DISTRICT COURT OF QUEENSLAND

CITATION:	*Deputy Commissioner of Taxation v. Ruddy* [2001] QDC 028
PARTIES:	**DEPUTY COMMISSIONER OF TAXATION (Plaintiff)** **v.** **MARK HARRY RUDDY (Defendant)**
FILE NO/S:	Plaint 2234 of 1997
DIVISION:	
PROCEEDING:	Trial
ORIGINATING COURT:	District Court Brisbane
DELIVERED ON:	2 March 2001
DELIVERED AT:	Brisbane
HEARING DATE:	29, 30 November, 1 December 2000
JUDGE:	McGill DCJ
ORDER:	**Claim dismissed with costs**
CATCHWORDS:	CORPORATIONS LAW – directors' liability – unremitted group tax – company failed to comply with agreement to pay – whether director personally liable – *Income Tax Assessment Act 1936* (C'wth) ss. 222AQA, 222AQD. INCOME TAX – group tax – failure by employer company to remit – failure to comply with agreement to pay – whether director personally liable – *Income Tax Assessment Act 1936* (C'wth) ss. 222AQA, 222AQD
COUNSEL:	P. G. Bickford for the plaintiff D.L.K. Atkinson for the defendant
SOLICITORS:	Australian Government Solicitor for the plaintiff Kinneally Mahoney for the defendant

[1] At all material times the defendant was a director of a company Grand Orbit Pty Ltd ("the company") which for a time operated a restaurant and night club in Brisbane ("Grand Orbit"). The company did not pay the plaintiff, as required by s.221F(5) of the *Income Tax Assessment Act* 1936 (Cth) ("the Act") all of the amounts deducted pursuant to s.221C(1A) of the Act from the salary or wages of employees, an amount conveniently referred to as group tax, for the months of August, September and October 1996[1]. On 5 February 1997, the plaintiff entered

---

[1] Part of the group tax for August was paid: Exhibit 1, Doc. 37. The rest of August, September and October group tax were not paid (and see Doc. 45).

into an agreement in writing with the company pursuant to s.222ALA of the Act to pay the balance of the group tax for those months, and that for January 1997, a total of $106,910.82, to the plaintiff on 10 May 1997. Those amounts were not paid by the company on that date, and have not been paid subsequently.

[2] It follows that prima facie the defendant is liable to pay the amount required to be paid by the company pursuant to s.222AQA of the Act. That section provides as follows:

> "(1) If a company incorporated under the Corporations Law of a State or Territory makes an agreement with the Commissioner under s.222ALA of this Act, the persons who are directors of the company from time to time must cause the company to comply with the agreement.
>
> (2) If the company contravenes the agreement by failing to pay a specified amount on or before the specified day, or by contravening a special condition, each person who was a director of the company at any time during the period beginning on the day that the agreement was made and ending on the day of the contravention is liable to pay to the Commissioner, by way of penalty, an amount equal to the balance payable under the agreement."

[3] The defendant was a director of the company during the specified period, indeed during the whole of that period, and the company failed to pay the amount payable by the company pursuant to that agreement in accordance with the terms of that agreement, so the defendant is prima facie liable to pay to the plaintiff by way of penalty an amount equal to the balance payable under the agreement.

[4] There is on the pleadings some dispute as to whether the agreement under s.222ALA was validly made, but reliance on this matter was abandoned by counsel for the defendant at the trial: p.234. But the liability under s.222AQA(2) is not absolute; statutory defences are provided in s.222AQD of the Act, the relevant parts of which are as follows:

> "(3) It is also a defence if it is proved that:
>
> (a) the person took all reasonable steps to ensure that the company complied with the agreement; or
>
> (b) there were no such steps that the person could have taken.
>
> (4) In subsection (3), "reasonable" means reasonable having regard to:
>
> (a) when, and for how long, the person was a director and took part in the management of the company; and
> (b) all other relevant circumstances.

(5) If the person was a director of the company at the time when the agreement was made, he or she is not entitled to rely on a defence under subsection (2) or (3) unless it is also proved that, at the time, the person had reasonable grounds to expect, and did expect, that the company would comply with the agreement."

[5] It was submitted on behalf of the defendant that, at the time the company entered the agreement, the defendant had reasonable grounds to expect and did expect that the company would comply with the agreement, and that subsequent to the making of the agreement the defendant took all reasonable steps to ensure that the company complied with the agreement. The defendant is liable unless the statutory defence is made out. This is a matter on which the defendant carries the onus of proof. For this reason at the trial the defendant started.

Background

[6] The company took a lease of certain premises which were established as a restaurant and night club opening in about March 1995: p.58. The company was financed by money lent through a unit trust of which another company, Haysara Pty Ltd, was trustee: p.35, Exhibit 1, Doc. 6. The defendant, and other members of his family, invested money in the unit trust, acquiring 20% of the units: Exhibit 2, para. 1-5. Apart from money provided by the unit holders, some money was borrowed from the lessor to fund the fit out (p.47); as a result the company was liable to pay the lessor $9,181.87 in repayment of that loan each month, as well as rent and outgoings.

