FEDERAL COURT OF AUSTRALIA

Cribb v Kingsbury (No 2) [2021] FCA 1397

|  |  |
| --- | --- |
| File number: |  |
|  |  |
| Judgment of: | **MCKERRACHER J** |
|  |  |
| Date of judgment: | 11 November 2021 |
|  |  |
| Catchwords: | **CORPORATIONS** – recovery proceedings against former director – claims for insolvent trading, breach of directors duties, voidable transactions and debt recovery – where company incorporated as business venture by the two directors who are also the only shareholders – where the first director has day-to-day control of the business and the second director provides financial support to the company – where the first director deliberately concealed the company’s tax and superannuation liabilities from the second director – whether the second director breached his statutory or fiduciary duties by failing to inform himself of the company’s position independently of the first director**CORPORATIONS** – insolvent trading – whether company was insolvent at the relevant times – where company received financial support from one of its directors and a related company – whether there was the necessary degree of assuredness that the director would continue to support the company to enable it to pay its debts as and when they fell due**CORPORATIONS** – voidable transactions – payments by company to one of its directors and a related company pursuant to a lease agreement and hire agreements – whether the transactions are unreasonable director-related transactions pursuant to s 588FDA of the *Corporations Act 2001* (Cth) – whether a reasonable person in the company’s circumstances would not have entered into the transactions |
|  |  |
| Legislation: | *Corporations Act 2001* (Cth) ss 9, 79(c), 95A, 180, 180(1), 181, 182, 183, 588FB, 588FDA, 588FDA(1)(a), 588FDA(1)(b), 588FE, 588FF, 588G, 588G(1), 588G(1)(c), 588G(2), 588H(2), 588M, 1317E, 1317H |
|  |  |
| Cases cited: | *ASIC v Flugge & Geary* [2016] VSC 779; (2016) 342 ALR 1*Australian Securities and Investments Commission v Cassimatis (No 8)* [2016] FCA 1023 *Australian Securities and Investments Commission v Edwards* [2005] NSWSC 831; (2005) 54 ACSR 583 *Australian Securities and Investments Commission v Maxwell* [2006] NSWSC 1052*Australian Securities and Investments Commission v Plymin* [2003] VSC 123;(2003) 175 FLR 124*Australian Securities and Investments Commission v Rich* [2009] NSWSC 1229; (2009) 236 FLR 1*Capital Finance Australia Ltd v Tolcher* [2007] FCAFC 185; (2007) 164 FCR 83*Carna Group Pty Ltd v The Griffin Coal Mining Company (No 6)* [2021] FCA 1214*Chan v First Strategic Development Corporation Ltd (in liq)* [2015] QCA 28 *Hussain v CSR Building Products Ltd* [2016] FCA 392; (2016) 246 FCR 62*Lewis v Doran* [2005] NSWCA 243; (2005) 219 ALR 555*Mulherin v Bank of Western Australia Ltd* [2006] QCA 175 *Playspace Playground Pty Ltd v Osborn* [2009] FCA 1486 *Scott v Duncan* [2007] FCAFC 30*Smith v Boné* [2015] FCA 319; (2015) 104 ACSR 528*Super Art Australia Pty Ltd v Foden* [2014] FCA 1168; (2014) 9 BFRA 702*Termite Resources NL (in liq) v Meadows (No 2)* [2019] FCA 354*VL Finance Pty Ltd v Legudi* [2003] VSC 57; (2003) 54 ATR 221*Vrisakis v Australian Securities Commission* (1993) 9 WAR 395*Westgem Investments Pty Ltd v Commonwealth Bank of Australia Ltd (No 6)* [2020] WASC 302*Williams v Scholz* [2008] QCA 94 *Yorke v Lucas* [1985] HCA 65; (1985) 158 CLR 661*Ziade Investments Pty Ltd (in liq) v Welcome Homes Real Estate Pty Ltd* [2006] NSWSC 457  |
|  |  |
| Division: | General Division |
|  |  |
| Registry: | Western Australia |
|  |  |
| National Practice Area: | Commercial and Corporations |
|  |  |
| Sub-area: | Corporations and Corporate Insolvency |
|  |  |
| Number of paragraphs: | 211 |
|  |  |
| Date of hearing: | 31 May 2021-2 June 2021 |
|  |  |
| Counsel for the Plaintiffs: | Mr J Scovell |
|  |  |
| Solicitor for the Plaintiffs: | Stacks |
|  |  |
| Counsel for the Defendants: | Mr A Hershowitz |
|  |  |
| Solicitor for the Defendants: | Paiker & Overmeire |

