this had changed so that MMS was proposed as manager.[38]

[58] By 16 October 2009 Joe Phillips was instructing the solicitor to add provisions into the drafting of the option agreement, relating to a put and call option between the new company and MMS, in relation to the acquisition of equity in the new company.[39] Then by the end of October Joe Phillips discussed with Mr Kwok the general nature of the proposal, including suggested prices for the minerals located. More importantly, what was being proposed was that MMS' option for the purchase of the tenements from First Strategic would be excisable "within 60 days from the exercising of the purchase Option" between First Strategic and Dalla-Costa.[40] Further, in the same email, dated 28 October 2009, Joe Phillips described how the proposal "fitted together". That explanation assumed that at a certain point in time MMS shares would be trading at a certain price, with a consequent market capitalisation, that the predicted tonnages of minerals would therefore result in a particular value for First Strategic's option (A$39 million) and MMS' option

---

31 AB 950.
32 AB 953.
33 AB 952.
34 Retained on behalf of First Strategic.
35 AB 954.
36 AB 955.
37 AB 957.
38 AB 964.
39 AB 964.
40 AB 970.

(A$60 million), with the resultant calculation of what percentage of the equity in MMS that First Strategic would end up holding.[41]

[59] What is plain at that point was that several risks were identified quite clearly. The first was the risk that the exploration would establish a particular level of resource. The second was the risk that as a consequence First Strategic would exercise its option to acquire the Dalla-Costa tenements. This was a risk because even though Charles Chan, Victor Chan and Mr Kwok might have thought it a stepping stone to a greater equity position in MMS, nonetheless First Strategic did not have the ability to complete the purchase of the Dalla-Costa tenements absent an arrangement with MMS. The third and obvious risk is that relating to whether MMS would exercise its option to acquire either the tenements or the shares in First Strategic. None of Charles Chan, Victor Chan or Mr Kwok were on the board of MMS, and the option was just that, merely an option. Part of the risk as to MMS' exercising of that option related to what Joe Phillips had identified in his assumptions, when describing how the proposal fitted together. That concerned the MMS share trading price at the relevant time, the market capitalisation, the amount of the resource, and the likely equity to be held by First Strategic as a consequence of both options being completed.

[60] The appellants' contention was that those risks were identified as early as October 2009, and remained the same. So much may be accepted. However, none of those risks comprehended the one which, as will be seen, had greatest impact upon Charles Chan's decision to withdraw funding. That was the risk that MMS would not enter into an option agreement at all.

[61] There can be little doubt that by October 2009 each of First Strategic and MMS were contemplating that the two option agreements would be executed, and that if an appropriate resource was established, some form of development of that resource, or sale of it to a third party, would result.

[62] By early November 2009 the relevant parties had been on a site visit to the Dalla-Costa tenements. Each spoke to the other subsequently in enthusiastic terms about the prospect.[42] Joe and Alan Phillips referred to "the opportunity to share our vision and enthausism (sic) with you on this great project", in response to Charles Chan saying that he wished to "see our project moving forward and seeing a bright future".

[63] On 2 November 2009 Mr Kwok, acting on behalf of Charles Chan, requested the payment schedule from Joe Phillips, saying there was no problem to secure the tenements, and asking for Joe Phillips to commence one of the exploration studies.[43] In response, on 3 November 2009 Joe Phillips dealt with a proposal in respect of his non-contributing 10 per cent interest, which had been raised by him in an earlier email. His response was to emphasise the importance for the whole transaction that the MMS share price be at a certain level: "It is very important for the 317 transaction that the share price is around $3.50 for the call option to work".[44] His point was that if the shares were below that level, then First Strategic would end

---

41 AB 971, 974-976.
42 AB 983.
43 AB 984-985.
44 AB 984.

up with equity at a level where full shareholder approval would be required, and that "may be problematic".

[64] The contingency referred to by Joe Phillips in the email of 3 November 2009 is the one referred to by the learned primary judge in paragraph [74] of the Reasons. Two of the critical factors at the time when MMS might exercise its call option were the then share trading price and the extent of the resource which had been established, as both had a direct influence on the resultant equity that First Strategic would hold in MMS. The appellant correctly makes the point that this contingency or risk was identified early and remained present.