[7] During the period to 30 June 1995 sales totalled in excess of $2 million, and turnover for this period (assuming the business commenced on 16 March 1995) averaged $132,677 per week: Doc. 10[2]. Gross profit from trading for the period was $624,232.01, or an average per week of $40,838. However, after deducting expenses a net loss of $129,413.07 was produced. This was an amount only slightly more of the amount spent on marketing and promotion, which might have been unusually high because of the extra cost of establishing the business. Some of the expenses did not impact on cash flow, namely depreciation and amortisation, which together came to $44,421. The business was soon employing 120 staff: p.58. It was doing well in terms of building turnover but it was operating at a significant loss. In technical terms it was probably insolvent (p.202), but in spite of this it continued to trade for over 20 months.

[8] In the 1995-96 financial year sales were about $6 million, with turnover averaging $118,000 per week: Exhibit 1, Doc MHR 11. Gross profit from trading was $2,139,935.57, or an average per week of $41,152.61. The business was therefore becoming more efficient, gross profit going from 31% to 35% of sales revenue, but it still showed a substantial loss after expenses of $402,101. That included an

---

2 References are to documents by number in the bundle of documents which became Exhibit 1 by consent: p.14.

abnormal item of almost $200,000 which was the loss incurred on one particular function. However, these accounts were kept on an accruals basis: p.158. For example, the figure for rent apparently includes an amount claimed by AMP as additional rent as a percentage of turnover, which had not been paid: p.157. Because of this, and because the profit and loss account includes figures for depreciation and amortisation, the profit and loss account does not give a proper basis for a cash flow analysis during that year: p.158.

[9] Unfortunately, on 29 June 1996 a security guard employed at Grand Orbit was shot and killed as he opened a back door to the premises: p.37. This caused a drop in sales, as appears from the graph, Doc.13, prepared by Mr. Portway (p.159) the financial controller of the business: p.153. That graph suggests that during most of 1995 the turnover figures per week were around $140,000, but that during the first six months of 1996, they were fluctuating around $100,000. July, August, September and October were significantly lower, with July and August around $70,000 and September/October not much more than $50,000, but by November business had picked up again to about $80,000.

[10] The company had some insurance cover against business losses from such an event, and ultimately received a payment under that policy of $600,000 (para. 62); some of this was spent on refurbishment and marketing, and this may have been the cause of the increase in turnover in November and December 1996, coupled with the fact that, as the graph shows and as one would expect, this is a period of relatively high seasonal turnover. Some of the proceeds of the insurance claim, about $360,000 (p.79) was spent on paying creditors of the business, although the defendant now cannot trace just who was paid: p.80.

The Involvement With Delaware North

[11] Following the settlement of the insurance claim, the investors in the company decided that the business would be sold by tender: para. 68[3]. That was done with the assistance of some brokers, auctioneers and valuers, and the advertisements for the business came to the attention of a Mr. Joyce who was employed then as a business development manager by a company Delaware North (Australia) Pty Ltd ("Delaware North") (p.98), a subsidiary of an American company which operated a business providing food service and catering at a wide range of venues: p.102. Mr. Joyce had been briefly involved in setting up Grand Orbit prior to his joining Delaware North, so he was familiar with the business and he was very impressed with it: p.98. He therefore drew the offer to the attention of his superiors, and was instructed to look into it: p.100. He obtained figures for the business (p.110), and prepared a "fact sheet" for his superiors (Exhibit 6) giving an assessment of the business in which he spoke positively of Grand Orbit, but was critical of the management:

---

[3] References are to paragraphs in the affidavit of the defendant filed on 29 January 1998 which became Exhibit 2.

> "The owners of this business were not at all professional, they partied hard and the business paid for it. The business has not been well managed. The Grand Orbit had excellent business, but the current directors and management had difficulty in controlling costs and expenses."

He also suggested that revenue was being understated. It is unnecessary for me to determine whether any of this was accurate, but if that was his view it could explain a belief on his part that the business could be made profitable by Delaware North, which knew what it was doing. The report included some calculations which show that if expenses were handled differently and reduced, the business would have produced a net profit of almost 14% of sales.

[12] In the light of this Delaware North management was sufficiently interested in the business to allow Mr. Joyce to put together a "presentation": Doc. 25. Although a lot of this would have involved standard Delaware North material, some of it was tailored to suit Grand Orbit: p.103. I accept that Mr. Joyce had approval from his superiors to send this document (p.106) and that this approval shows that there was some genuine interest on the part of Delaware North management in this business. What was proposed was not an acquisition of the business but a "partnership approach" under which Delaware North would manage the business for a designated term and then it could be sold with Delaware North having a right of first refusal. The defendant and the other directors regarded the response from Delaware North as being the most attractive of the various responses to the request for tenders: para. 76.