ORDERS

|  |  |
| --- | --- |
|  | WAD 87 of 2019 |
|  |
| BETWEEN: | NEIL RAYMOND CRIBB, AS LIQUIDATOR OF PILBARA BAKERIES PTY LTD (IN LIQUIDATION) ACN 149 201 230First PlaintiffPILBARA BAKERIES PTY LTD (IN LIQUIDATION) ACN 149 201 230Second Plaintiff |
| AND: | JAMES RICHARD KINGSBURYFirst DefendantMALAGA PROPERTIES PTY LTD ACN 072 232 869Second Defendant |

|  |  |
| --- | --- |
| order made by: | MCKERRACHER J |
| DATE OF ORDER: | 11 NOVEMBER 2021 |

THE COURT ORDERS THAT:

1. The amended originating process dated 9 September 2020 be dismissed.

2. Unless within five days the plaintiffs file submissions seeking an order to the contrary, the plaintiffs pay the defendants’ costs, to be taxed or assessed if not agreed.

3. If the plaintiffs file any submissions in accordance with order 2 above, the defendants be permitted a further 5 days to file any submissions in response.

4. Unless otherwise ordered, the question of costs be determined on the papers.

Note: Entry of orders is dealt with in Rule 39.32 of the *Federal Court Rules 2011*.

REASONS FOR JUDGMENT

# INTRODUCTION

1 The first plaintiff, **Mr** Neil **Cribb** is the **liquidator** of the second plaintiff, **Pilbara Bakeries** Pty Ltd (in liquidation). They claim relief against the first defendant, **Mr** James **Kingsbury** and a company he controls, the second defendant, **Malaga** Properties Pty Ltd. Mr Kingsbury was one of two directors of Pilbara Bakeries until just prior to its liquidation. He was also the sole source of capital for Pilbara Bakeries. The plaintiffs assert that Mr Kingsbury failed to adequately discharge his duties as a director of Pilbara Bakeries. In particular, they complain about his lack of control over the activities of his co-director and day-to-day controller of Pilbara Bakeries, **Mr** Adrian **Catlin**, who misled Mr Kingsbury as to the financial position of the company. They also say Mr Kingsbury derived benefits which should be disgorged.

2 Pilbara Bakeries was wound up in insolvency on 13 June 2017 on the application of the Deputy Commissioner of Taxation. Although there has been no formal adjudication of proofs of debt, it is understood that the Australian Taxation Office (the **ATO**) is one of only two unrelated creditors, and is by far the dominant unrelated creditor. It is also understood that Malaga likely has the largest claim as a creditor of the company.

3 Pilbara Bakeries was incorporated in February 2011 as the vehicle through which Mr Catlin and Mr Kingsbury proposed to operate a wholesale **Bakery Business** in the Pilbara region of Western Australia. The venture was proposed by Mr Catlin who had some previous experience in operating bakeries and who wished to lease premises owned by Malaga to conduct the Bakery Business. In broad terms, it was agreed between Mr Catlin and Mr Kingsbury that Mr Catlin would be responsible for the day-to-day running of the Bakery Business while Mr Kingsbury would provide the necessary premises, equipment and capital. Mr Kingsbury, who was previously a banker, businessman and property developer, did not have any experience in the operation of bakeries.

4 As will be seen in these reasons, it is accepted by all parties that the failure of the Business was primarily caused by Mr Catlin’s concealment from Mr Kingsbury of substantial liabilities owing to the ATO. This concealment took place over a number of years despite regular communication between Mr Catlin and Mr Kingsbury. There can be little doubt that Mr Kingsbury believed the information he received from Mr Catlin because it was his own money in funding Pilbara Bakeries which was at stake. The main complaint against Mr Kingsbury is that he should have been more careful to ensure that the activities of Pilbara Bakeries were as Mr Catlin reported them to be. It is said that he should have taken more active steps to supervise Mr Catlin and to more carefully review the information supplied by Mr Catlin.

5 The case raises the interesting question of whether a director whose own funds (as well as the funds of creditors) were at stake, and who clearly did wish to protect his investment, is to be criticised for failing to take those steps which, in hindsight, might be seen as having been preferable. No doubt such cases will come in many different forms, but certainly in this case I do not consider Mr Kingsbury’s diligence to have been relevantly wanting. He was actively misled.

6 The case for the plaintiffs is supported by expert evidence from Mr Cribb himself (the liquidator). The defence case is supported by independent expert evidence. The reports of both experts go well beyond the usual role of an expert in expressing views as to the reasonableness of the conduct of Mr Kingsbury, which is a conclusion, indeed the fundamental conclusion, that the Court is required to determine.

7 The reasoning of the defence expert is to be preferred, not just because it is given by a non-party to the litigation, but primarily because it paints a much more realistic and balanced picture of what might be expected regarding the extent of oversight and supervision required by a ‘silent director’ whose own funds were very much at stake in the business venture.

8 It is also said that Mr Kingsbury, in breach of his duties, received substantial monetary benefits from Pilbara Bakeries that should be repaid. For reasons that follow, the plaintiffs have not established this case or any part of their case. It should not have been brought. Mr Kingsbury should not have been required to endure the stress of this litigation.