[65] Within a few days of that exchange, the parties were discussing who the directors of First Strategic should be, and whether Dalla-Costa might accept a royalty arrangement, rather than full payment for his tenements.[45] Then, by 9 November Mr Kwok and Joe Phillips were identifying a target date to sign the First Strategic option agreement, namely 1 December 2009.[46] On 10 November Joe Phillips responded to a number of questions raised by Mr Kwok. These included that: the proposed figures per tonne for the ore were commercially sound; the MMS call option was for 90 days with the ability to extend if both parties agreed; the exploration program for the Dalla-Costa tenements was "low risk" because of known resources in the proximity; a management agreement with MMS was being prepared; and unless First Strategic were prepared to do the Dalla-Costa transaction then MMS would have to find an alternative because Joe Phillips did not want to damage the relationship with Dalla-Costa.[47] Joe Phillips ended by saying: "Let us get this simple one over the line so we can focus on the bigger picture".

[66] By 10 November 2009 a draft option agreement had been prepared and was ready for review on the First Strategic's side. The target date for execution of the agreement, 1 December 2009, was agreed, as was the commerciality of the prices for the ore. In relation to the 90 day period for the MMS call option, and the impact of the share price at the time of its exercise, Mr Kwok responded: "We need to discuss, timing is very important".[48]

[67] During November 2009 Joe Phillips retained a solicitor to provide a draft of the MMS option agreement. On 12 November 2009 Joe Phillips provided the then current draft of the First Strategic option asking whether Mr Kwok's lawyers had any input.[49] Joe Phillips noted that he was "accumulating major expense on 317 [the Dalla-Costa tenements] so I am keen to finalise the agreement".

[68] On 19 November 2009 Joe Phillips wrote to Mr Kwok urging completion of the transaction for the Dalla-Costa tenements because of the forecast that Dalla-Costa was running out of patience.[50] He was able to announce that the MMS board had approved the commissioning of First Strategic "to deliver the Development, off-take and funding for the Lake Giles Project". Once again he reminded Mr Kwok that he was incurring "significant expenses on a daily basis. In response Mr Chan's

---

45 AB 989.
46 AB 999-1000.
47 AB 1000.
48 AB 1007.
49 AB 1004.
50 AB 1034.

representative instructed Joe Phillips to proceed with the option agreement, noting that "the funding is available for 317 and MMS".[51]

[69] By 23 November the drafting process in respect of both the First Strategic option agreement and the MMS option agreement was continuing.[52] By November 28, 2009 Joe Phillips was in possession of an option agreement signed by Dalla-Costa.[53] In response to a telephone call from Mr Kwok some points were made about the arrangement, including this statement:

> "MMS on the other side have a Call agreement which, appoints MMS the project managers for FSDC, and allows MMS to acquire the Tenements for $0.15 per tonne for magnetite and $0.40 for haematite. This payment is to be in the form of equity from MMS to FSDC which reliant on the resource delineated could yield 30 to 40% of MMS."[54]

[70] At that point the management agreement with MMS had not been finalised, nor had the draft MMS option agreement been provided. However, the program for development was proceeding, at least in some respects, and discussions took place concerning the need to establish local banking facilities on the part of First Strategic.

[71] Notwithstanding the fact that the MMS option agreement had not been provided by early December 2009, First Strategic and its directors knew that costs were being incurred on the development program. An example is the recognition by Mr Kwok on 4 December 2009, asking Joe Phillips "to furnish me the breakdown for those fees being incurred".[55] Another is the response on 7 December by Joe Phillips, providing a "list of exploration activities currently underway or completed on Tenement 317".[56] That situation continued into January 2010, with Charles Chan's representative requesting an "estimate of expenses/outlays to be incurred by FSDC in the next 3 months, between January 2010 – March 2010".[57] Around 20 January 2010 invoices were provided for some of the costs,[58] and discussions occurred as to payment on behalf of First Strategic.[59]

[72] On 29 January 2010 Mr Kwok pressed for completion of the off-take and option agreements, asking that they be prepared by 12 February for a target signing date of 15 February.[60] As a result the draft MMS option agreement and project management services agreement were provided on 12 February 2010.[61] As the learned primary judge noted, the MMS option agreement was never, in fact, signed.

[73] The exploration expenses continued to accrue, and accounts were sent from time to time to the First Strategic directors.[62]

---

51 AB 1034.
52 AB 1036.
53 AB 1042.
54 AB 1042.
55 AB 1052.
56 AB 1055.
57 AB 1075.
58 AB 1084.
59 AB 1088, 1092, 1094, 1096.
60 AB 1105.
61 AB 1112 and 1113.
62 For example, on 23 February 2010, AB 1117-1122.