[13] After further negotiations, Mr. Joyce wrote on 29 November 1996, enclosing a document which set out the essential elements of the deal which was the product of the negotiations up to that point: p.112, Doc. 26. This involved Delaware North managing the business for a period in return for a fee of $200,000 per annum plus a percentage of gross operating profit, a percentage of net profit, and a percentage of sales if turnover exceeded a particular level. In return, Delaware North would provide $200,000 "key money" repayable over 3 years. With this letter was an analysis for a hypothetical year setting out results which if achieved would enable the business to cover all those costs, and pay some money to the directors by way of repayment of monies that they had advanced to the business, and still return a profit of almost $500,000 for the full year. These figures assume an average weekly turnover of just over $106,000. They were provided to the defendant: p.41. The arrangement of expenses is different from that used in the profit and loss account by the business, so it is difficult to identify just what was to be changed by Delaware North in order to turn a substantial profit at that level of turnover. No attention was directed to that issue at the trial, nor was it suggested that the defendant should have regarded these figures as obviously unrealistic. There was no evidence from Mr. Walters, the former director of finance of Delaware North (p.163) who was called as a witness by the plaintiff, that these figures were in fact unrealistic for that level of turnover. These figures would have encouraged a belief that once Delaware North took over the business would pay its way: p.92.

[14] Mr. Joyce said that he believed at the time that Delaware North could have improved the business by bringing in additional special events, by cutting the cost of sales dramatically through better control and better terms with suppliers, and by reducing labour costs: p.113. He expressed the opinion that some of the staff were overpaid: p.114. It seems to me that this letter is really just recording where the parties have reached in their negotiations, and does not represent a position to which Delaware North was committed; I accept that there had not been a formal corporate approval for a deal in those terms: p.176. Nevertheless, I accept that Mr. Joyce's superiors were well aware of what he was doing, and at least he was not told to stop doing it.

[15] The "basis of the deal" was not entirely satisfactory to Grand Orbit, as appears from a letter the defendant wrote in response on 3 December 1996: Doc. 27. This sought a somewhat more modest management fee, and also payment by Delaware North at the beginning of the contract of $300,000, half of which was to be non-refundable. Mr. Joyce passed this on to his superiors, and reworked the figures: p.114. There were then some further negotiations with further letters sent on 17 December 1996, though the amount of the investment proposed from Delaware North did not change: Doc. 28. Mr. Joyce asked the defendant to put together a "heads of agreement" document, which resulted in a further letter from Grand Orbit on 3 Jan 1997: Doc. 29, p.114. This also provided for payments from Delaware North totalling $300,000 at the commencement of the business.

[16] No doubt one of the reasons why the defendant was keen for Delaware North to put money into the business at the beginning of its management period was that during the latter part of 1996 the financial position of the business seems to have deteriorated. Mr. Portway prepared a set of accounts which covered the month to 29 December 1996, including financial year to date figures: Doc. 20. The defendant saw these figures during January: p.40. These show weekly average total sales for the six months of $63,763, although the average for December was $101,430. Gross profit from sales for 26 weeks was an average of $11,320.25, or 18% of sales, so that the business was actually becoming less efficient. In December this was $28,424, or 28% of sales. For the six months a net loss of $106,282.62 had been achieved, taking into account the insurance payment; for December alone there was a net loss of $47,839.74. Again, however, the accounts were prepared on an accruals basis, and some of the expenses listed there were not paid. For example, interest to investors was accrued and not paid (p.161) and the payment by way of superannuation was accrued together with some group tax.

[17] One of the features of the operation of the business in the second half of 1996 was that the August payment of group tax was only partly made (Doc. 37) and the September and October payments were not made at all. As well as this there were substantial rental arrears; as at 13 December 1996, AMP was claiming arrears in excess of $350,000, although this included an amount of turnover rent which was disputed: Doc. 41. On that day it offered to write off the bulk of the arrears provided that a payment of $100,000 was received on the first business day following 1 February 1997, an arrangement which had been sought by the company (para 95) and was accepted by Grand Orbit: Doc. 42. There were also arrears in

the monthly loan repayments, which AMP agreed to extend for seven months. This arrangement was entered into in the light of progress with the negotiations with Delaware North, and obviously it was expected that the sum of $100,000 would be paid from money made available by Delaware North. Apart from this, various trade creditors had negotiated repayment schedules with Mr. Portway: p.161. In January 1997 payments due to AMP were not made: p.90.

[18] Later in January, apparently on 22 January 1997 (Doc. 49), the defendant and another director met in Melbourne with the executives from Delaware North. At that meeting they were told that Delaware North was not then willing to enter into a long term arrangement which had been discussed with Mr. Joyce: p.137. Nevertheless, the company did, on 4 February 1997, enter into a management agreement with AFS Catering Pty Ltd (a subsidiary of Delaware North: p.174), but for a term of only 3 months: Doc. 43. There was some difference in the evidence as to whether this agreement was negotiated in the meeting at Melbourne. Both the defendant (para. 87) and Mr. Joyce (p.117, p.136) said that it was discussed at that time. On the other hand, Mr. Walters, who was then the director of finance for Delaware North (p.163) and who was also present, said that this agreement was not discussed at the Melbourne meeting: p.190, 193. On this point I prefer the evidence of the defendant and Mr. Joyce. Mr. Joyce was not challenged on this in cross-examination, and it is consistent with his memo on 28 January 1997: Exhibit 7. The defendant referred to this meeting as the time when the three month management agreement was raised in his letter of 5 February 1997: Doc 49.