# BACKGROUND FACTS

9 The plaintiffs rely on five affidavits of Mr Cribb, one affirmed on 8 February 2019, two affirmed on 30 October 2019, one affirmed on 1 July 2020 and a further affidavit affirmed on 16 October 2020. The defendants rely on the expert affidavit of **Ms** Jennifer **Low** sworn on 25 March 2020, an affidavit of Mr Kingsbury sworn on 27 March 2020, an affidavit of Mr Catlin sworn on 6 May 2020, an affidavit of Mr Kingsbury sworn on 26 June 2020 and a further affidavit of Mr Kingsbury sworn on 23 March 2021.

10 The evidence, which will be discussed in greater detail below, establishes the following key facts:

11 In early 2010, Malaga developed, and became the owner of, eight strata units on Coolawanyah Road, Karratha. Through a real estate agent engaged by Malaga, Mr Kingsbury was approached by Mr Catlin with a proposal to lease two of the strata units for the purpose of starting the Bakery Business (**Premises**). Mr Kingsbury initially rejected a number of offers made by Mr Catlin to lease the Premises. The two men then met in late 2010 and discussed various options as to the commercial viability of the venture. Mr Catlin advised Mr Kingsbury that he was an experienced baker and would conduct the Bakery Business with his two sons who had similar experience. He also considered that the Business presented a commercial opportunity because there was at that time no wholesale bakery north of Geraldton, with most bread in the north-west of Western Australia being transported frozen from Perth.

12 After further discussions it was agreed between Mr Catlin and Mr Kingsbury that they would embark upon the wholesale Bakery Business venture in Karratha on a 50/50 basis. Mr Catlin was to operate and manage the bakery on a daily basis, as Mr Kingsbury resided in Perth (about 1527 kilometres apart by road) and Mr Kingsbury would fund the fit-out of the Premises and purchase the necessary equipment to conduct the Bakery.

13 Pilbara Bakeries was incorporated on 8 February 2011 as the entity to run and operate the Bakery. At incorporation, Pilbara Bakeries had two ordinary shares issued, one each to Mr Catlin and Malaga. Both Messrs Catlin and Kingsbury were directors of Pilbara Bakeries from its incorporation.

14 Mr Catlin subsequently, on 10 March 2011, provided Mr Kingsbury with a proposed cash flow budget and ‘master plan’ for the Bakery Business. It forecasted estimated net profits of $470,000 for the year ended 30 June 2012, which was expected to gradually increase to $904,753 by the year ending 30 June 2016.

15 To formalise the arrangements for the Bakery Business, Mr Kingsbury, Mr Catlin, Malaga and Pilbara Bakeries executed a Shareholders **Agreement** dated 18 March 2011. Clause 2.1 of the Agreement described the company’s purpose as being to conduct the Bakery Business. Clause 6.1 and cl 6.2 provided for the annual adoption of a budget and business plan by the directors. Clause 8.1 then provided as follows:

8.1 [Mr] Catlin is responsible for all the day to day management and the conduct of the business of the Company. For the purposes of this clause day to day management and the conduct of the business of the Company includes but is not limited to conducting all aspects of the business of the Company which include but are not limited to purchasing products, manufacture of products, managing the baking process, contracting with purchasers of the Products, record keeping, invoicing, account keeping in respect to all expenses purchases and sales of the Products manufactured by the Company .

16 An undated **Lease** for the Premises was also entered into with Malaga as lessor and Pilbara Bakeries as lessee. The Lease had a commencement date of 1 July 2011 and a term of 10 years, with annual rent of $150,000 payable in monthly instalments of $12,500 (excl. GST) (**Rent Payments**). Pilbara Bakeries was also required to meet the costs of all ‘variable outgoings’ for the Premises which included ongoing costs such as insurances, utility charges, pest control, maintenance etc., which were payable on demand (**Variable Outgoing Payments**).

17 Malaga initially paid for the fit-out of the Premises as a commercial bakery when Pilbara Bakeries commenced trading in or around early 2011. Malaga borrowed $343,200 from the Commonwealth Bank of Australia (the **CBA**) on or around 1 March 2011 to pay for the fit-out. It was a further term of the Lease that Pilbara Bakeries would repay Malaga the cost of the fit-out in monthly instalments of $4,541.95 (excl. GST) (the **Fit-Out Payments**).

18 Malaga also purchased, and then hired bakery equipment to Pilbara Bakeries for it to use in the Bakery Business pursuant to a **Hire Agreement** dated 18 March 2011. Malaga borrowed $621,779.40 from the CBA to purchase the bakery equipment which it then hired to Pilbara Bakeries. It was a term of the Hire Agreement that Pilbara Bakeries would repay Malaga the costs of the bakery equipment in monthly instalments of $14,592 (incl. GST) over five years from 1 June 2011 (the **Equipment Payments**). Malaga owned the bakery equipment at all times.