[74] On 25 February 2010 Alan Phillips notified Mr Kwok that in respect of the MMS option agreement and management agreement, "MMS has agreed at the Board to execute these Agreement (sic) but we need FSDC approval to the agreements. Can you look into this matter for me?"[63]

[75] Before the MMS option agreement was approved by First Strategic, a new issue intervened. That was the potential dilution of the shareholding held by the Chinese investors in MMS, namely Charles Chan for Continental and Minmetals. An email in that respect was sent on 6 March 2010 by Mr Kwok on behalf of the Chinese investors, to Alan Phillips and Joe Phillips.[64] MMS was proposing an issue of shares and Mr Kwok made these points:

(a) the Chinese shareholders "do not want to dilute their interests";

(b) Minmetals wished to have control of the off-take agreements, and without that "it is hard to convince them to provide such commitments";

(c) the Chinese investors wish to "take up the entire placement 12 million shares, our stand has never changed, since we would be responsible for the fund raising exercise, off-takes and development plan commitments"; and

(d) whilst the Chinese investors would acknowledge the relationship with all shareholders, "we need to face the undoubted fact that without Minmetals commitment thereon, it is very hard to move as what we want to achieve …", and "Minmetals has been patient to cooperate; they don't want to change too much on our game plan".[65]

[76] Alan Phillips responded on 9 March 2010 summarising various points raised by the Chinese and other shareholders. This revealed a difference in direction on the part of the Chinese shareholders from the others. Other shareholders were:

> "confused by the intention of CMML[66] and therefore are very suspicious.– The Shareholders are anticipating a takeover by stealth and have indicated that any actions by the MMS board that results in an inequitable outcome will lead to legal and regulatory review."[67]

[77] By the end of March 2010 exploration was continuing, with Joe Phillips being on site with geologists to review the drill site planning, and other works being performed. The management agreement between MMS and First Strategic had not, at that time, been signed and that was an issue raised by Joe Phillips on 24 March 2010, directly with Charles Chan.[68] Joe Phillips urged that the matter be finalised as soon as possible. The issue was not immediately resolved and on 28 March 2010 Joe Phillips wrote to Charles Chan:

> "Last Wednesday I sent an email seeking instruction for the next round of exploration on E30/317. I have not received this direction. Further more, I have taken responsibility for the exploration delivery in the absence of a completed Management Agreement between MMS and

---

63 AB 1124.
64 AB 1139-1140.
65 AB 1140.
66 A reference to Minmetals.
67 AB 1137.
68 AB 1148.

> FSDC. This agreement was sent to FSDL (sic) in January this year. Both these circumstances are totally untenable."[69]

[78] Joe Phillips went on to make various points about the re-deployment and re-scheduling of the drilling crew and the danger of harming the relationships with Dalla-Costa. In response Charles Chan apologised that "we have overlooked, please go ahead and catch it up immediately, and will get back to you shortly".[70]

[79] Finalisation of the project management agreement then became the focus of attention, with emails and amendments being exchanged through to the end of March 2010. That continued into May 2010. On 19 May 2010 Charles Chan was provided with the form of management agreement that had been submitted to the MMS board for approval.[71] The final version for execution was provided on 24 May 2010.[72]

[80] Before that was finalised, however, it seems that the MMS option agreement was encountering further delay. On 14 April 2010 one of the advisers to Victor Chan and Charles Chan provided a summary in respect of the option agreement as well as both his own comments and another advisor in respect of some aspects concerning the draft. Consideration of those aspects included what would follow if "we want to call a quit",[73] the impact of failing to expend the $2.5 million, and the exposure of Charles Chan in the event that First Strategic breached its contract by failure to expend the $2.5 million.[74] One should not infer from those comments that Charles Chan or Victor Chan, or First Strategic for that matter, were looking for a way out at that point. It is just as likely that the advisors were doing what they should do, namely giving advice on the exposure of those concerned.

[81] Outwardly both parties progressed the development of the Dalla-Costa tenements. Invoices were sent for some of the services provided by CSA Global[75] with Joe Phillips reviewing them and asking for them not to be paid until he had obtained updated invoices. Victor Chan responded to Joe Phillips in respect of an update on the progress saying "Everything is in good progress and we also hope to speed up the project".[76] The appellant points to comments such as that in support of a submission that one could infer that the project was going well, with no reservation about funding on the part of Charles Chan. However, for reasons which will appear that belies what was otherwise occurring.