[19] I think it likely that Delaware North would have worked out what it wanted to do, which was to enter into a three month agreement and see what happened with the business, before it met with the directors of the company. Generally in relation to the Melbourne meeting I prefer the evidence of Mr. Joyce. Mr. Walters was vague about just when that proposal was raised, and his evidence about that meeting was at odds with that of the other two witnesses. It is also apparent that he personally was a lot less enthusiastic about the idea of some sort of long term deal with Grand Orbit than was Mr. Joyce: p.177. His position then was that the business was not worth going into and he did not think that it would ever be worth going into: p.191. Mr. Joyce, on the other hand, was quite enthusiastic about Delaware North doing a deal with Grand Orbit, and obviously spent a lot of his time and devoted a lot of his attention to the matter in November and December and January, prior to the three month management agreement being put in place. Mr. Walters acknowledged the enthusiasm of Mr. Joyce: p.180. I think it is unlikely that Delaware North would have taken as much interest as they did in the business, to the point of allowing Mr. Joyce to devote so much of his time to it, and entering into the three month management agreement, unless they were seriously interested in some sort of long term arrangement.

[20] Although a management fee of $4,000 per week was to be paid under the three month agreement, this was merely intended to make a small profit after paying Mr. Joyce's travel and accommodation expenses, (he flew up each week: p.120) on the

basis that all the other costs involved would be "overhead" : p.184[4]. But even though the salary of Mr. Joyce and the cost of other Delaware North people involved would have been met anyway by that company, in my opinion that company was not making those resources available for the management of Grand Orbit simply for the sake of $4,000 per week. That was, I suspect, a low fee for the full benefit of the management expertise of Delaware North. In addition, one of the recitals of the management agreement (Doc. 30) refers to evaluating the viability and desirability of the continued management of the business for a longer term. This was not the sort of agreement that Delaware North entered into very often: p.191. In my opinion, what happened is that Delaware North was not happy about the business in its current state, under the control of the existing management, but was interested in seeing whether, if Delaware North were managing it, its financial position could be turned around, so that it would be worthwhile to enter into a long term arrangement under which some money would be put in at the outset.

[21] Even if the upper management of Delaware North was not optimistic about the prospect of this working (p.191), what is of more importance for present purposes is what would have been conveyed to the defendant. Mr. Joyce was certainly enthusiastic and positive about a long term arrangement being made, and he was the person on behalf of Delaware North who had the most contact with the defendant. Apart from that, it would not have made sense for the more senior people to have presented this management agreement to the defendant other than in reasonably optimistic terms; they would not have been trying to give the impression that their objective was simply to extract $52,000 from a dying company. I think it much more likely that they would have spoken positively in terms of the deal going ahead *if* the figures could be turned around sufficiently to justify it. If that had occurred there was no reason why Delaware North would not have been prepared to do the deal, and I accept that this was said to Mr. Ruddy at the meeting in Melbourne: p.151.

[22] I also accept that Mr. Joyce communicated his enthusiasm for the business, and for his own ability to turn the figures around in this way, to Mr. Ruddy: p.139. In these circumstances Mr. Ruddy would have been reasonably left with the impression that the three month agreement was simply something which postponed the commencement of the long term arrangement: p.56. Clearly there was no formal commitment to a long term arrangement at that stage, but if he believed in Mr. Joyce's ability to turn the business around (as he did: p.86), it is quite plausible that he could expect that in due course the long term arrangement would be made.

[23] Once this management agreement had been discussed (indeed apparently before it was even signed), Mr. Joyce took over as the manager of the business (p.87), and arranged for other Delaware North people to be involved: p.118. The national training manager conducted various training courses for staff of the business (Doc. 31), the purchasing director spoke to suppliers and gave them a good deal of comfort, and other people from Delaware North were involved: p.118. It brought a large function to Grand Orbit (p.141) in February when there was a launch of Super

---

4 It was to leave a profit after paying marginal cost, but would not have covered fully allocated costs.

League there, which a number of executives attended, a successful function producing favourable coverage: p.121. In addition, Mr. Joyce put off some staff (p.119) and made a number of other changes to improve the financial position of the business: p.124. He also made contact with AMP representatives, and although they made no promises, he was left with the impression that they were reassuring about the business: p. 127, p.151 and see p.243.

[24] There was a meeting at which the defendant told AMP that the company was not able to make the payment of $100,000 in early February, and they were asked to wait three months until a long term arrangement was in place: p.240, 242 and see Doc. 35. I accept that there was no formal commitment to do so, but AMP was in a difficult position as well; they had this space which was difficult to let (p.247), and if Grand Orbit went they were not going to get rent from the space anyway, at least for a time, so from a practical point of view it was in their interest to be patient with Grand Orbit and hope for the best. That was what they did p.246. I accept that what they then said and did gave rise to a reasonable inference in that context that that was what they were going to do.