[82] April 2010 was when the first signs of the breakdown of the relationship between Mr Kwok and Alan and Joe Phillips became evident. The solicitor who had been retained by Joe Phillips, but on behalf of First Strategic, requested an update in respect of the MMS option agreement, by email on 28 April 2010 to the Chief Financial Officer of MMS, and Joe Phillips.[77] The response from the CFO was that "This matter has been placed on hold for the moment following determination of

---

69 AB 1147.
70 AB 1147.
71 AB 1255.
72 AB 1291.
73 AB 1162.
74 AB 1163.
75 AB 1179.
76 AB 1177.
77 AB 1182.

some issues". She was told that "no action is required for the time being".[78] As the learned primary judge noted, the evidence of Alan Phillips was that at this point he would not do business with Mr Kwok, because he had threatened legal proceedings against MMS.[79]

[83] What followed was the period when Alan Phillips and Joe Phillips required that Mr Kwok be removed from First Strategic, both as shareholder and director. Various steps were taken to achieve this, although ultimately he remained on the register as a director.

[84] At the same time, internal advice was being sought by Victor Chan in relation to the exploration schedule and activity proposals for the Dalla-Costa tenements. That included Mr Yeung giving this advice on 4 May 2010:

> "At this stage, it seems it is unlikely that we can control the board of MMS. If the exploration result is promising, my biggest question is how can we convince MMS to take over the project at a favourable price? This project will be too small to stand on its own in such a remote area. MMS knows this. They will surely squeeze us on the acquisition price if and only if they are interested. They have plenty of resources option other than 317. There is no urgency for them to acquire this plot. Without this assurance, it does not make any commercial sense to start the exploration at all."[80]

[85] That email was sent to Victor Chan and some other advisors, but in my view it is reasonable to assume that the advice was passed on to Charles Chan. After all, Victor Chan was the son and right hand man of Charles Chan.

[86] The importance to the MMS side of having Mr Kwok removed from First Strategic was emphasised when Joe Phillips emailed Charles Chan and Victor Chan on 5 May 2010 to tell them that the MMS board had authorised entry into the management agreement "conditional upon MMS's satisfaction that FSDC management and shareholder matters have been resolved".[81] The response from Victor Chan was to say that "it may take some time for all documents to be in place", and that Charles Chan would call Alan Phillips later and "we hope to move forward with the Management Agreement in order to catch up on the lost time."[82]

[87] On 11 May 2010 Charles Chan advised Alan Phillips that he was "in effective control of First Strategic Development Corporation Limited".[83]

[88] Outwardly things progressed at a slow pace. Approval was given by Charles Chan's advisor, Mr Yeung, to engage Orbit Drilling, and at the same time he raised the question of beginning negotiations to get an extension on the option, requesting Joe Phillips to do so.[84] Invoices were sent for the work being carried out, and some payments were made.[85]

---

78 AB 1183.
79 Reasons at [26] and [27].
80 AB 1187.
81 AB 1200.
82 AB 1201.
83 AB 1228.
84 AB 1246.
85 AB 1260, AB 1268.

[89] Mr Yeung's authorisation to engage Orbit Drilling given by email on 2 June 2010, was the subject of a response the same day from Joe Phillips.[86] He also agreed to make contact with Dalla-Costa in relation to obtaining an extension.[87] It was on that day that Orbit Drilling was retained. A copy of their signed quotation was sent on 21 June, internally in Charles Chan's organisation, together with the notation that drilling had already started.[88] The quotation noted the requirement for payment within 14 days from receipt of invoices.[89] Joe Phillips sought confirmation for the drill program to commence in early July, and received that confirmation on 2 July from Mr Yeung.[90]

[90] The review of the material so far brings matters to the point where Charles Chan had decided to suspend the project. I will shortly turn to his oral evidence in that respect. The sequence of events as reflected in the email exchanges is reflected in paragraphs [34] to [37] of the reasons of the learned primary judge:

> "[34] On 8 July 2010, the first defendant emailed Alan Phillips saying that he would be in Brisbane shortly and wished to discuss with him the "317 MMS contract" and the "317 extension with the original mill operator" for the purpose of providing some assurance to the first defendant for him to "move forward". That first contract was an apparent reference to the draft call option to be granted to MMS by the company. The second reference was to a proposed extension of the time for the company to exercise its own call option.
>
> [35] There followed email exchanges between representatives of MMS and the company. There was also correspondence within those on the company's side of the transaction, in which Mr Au Yeung explained that there was a "cash flow consideration" which would result from the interval of time between the required payment to Mr Dalla-Costa and the receipt of payment from MMS. Mr Au Yeung wrote to the second defendant on 7 July 2010 that he had discussed this issue with the first defendant a couple of weeks earlier and had the understanding that "neither [the company] nor MMS have the cash to complete the transaction". Therefore, the first defendant had to negotiate with Mr Dalla-Costa as well as with MMS. Consequently, in late July 2010 there was a visit to the site of the tenements by the first and second defendants and Mr Au Yeung, who were there introduced to Mr Dalla-Costa by Alan Phillips. Also present was a Mr Betts, who represented a company which was proposing to make a takeover offer for MMS. There were discussions about whether Mr Dalla-Costa would extend the option period but no concluded agreement for an extension appears to have been made

---

86 AB 1371.
87 AB 1371.
88 AB 1421.
89 AB 1421.
90 AB 1464.

> [36] By early August the company was being pressured to pay some creditors. On 6 August 2010, the first defendant sent this email to Alan Phillips:
>
> "… I feel uncomfortable with the immediate prospect of the Lake Giles E317 exploration program. I have to request you to suspend the exploration with immediate effect until further notice and until the concerns below are resolved.
>
> I have a few concerns. We have secured the buy option from the tenement owner but we cannot secure the sell option to MMS. This does not make commercial sense for me to proceed further. Given the uncertainty of the dispute regarding [the third defendant] vs MMS, I feel very unsecure [sic] to move forward.
>
> I understand [the company] is responsible for the exploration cost and other expenses accrued so far. Please send me the most up to date account upon suspension. [The company] shall settle the account in due course …"
>
> [37] On 16 August 2010, Alan Phillips replied that as a result of his email of 6 August, MMS as the project manager had suspended all geological activity on the tenements. He said that he would compile a list of outstanding accounts for the company."

[91] The appellants' accepted at trial that Charles Chan's position meant that, even on their own case, First Strategic was insolvent from 6 August 2010.

Oral evidence of Charles Chan

[92] It is evident from the learned primary judge's reasons, in particular paragraph [81], that his finding that Charles Chan did not impress as a credible witness, should not be taken as meaning that there was a wholesale rejection of his evidence. His Honour was careful to say that statements by Charles Chan as to his preparedness to fund First Strategic's activity "have to be assessed against what he did or did not do", and that the assessment of First Strategic's solvency was more accurately undertaken by an objective assessment, rather than reliance on what Charles Chan said was in his mind.

[93] There are aspects of the oral evidence of Charles Chan which, in my view, bear on the resolution of the issues in this appeal.

[94] The evidence established that the source of the funds for the $2.5 million expenditure was Charles Chan's "personal company and personal area".[91] However, there were no formal discussions with anyone about paying that money, nor was any document signed containing a promise to do so.[92] That lack of formality was reflected in Charles Chan's lack of attention to the documentary side

---

91 AB 160.

92 AB 161.

of the arrangements. On a number of occasions he explained that he didn't pay much attention to documents, relying on Victor Chan to do so.[93]

[95] Charles Chan gave evidence-in-chief about why the invoices were not paid. Specifically he was asked what changed after 6 August 2010. His answer was:

> "Well, after I sent that – an email to Aaron to start the project and I keep considering about that a lot of factor. First of all, EK relation with Alan. I mean, Edward Kwok relation with Alan. Why did it deteriorate, because they so many friend. EK had been helping to exploit the project, introduce something that in MMS – I invest more than hundred million Hong Kong in MMS. Why did the relation deteriorate? And why later on, and He don't want to get in – and also, and things are getting fishy and I – and also they dilute our shareholding. And even we talk about he don't have to issue share. He can more price to the company. He issue – I said you issue and we can pay more, you know. I mean – and then I thinking all this in error, I think I might being cheated. I worry about being cheated."[94]

[96] The events being referred to were events well prior to 6 August 2010. The deterioration in the relationship between Mr Kwok and Alan Phillips manifested itself in March 2010. The issue of diluting the shareholding also arose in March 2010. The reference by Charles Chan to "we can pay more" was to the debate about the private share placement and the fact that the Chinese shareholders had expressed a desire to purchase the entire placement. What seems evident from the passage referred to above is that Charles Chan experienced doubts about his dealings with MMS from as early as March or April 2010. That concern was reflected in the expression that he might have been cheated.