Payment Agreement For Group Tax

[25] During January, the Australian Taxation Office wrote to the defendant (on 22 January) imposing a penalty on him under s.222AOE of the Act because of the failure of the company to pay the August, September and December deductions. However, the covering letter pointed out that the penalty would be remitted if, among other things, an agreement to pay the liability was in force with the company. The defendant, by a letter 5 February 1997 but sent on 4 February (para. 114) proposed that Grand Orbit enter into an agreement under s.222ALA of the Act under which the amount outstanding would be paid partly on 10 May and partly on 10 July 1997, with future liability to be kept current. There was then a meeting with the Office, as a result of which the payment agreement was entered into; it provided for payment of the arrears, and the amount for January, on 10 May 1997.

[26] Before the defendant signed this agreement on behalf of the company, he discussed with Mr. Portway the financial position of the company, and its ability to honour that agreement: p.195. Mr. Portway was the person who dealt with the trade creditors: p.34, p.162. According to Mr. Portway, he told the defendant that he felt he had the creditors in a situation where he could continue to trade with them, and keep them reasonably happy, and the company could fund the payments to the Tax Office and to AMP from the $300,000 from Delaware North: p.195. He also expressed confidence that the business would be able to continue with the benefit of Mr. Joyce's enthusiasm and Delaware North's management expertise: p.196. By this time Mr. Joyce was running the business and bustling about, various other people from Delaware North had been brought in to advise, and the defendant knew about the forthcoming Super League function which was new business brought by Delaware North. At that stage however there had been insufficient time to see just how effective this change of management would be.

[27] There are some figures for the business for February 1997 in document 58 (p.69), although I am a little wary about these figures because parts of them are difficult to follow and the classification of the expenses is not clear; the difference between "overheads" and "non-controllables" for example. At face value they suggest that there was one good week, 23 February 1997, where turnover exceeded $70,000, but the following three weeks turnover steadily declined to under $40,000. The labour costs actually rose then fell again, but they were nevertheless significantly lower than the weekly average during December which I have derived from document 20, about $33,500. Nevertheless throughout the period these figures show that the business made a loss, and if that part of the document is correct, Mr. Joyce's efforts were in fact ultimately unsuccessful.

[28] However, it is not known what would have happened if the management agreement had run its course. Further law and order problems intervened. In late February 1997 there was an account published in a newspaper of a woman having been murdered in the early hours of the morning after leaving City Rowers Nightclub, with her body being found in the river. Then on the evening of 13 March 1997, there was another incident at City Rowers resulting in the murder of a security officer: para. 127. City Rowers Nightclub was only a short distance from Grand Orbit, and part of the same building complex, and these incidents, particularly the second, received considerable attention from the press: Doc. 46, Exhibit 9. They contributed to a very substantial reduction in the turnover of Grand Orbit: p.32, p.230. Mr. Joyce estimated that the effect of the second murder was that the business went down to 20% of its former level: p.130. There was a really quiet weekend immediately after the murder, and when trade on the following Wednesday night was also very quiet, it appeared that the business was not going to survive: p.95, p.130.

[29] The defendant was also influenced by a consideration that he had at about that time seen the details of the letter of 5 February 1997 from the Australian Taxation Office (Doc 44) and realised that he could have personal liability for the company's debt if the agreement was not honoured: para. 131. He concluded that the appropriate course was to place the company in voluntary administration: para. 152. He spoke to Mr. Stevenson, an accountant (p.32), and on 24 March 1997 the company was placed in voluntary administration: para. 137. The business closed on 16 April 1997: Doc. 56.

Arguments On Behalf of the Plaintiff

[30] It was submitted on behalf of the plaintiff that s.222AQD(5) had both an objective and subjective requirement: the defendant must prove that he honestly believed the company would comply with the agreement and that he had objectively reasonable grounds for that expectation. I agree that both are required. As to what is required by way of an expectation that the company would comply with the agreement, in my opinion the test required is that the director should expect that the company would comply with the agreement, rather than expecting that it would not. In circumstances where the agreement is one requiring something to be done at a

future date, and one requiring it to be done by a company which has already failed to make payments required to be made under the Act, a circumstance suggesting of some financial difficulty, clearly the legislature must have contemplated that at the time when an agreement was made two possible outcomes were open: the company might comply with the agreement or the company might not do so. The wording of the section suggests that the intention of the legislature was that, faced with that choice, the director must have the expectation that it will be the former rather than the latter which will ultimately occur.

[31] The test does not require certainty of compliance. If there are two possible outcomes, there are three possible states of mind of the director; he might expect compliance, expect non-compliance or not have any expectation as to what will occur. I do not think the section is concerned with probabilities, much less a subjective assessment of probability at the time; if a director was not sufficiently confident in the outcome to expect that the agreement would be complied with (not *might* be complied with) then the test would not be satisfied. The evidence of the defendant was that he did expect that the company would comply with the agreement, because he believed that a long term arrangement with Delaware North, under which that company would provide sufficient funds to pay this amount, would come into existence by early May 1997: Exhibit 2, para. 122, 91. There was no other available source of outside funds: p.35. Although he expected the company to become profitable under Delaware North management, he did not expect that it would be able to pay this amount just from those profits.

[32] I think it is significant that there was no suggestion that, if there were a long term agreement with Delaware North, it would be on terms other than those which had been negotiated by Mr. Joyce: p.56. Logically, the deal would have been more attractive for Delaware North if it did not put in $300,000 at the beginning, but no doubt everyone recognised that if the business was to survive the money had to be put in, in order to prevent either the Tax Office or AMP from closing it down. Any long term contract therefore had to be one under which Delaware North would provide the necessary rescue funds. There would have been no point in signing up to manage a business which was about to be closed down by the plaintiff.

[33] If a deal with Delaware North incorporating such a rescue package were not a serious prospect, it would have made sense for the company to try again to sell the business, and to cut its losses that way. That would be a better course than allowing the landlord to terminate the lease, or allowing the plaintiff to wind up the company. There was evidence that there were other potential purchasers interested at the time when tenders were called (para. 76, Docs. 23, 24), and even though they were seen as much less attractive than Delaware North, there were alternatives. I think it is of some significance that there was no suggestion that the defendant and the other directors of the company made any attempt to look for some alternative course if, for some reason, a deal with Delaware North did not eventuate. In that situation, they plainly could not have carried on the company indefinitely; all they could do was sell the business for what they could get, and pay the debts as far as the sale proceeds would go. That was not an attractive proposition, but it would have been better than just letting the company collapse. Yet it was not even

suggested in cross-examination to the defendant that he took any steps to pursue any potential purchaser so that the business could be sold (as a going concern) if the deal with Delaware North fell through.

[34] Once the business collapsed in March 1997 of course there was neither time to organise a sale nor much of a business left to sell, but that was not the situation in January. If the defendant had not expected that the deal with Delaware North would materialise in due course, I would certainly have expected him to be pursuing some alternative potential purchaser, as a fall back position. There was no evidence, and it was not suggested, that he did so.

[35] It was submitted that I should not accept the defendant's evidence about these matters, and reference was made to some aspects of his evidence where it was alleged that he was evasive. I do not think that in general he was evasive in his evidence, although there were occasions when I thought that answers were not quite accurate, or were incomplete. This may have been simply a product of the difficulty of keeping track of all of the details of what is overall a fairly complex matter, and one which in significant parts was not well documented. Overall, my impression of the defendant is not that he was dishonest or particularly unreliable in his evidence. It may be that in his letter to the Taxation Office of 5 January 1997 he was in some respects overstating the position, particularly in relation to his dealings with AMP.

[36] I accept that AMP did not, after the letter of 13 December 1996, actually enter into an agreement with Grand Orbit about anything, but for practical purposes I think the position is much the same as if it had. I do not doubt that if things had gone on as they had been going on, except that the business was knocked into shape by Mr. Joyce during that three month period, and AMP had been kept informed about this, it would have held off to see whether there was going to be an agreement with Delaware North under which money would become available to pay off some of the arrears. AMP's interest was in getting its money, and it would have been alive to the commercial reality that closing down Grand Orbit was not going to produce one cent of its rent, for which it was unsecured: p.260. For that reason AMP had a very strong incentive to be as co-operative with Delaware North as it could. On the whole I am prepared to accept his evidence and find that the defendant did expect that Grand Orbit would comply with the agreement.

Were There Reasonable Grounds To Expect?

[37] Ultimately an issue as to the scope of this test went away; it was common ground (in my opinion correctly) that this is assessed on the basis of what a reasonable person in the position of the defendant would or ought to have known at the time. It was submitted that the defendant did not have reasonable grounds to expect this, for a number of reasons. It was submitted that the company had always been technically insolvent since it commenced to trade, which may well be right, but as I have mentioned earlier it had managed to continue to trade for over 20 months in spite of this, so that in itself was not necessarily a reason why it would be unable to

comply with the agreement. It is not unusual for a business to survive on the credit extended by its suppliers; p.258. It had no bank overdraft: p.83. If Delaware North had taken over the management of this business and paid $300,000 so the debt to the Taxation Office could have been paid, whether or not the company was otherwise insolvent would not have mattered. In my opinion, whether the company was insolvent, or indeed whether it had been up until then trading at a loss, is not of great significance[5] although it is not irrelevant. For that reason evidence on this point is admissible – see p.18.

[38] What mattered was whether the company would (a) survive for the three month period and (b) at the end of that period enter into the agreement with Delaware North. The latter of course required rather more than survival for the three month period, but that is mixed up with the question of whether there were reasonable grounds to expect that that agreement would come about. Apart from that consideration, the defendant had the benefit of the advice from Mr. Portway that he believed the company could be kept afloat through the three month period, apart from any improvements which Delaware North might produce in the financial position of the company. Indeed, what ultimately happened with the business is of some significance; it did not just collapse under the weight of debts, but rather its turnover collapsed because of specific new problems which occurred by chance.