[97] He was then asked when that concern first arose. His answer was in these terms:

> "Well, … I always concern a little bit. I still not quite sure because it – I think, you know, I – we have a Chinese party behind. We have been – have a joint venture with Chinese party and already fifty-fifty. And now it's into public, and I think I may still have an opportunity to work and I still try to think of that. And think – so, I mean, I kept thinking about it and why did I – I said and all this scenario, and then I said, Jesus, I better stop that. And then if he – he want to go with that, then he said he would come to us again, then I – I feel then I – am I being cheated.
>
> [And when asked if that feeling was before 6 August 2010]
>
> Well, before I had a little bit but I'm not … I cannot concentrate, think too much. I too many things to getting together. And then as long as it – you know, when I try and look at it, I – then I think more and more, then I send an email stop that."[95]

[98] It is evident from that passage that Charles Chan experienced his concerns about being cheated sometime before 6 August 2010, and the feeling gradually built to the point where he decided he had to stop his involvement. Bearing in mind the

---

93 For example, AB 1591, and in the context of payments, AB 161 and 163.

94 AB 164.

95 AB 164.

expression of concern at the time the 6 August email was sent, namely that there was no commercial sense in proceeding when First Strategic "cannot secure the sell option to MMS", the reservations about being cheated provide a foundation for the conclusion by the learned primary judge that Charles Chan's degree of commitment to the continuation of financial support was low.

[99] Charles Chan's concern over the failure to achieve an executed option agreement between First Strategic and MMS was expressed in this passage of his evidence-in-chief:

> "Well, before I – Victor told me, the one time, he said he may have difficulty to – with the – signing the agreement. Then I … in July some time, I explained the difficulty was the timing, because at that time we are asking for extension for six more months for Delacosta. And after Doug Betts sent a draft to Delacosta, no respond and no news and I called Doug before I send an email to Alan. I said, Doug, where the response for the other side here. Still no response, no news. So I still feel something wrong here."[96]

[100] The significance of achieving the executed form of the option agreement between MMS and First Strategic was also accepted by Charles Chan in his cross-examination. He was questioned on answers he gave in a public examination where he had agreed that he had promised to support First Strategic "but there are other conditions attached".[97] Charles Chan accepted that his evidence at the public examination was that his support of First Strategic was conditional upon MMS agreeing to purchase the exploration rights from First Strategic.[98]

[101] That evidence provides a foundation for the learned primary judge's conclusion[99] that Charles Chan's preparedness to fund First Strategic

> "was qualified by the prospect that, for one or more reasons, the on-sale to MMS and the consequential acquisition of a substantial shareholding in MMS would not eventuate."

It also supports the conclusion that the absence of the MMS option agreement "provided substantial reasons to doubt whether the proposed investment in MMS would proceed".[100]

[102] Charles Chan also emphasised that it was his concerns with the people he was dealing with that were important to him, rather than the risk of expending $2.5 million for no return:

> "Before the tenement for exploration, we assuming or they assuming that there was deposit of iron ore. I think by that time the exploration work already had been started. I think they know they may know something that which we don't know. We don't get any report. So on the other hand, if they know there's something, they can have it for nothing. If we don't know that, of course we don't

---

96 AB 165.
97 AB 177.
98 AB 181.
99 Reasons paragraph [72].
100 Reasons paragraph [73].

> know. We … the maximum risk is two and a half mill for me. So I – I guess in so circumstance I think I've been cheated. And also from day 1, I totally invest more than 100 million Hong Kong dollar to MMS. We will talk about how to exploration end up with 317 tenement. We would talk about how with the Chinese party, how to … How would the Chinese party arrangement infrastructure. And we talk a lot the big picture. And I – and two and a half million for me here, I think about I can afford to risk that. It not a lot of money for me. In this part I don't concern to much about that. I concern about the character of people, how we deal with people, the intention of people, what they think about that. I never thought about two and a half million is so important to me."[101]

[103] That evidence provides some foundation for the learned primary judge's reference to the "fragility of the relationship" between the controllers of MMS and Charles Chan, in particular.[102] It also provides a foundation to conclude that there were qualifications on the willingness to support First Strategic. The feeling that he had been cheated, reflected in Charles Chan's view of the character of the people he was dealing with, thus affected his willingness to continue to support First Strategic in circumstances where there was no option agreement with MMS.

[104] It is true to say, as the appellants argue, that the option being granted to MMS was always simply that, and not a binding sale agreement. It is also true that Charles Chan recognised, from the beginning, that there was a risk that MMS might not purchase the Dalla-Costa tenements, even if the resource was proved.[103] However, neither of those risks affect the considerations referred to above, which are derived from the evidence of Charles Chan, and reflected in the findings of the learned primary judge.

Evidence of Victor Chan

[105] In terms of credibility findings, Victor Chan stands in the same shoes as Charles Chan, as does Mr Kwok. All three participated in the attempts to control the appointment of a favourable liquidator, and for that purpose produced false claims for expenses. However, as with Charles Chan, the learned primary judge's adverse comments about credit do not mean a wholesale rejection of Victor Chan's evidence.