[39] It was submitted that Grand Orbit had not been paying rent and outgoings since July 1996. It had not been paying much (p.246) as shown by the arrears referred to in Doc. 33, although those arrears include $115,000 as turnover rent: p.245. That amount and a further $136,583.37 were written off by AMP in December 1996, and as a result credit notes were sent to Grand Orbit: p.36, p.239. One of these is Exhibit 3. Under the agreement set out in the letter of 13 December 1996 (Doc. 33) this was conditional on the payment of $100,000 being received in February 1997, and these credit notes may not ultimately have had any effect, but the fact that they were issued would have encouraged a belief that AMP was going to be co-operative. Although that agreement was dishonoured by a failure to pay on 3 February 1997, Mr. Joyce and Mr. Ruddy met with the representatives of AMP and, as I have said, were left with the (in my opinion correct) understand that AMP was willing to wait and see what happened: p.50. Given the commercial reality, they had every reason to expect that AMP would not take any action unless it appeared that nothing was to come of the proposed deal with Delaware North.

[40] Overall, it seems to me that, although the financial position of the company was not good in early February 1997, it had really been in that state for about seven months, and there was no particular reason to think that it was going to collapse prior to May 1997. Of greater importance, in my opinion, is whether the defendant had reasonable grounds to expect that a long term deal with Delaware North would emerge.

---

5 For this reason I have not discussed the status of the various investors loans, about which there was a lot of evidence; I regard them as of no significance to the real issues.

[41] I accept that Mr. Joyce never had authority to enter into a binding agreement on behalf of Delaware North, and that the defendant knew this: p.133. I also accept that on 22 January 1997 the defendant knew that Delaware North was not then prepared to enter into a long term agreement under which it made a large payment "up front". However, in my opinion, the true position of Delaware North at that stage was that it was interested in entering such an agreement provided that the business could be turned around to the point where such a move was worthwhile for it. Mr. Joyce believed that that could be done (p.149) and said so to the defendant: p. 139. He was enthusiastic about the prospects of the business, and he certainly expected that a long term deal would be done, and I accept that he said as much to the defendant, probably (from my assessment of Mr. Joyce in the witness box) fairly frequently. He believed that Delaware North would take on Grand Orbit, and in the past none of his recommendations had been rejected: p.104. To the extent that wiser heads within the Delaware North organisation had a more realistic appreciation of the business, I find that that was not being actively communicated to the defendant. There was no reason for Delaware North to do so, and I am not persuaded that it did. Mr. Walters did not say that he ever gave the defendant the benefit of his views about the subject, and in the circumstances I think it unlikely that he would have done so; as I pointed out earlier, Delaware North had no reason to be negative to the Grand Orbit people in case a deal did eventuate. If this business could be turned around, they did not want Grand Orbit to go anywhere else.

[42] From the point of view of the defendant, the fact that Mr. Joyce was able to command the various resources of Delaware North in providing assistance for the management of Grand Orbit would have supported a belief that Delaware North was serious about Grand Orbit. Even if Mr. Walters did not regard this effort as significant, and I think he was unaware of or reluctant to admit its extent, it would have looked impressive to someone in the defendant's position that so much was being done. That sort of effort and activity naturally leads one to reason that Delaware North would not have been making such an effort if it had not been serious about entering into a long term relationship. Mr. Joyce used that argument himself (p.118), and said that he said this to the defendant, and I accept that evidence. Indeed, I should say that generally I thought that Mr. Joyce was an honest and reliable witness, and, subject to something of a tendency to reconstruct which I have tried to make allowance for, I accept his evidence. I certainly prefer it to that of Mr. Walters, who did not make a favourable impression on me. I think it was also of some significance that, after all, it was Delaware North that first offered a partnership deal to the company; it was not the company that went knocking on Delaware North's door.

[43] In general I consider that the submissions on behalf of the plaintiff place too much emphasis on the distinction between what people (particularly Delaware North and AMP) had committed to do and what they were apparently going to do. Much was made of the fact that AMP had not actually agreed to the extension sought for the obligation to pay arrears of $100,000, and had not undertaken to hold off during the three months of the management agreement. What really matters is what they were apparently in fact going to do. The same applies to Delaware North. No doubt if it had agreed to enter into the long term arrangement as at 5 February 1997, the

defendant would have had stronger reasonable grounds to expect that the company would pay the tax, but in my opinion the statute does not require that only the existence of binding agreements on the part of the relevant people to act in a way which would enable the company to comply with the agreement can amount to reasonable grounds for the expectation. In my opinion it is not fatal to the defendant's defence that there was no agreement binding on Delaware North to make available to the company the funds it would require in order to enable it to pay the plaintiff the amount payable under the agreement when it was payable.