[106] Victor Chan understood at all relevant times Charles Chan's support was conditional upon the MMS option being executed. In cross-examination this exchange occurred:

> "MR MARTIN: So did you understand then that your father was only willing to support First Strategic whilst he thought an option agreement would be signed? --- Do you mind saying that ---
>
> Did you understand---?---Mmm.

---

101 AB 172-173.

102 Reasons at paragraph [76].

103 As Charles Chan acknowledged in cross-examination, at AB 189.

> ---that your father was only willing to support First Strategic and pay money whilst he thought Macarthur Minerals was going to sign this option agreement? --- The understanding was my father was going to invest in the company and support, given that the second option will – will be executed.
>
> All right. And that was your understanding from the beginning, wasn't it? --- Yes."[104]

[107] Victor Chan said that his understanding was always that First Strategic would enter into a "back-to-back option agreement" with MMS.[105] The importance of achieving that agreement was reflected in Victor Chan's evidence that there were discussions **prior to 6 August** between his father and himself, in these terms:

> There was discussion prior to the August 6th. Was my – my father expressed concern about going forward because the second option agreement was never signed. He felt that it was a small part of the entire deal. So by not signing a simple option agreement, he felt that the whole deal will be off."[106]

[108] The conditional nature of Charles Chan's willingness to support, at least as Victor Chan understood it, was reflected in an answer relating to whether Charles Chan was acting honourably in refusing to pay the invoices. As to that Victor Chan said:

> "He's a man of honour and he – he gave what his word is. If the option – second option agreement was to signed, then he would pay up to $2.5 million."[107]

[109] That qualification on the willingness to financially support First Strategic was also understood by others in Charles Chan's organisation. Mr Yeung sent an email to Charles Chan, Victor Chan and others on 29 November 2010 referring to a strategy to be used in the liquidation of First Strategic. One strategy that it was said the liquidator wanted to use was MMS' awareness that "our funding support hinged on the successful execution of the S & P agreement btw MMS and FSDC".[108] Mr Yeung explained that the reference to "S & P" was to the option agreement under which a subsidiary of MMS would acquire the Dalla-Costa tenements from First Strategic.[109]

Evidence of Mr Kwok

[110] Mr Kwok gave evidence as to his understanding of the relationship between the MMS option agreement and the security of the financial support for First Strategic. In the context of Charles Chan funding the project, Charles Chan told Mr Kwok that "there are several conditions that we have to achieve", one of which was the MMS option agreement.[110] Mr Kwok made it clear that he understood it was related to the

---

104 AB 230.
105 AB 232.
106 AB 233.
107 AB 237.
108 Exhibit 10, AB 1895.
109 AB 259-260.
110 AB 282.

funding for the exploration of the Dalla-Costa tenements and he explained it as "the most critical condition" for First Strategic.[111] He went on to explain why it was critical to have the back-to-back option agreement:

> "Number 1, because for the amassment of 317, we need the exit strategy. That mean who will be the buyer. So we assume that at that time is MMS is a party or is conditioned to buy the tenement. So that to protect Mr Charles Chan funding $2.5 million."[112]

[111] Mr Kwok was aware that Charles Chan viewed the MMS option agreement as being very important to the proposal to fund First Strategic. When asked what Charles Chan had said about that aspect of the proposal, and how important it was, the answer was:

> "Of course, because this the only way to back up the Delacosta option agreement, as my knowledge, the A$2.5 million put into the tenement is very risky. Without the MMS buyback agreement, it would be very dangerous."[113]

[112] Mr Kwok himself regarded MMS entering into the option agreement as being important, describing it as "a must".[114] He added that Charles Chan had expressed to him that the entry into the MMS option agreement was important to Charles Chan.

[113] In cross-examination Mr Kwok reiterated that what Charles Chan had told him was that Charles Chan was prepared to support First Strategic on three conditions, one of which was achieving the MMS option agreement.[115] Mr Kwok's understanding was then clarified:

> "Okay, and you told me before lunch that Mr Chan's willingness or his agreement to support First Strategic was conditional upon MacArthur Minerals signing that auction agreement with First Strategic, that's right, isn't it? --- Yes.
>
> Okay. So at any time, Mr Charles Chan could have withdrawn his support for the company, couldn't he, if he didn't think he was going to get his auction[116] agreement with MacArthur Minerals? --- Correct."[117]

[114] The evidence of Victor Chan and Mr Kwok, seen against the objective evidence referred to in paragraphs [105] to [113] above, amply support the learned primary judge's findings about the qualified nature of the financial support being offered by Charles Chan. When put together with the evidence of Charles Chan himself, it provides ample support for the conclusion that the degree of commitment was low, and insufficient to meet the tests in *Williams v Scholz* and *International Cat*.

Reasonable grounds to suspect insolvency?

---

111 AB 290.
112 AB 290.
113 AB 304.
114 AB 305.
115 AB 316.
116 This is an obvious typographical error and should read "option".
117 AB 352.

[115] Furthermore, that evidence also provides an answer to the appellants' challenge to the learned primary judge's findings in respect of whether Victor Chan and Mr Kwok had grounds for suspecting insolvency. Each of them was well aware that Charles Chan's willingness to fund First Strategic depended upon a number of conditions, the most critical of which was achieving an executed option agreement between First Strategic and MMS. Both of them well understood that without that critical factor, the arrangement made no commercial sense, and the expenditure of the A$2.5 million was more than risky. It was therefore open to his Honour to find that each of them knew or should have known of the uncertainties or risks which could have led to funding being withdrawn at any time.

[116] The appellants' approach on these grounds was to point to the confidence that Alan Phillips had, that Charles Chan would continue funding. However, Alan Phillips was not on the inside of the Chan organisation, or had the appreciation that Victor Chan and Mr Kwok did, of the things that mattered to Charles Chan. The learned primary judge's findings in respect of these grounds were amply supported.

Mr Kwok's participation in the management of the company

[117] This ground relies on s 588H(4) of the *Corporations Act* 2001 (Cth) which provides:

> "If the person was a director of the company at the time when the debt was incurred, it is a defence if it is proved that, because of illness, or for some other good reason, he or she did not take part at that time in the management of the company."

[118] The appellant contends that he was not a director, and took no part in the management of First Strategic, after May 2010. That is well ahead of the date many of the outstanding debts were incurred.

[119] The appellant challenges the findings of the learned primary judge in an indirect way. No challenge is mounted to the factual findings which include that Mr Kwok:

(a) in his capacity as a director of First Strategic, signed a notification to be presented to the Australian Securities and Investment Commission, that creditors had resolved on 17 November 2010 that First Strategic should be wound up;[118]

(b) lodged a proof of debt in the winding up of First Strategic, claiming director's fees for a period up to 24 October 2010;[119]

(c) gave evidence at the public examination that he was "aware of his obligations as a director and continued to discharge them for the entire period for which he had claimed a director's fee";[120]

(d) gave evidence at the trial that whilst he had ceased to be a director he continued to be involved in First Strategic affairs as a "consultant";[121]

---

118 Reasons at paragraph [40].
119 Reasons at paragraph [91].
120 Reasons at paragraph [91].
121 Reasons at paragraph [91].

(e) wrote a letter to the liquidators on 4 January 2011, setting out the services which he said he had provided in his capacity as a director, but which made no reference to his ceasing as a director or ceasing to act as one;[122] and further agreed in cross-examination that the letter to the liquidator accurately described what he had done.

[120] Instead the appellants' argument again pointed to the evidence of Alan Phillips, to the effect that Mr Kwok was sidelined as a director in April or May 2010. The appellant then says that there is no evidence of his involvement after that.

[121] The submission faces the difficulty that Alan Phillips was not inside First Strategic's organisation. His evidence therefore is quite limited in terms of providing any support that would enable Mr Kwok to succeed in proving the defence. As the learned primary judge held, the onus of proving the defence rested on Mr Kwok. His evidence that he was not involved was rejected[123] and his Honour relied upon the evidence referred to above in paragraph [119] to conclude that the defence was not made out. No sound basis has been demonstrated for doubting that finding, and no evidence has been pointed to which would suggest that his Honour's findings should be set aside.

Conclusion

[122] The learned primary judge's findings in respect of the solvency of First Strategic were open to him, and supported by the evidence. Furthermore, each of Victor Chan and Mr Kwok were well aware of the very factors that qualified Charles Chan's willingness to provide financial support to First Strategic, such that the findings by the learned primary judge in respect of those challenges were open to him, and supported on the evidence. Further, it has not been demonstrated that the findings in respect of Mr Kwok's defence under s 588H(4) of the *Corporations Act* 2001 (Cth) should be set aside.

[123] As all grounds have failed, I would dismiss the appeal. There is no reason why costs should not follow the event. The orders I propose are:

1. appeal dismissed;

2. the appellants are to pay the respondents' costs of and incidental to the appeal, to be assessed on the standard basis.

[124] **BODDICE J:** I have read the reasons of Morrison JA. I agree with those reasons and proposed orders.

---

122 Reasons at paragraph [92].

123 Reasons at paragraph [94].