[44] I am also not persuaded by the submission that what happened at the meeting of 22 January 1997 would have left the defendant without reasonable grounds of an expectation that the agreement would ultimately be entered into. It may well be largely an amount of emphasis, and there is the further consideration that it would have been reasonable in the circumstances for the defendant to be guided in the interpretation of what was said at that meeting by Mr. Joyce. Mr. Joyce believed that he had the support of the executives, and it would in the circumstances have been reasonable for them to allow him to retain that belief because it maximised his incentive to work hard to see that the deal went through. He passed on to the defendant his interpretation of the thinking of the Delaware North management: p.114. It is not as though Mr. Joyce were an independent person, like a broker; the defendant had no reason not to take what Mr. Joyce said at face value, and whatever was said at the meeting of 22 January would not have been so negative that Mr. Joyce could not interpret it to the defendant as no more than a delay in the deal. I accept that in substance he did so, and that the fact that he remained so positive about the situation was an important, probably the principal, element in constituting reasonable grounds for the defendant's expectation. Another important element was the advice from Mr. Portway, referred to earlier.

[45] In view of the figures that Mr. Joyce had produced and shown to the defendant, such as the projections which form part of Doc. 26, the defendant had ample grounds for believing that the management of Delaware North would be much more efficient than the management of Grand Orbit up to that time. This modelling had been produced with the assistance of Mr. Walter's department, and in those circumstances there was no reason to assume that the essential features associated with efficiency of management, such as costs of goods sold and labour as percentages of turnover, were unrealistic or other than attainable with the benefit of Delaware North's management expertise. The defendant had no experience in this industry prior to his involvement with Grand Orbit: para. 47. He therefore was not in a position to assess independently the financial projections produced by Delaware North, and it was reaonable for him to accept that such a large and successful company would know what it could generate from a particular level of turnover. I regard these optimistic projections as another important reasonable ground.

[46] It was also submitted on behalf of the plaintiff that even if the deal with Delaware North had come into existence, and the $300,000 had been paid, it would not have been enough to satisfy the various pressing creditors. It would certainly not have been enough to pay all the company's debts, but it would have been enough to pay

the amount owing to the tax office under this agreement, and provide a substantial balance which would have been available to pay a significant amount to AMP, and deal with any other pressing creditors. Even if there were not enough to pay everything which was owing to AMP, even allowing for the credit notes issued in late 1996 being honoured, I think if a large payment had been made and AMP had the comfort of Delaware North's involvement it would not have risked the whole arrangement by insisting on immediate payment of all arrears. There was no reason for the company to have paid everything payable to AMP, accumulated superannuation contributions and any further group tax commitments incurred from February 1997 in priority to the payment due under this agreement. There is no reason to doubt that if $300,000 had been forthcoming from Delaware North the payment agreement would have been carried out; there were certainly reasonable grounds for that part of the expectation.

Remaining Issues

[47] The remaining question is whether the defendant took all reasonable steps to ensure that the company complied with the agreement or showed that there were no such steps the defendant could have taken. The only step suggested by the plaintiff as a step which could and should have been taken, but was not, was ensuring that the fee of $4,000 per week was actually paid to the Delaware North subsidiary. Ultimately two cheques for this fee were not met on presentation, and as a result of this the management agreement was terminated by a letter dated 27 March 1997: Exhibit 4. It is not clear from that letter whether the payment due for the week ending 23 March 1997, which was due at the beginning of that week on 17 March, was the first or second cheque not met, but if it was the first cheque it was the payment which would have been made after the weekend when the trade was severely affected. But for that downturn it would presumably have been made out of the proceeds of that trading. If the turnover had collapsed to the extent described there was no point in continuing to trade and no point in continuing the management agreement, and therefore no point at that stage in paying Delaware North, even if the company could afford to do so, and on the whole I think it unlikely that the company had the capacity to make that payment at that time anyway: p.94. Once it was apparent that the business was not going to survive, it was appropriate to terminate the agreement with Delaware North.

[48] The evidence about failure to make payments suggests that the problem was not that the company failed to make payments which it could have made and as a result the management agreement was terminated and therefore the business had to be placed in voluntary administration; rather termination of the management agreement and placing the business in voluntary administration were separate but parallel events caused by the collapse of the business. Overall I do not think that this is a situation where the defendant could have ensured that further payments of $4,000 per week were in fact made to Delaware North from the resources of the company. Even if they could and if in this way the management agreement had been able to continue for its full term, the fact that the turnover of the business had collapsed following these further deaths would have meant that Delaware North would not have entered into the further long term arrangement, the $300,000 would

not have been forthcoming, and the agreement would not have been fulfilled anyway. Once it became apparent that the business was not going to be revived, and that therefore there was not going to be a long term deal with Delaware North, continuing to pay the $4,000 would not have helped; it would simply have been throwing good money after bad.

[49] No other reasonable step which would have ensured that the company complied with the agreement was suggested on behalf of the plaintiff, and there were no others which occur to me. On the whole I am satisfied that there were no steps that the defendant could have taken to ensure that the company complied with the agreement, and accordingly s.222AQD(3)(b) is satisfied.

[50] It follows that the defendant has established the defence available under that subsection and the plaintiff's claim is dismissed with costs. In conclusion, I should acknowledge the considerable assistance I have received from the careful and thorough written submissions provided by both counsel in this matter.