19 From time to time at the request of Mr Catlin, Malaga also purchased vehicles (and retained ownership of those vehicles) that were used by Pilbara Bakeries to operate the Bakery Business. Pilbara Bakeries paid Malaga for the use of the vehicles (the **Vehicle Payments**).

20 From time to time, Malaga advanced funds to Pilbara Bakeries for working capital (**Malaga Payments**). Pilbara Bakeries never owned any material assets that it could sell, and its current assets at all times comprised cash, raw material and trade debtors.

21 It was under this model that the Bakery commenced operations in 2011. Pilbara Bakeries’ income tax return for the year ended 30 June 2011 shows a profit of $23,886, net current assets totalling $27,979 and net total assets of $16,722. This would be the only time the Bakery Business managed to turn a profit in the next five years of operation. Both Mr Kingsbury and Mr Catlin however viewed the Bakery as a long term venture, and it was anticipated that it would take some years for the Business (started from scratch) to build up a customer base and establish itself.

22 In terms of each director’s involvement in the Business, while it was agreed that Mr Catlin was responsible for daily operations, he and Mr Kingsbury communicated regularly by telephone and email and Mr Kingsbury would, from time to time, travel to Karratha to view the Premises and meet with Mr Catlin. Importantly, it was agreed that Mr Catlin would forward to Mr Kingsbury monthly management accounts of Pilbara Bakeries which Mr Kingsbury received from May 2011 until June 2016. Mr Catlin also engaged accountants to prepare Pilbara Bakeries’ financial statements at each year’s end. Mr Kingsbury had no contact with the company’s accountants and the statements were often prepared and provided to him some months after the end of each financial year. The clear intent was that the financial position of the company would be communicated to Mr Kingsbury via the monthly management accounts.

23 Both Mr Kingsbury and Mr Catlin were signatories to Pilbara Bakeries’ bank accounts and both directors authorised payments to Malaga from time to time, however in practice, all payments made out of the company’s bank account were authorised by Mr Catlin alone. Over the course of the Bakery’s operations, Mr Catlin made requests to Mr Kingsbury to defer payments due to Malaga under the Lease or Hire Agreement due to cash flow constraints. Mr Kingsbury agreed to these requests including a ‘payment holiday’ on all Equipment Payments from October 2011 to February 2012.

24 Although it would appear that in almost all instances Mr Catlin discussed with Mr Kingsbury the financial position of the Business and its ability to make various payments, Mr Catlin (deceptively at least) actively avoided informing Mr Kingsbury of Pilbara Bakeries’ difficulties in meeting its taxation and superannuation liabilities. On 9 June 2012, Mr Kingsbury emailed Mr Catlin stating:

Now when you do the figures I want a timeframe whereby you can tell me the GST accounts are all up to date as I don’t want the Tax Office to be chasing you down because of your GST liability.

Mr Catlin responded on the same day that the company’s business activity statements would be completed within four days.

25 However, on 10 September 2012, the ATO issued a garnishee notice in respect of Pilbara Bakeries’ unpaid PAYG liabilities in the sum of $39,917.98. The notice was sent to Mr Kingsbury’s personal accountant who brought it to his attention. Mr Kingsbury immediately contacted Mr Catlin who informed him that the company was in arrears in payment of PAYG tax. It was agreed that Mr Kingsbury would pay the debt the subject of the garnishee order provided that he was kept fully informed of the company’s compliance with all ongoing obligations to the ATO. Mr Catlin subsequently informed him that a tax payment plan had been entered into with the ATO.

26 Between 2012 and 2014, the Bakery did not perform as expected and continued to suffer losses despite increasing its turnover. Mr Kingsbury continued to fund the purchase of new equipment and vehicles as and when required, which would then be hired to the company for a fee. During this period Mr Catlin frequently travelled to Perth to care for his wife who had fallen ill with cancer, and passed away in July 2014. He was away from Karratha for a number of consecutive months during this period. While Mr Catlin was in Perth, his two sons operated the Bakery under his direction. Apart from those members of the Catlin family who were full-time employees, the Bakery employed a casual workforce of overseas backpackers.

27 Following his wife’s passing, Mr Catlin moved back to Karratha and he and Mr Kingsbury continued to discuss ways to make the Bakery more profitable. In March 2016, Mr Kingsbury agreed to purchase further equipment at a cost to him of $380,000, which was hired to Pilbara Bakeries. In April 2016, Mr Kingsbury caused two payments totalling $150,000 to be paid to the company as a loan to assist with cash flow. In the following months three new vehicles were also purchased at a total cost of $246,382.

28 Despite receiving regular assurances from Mr Catlin that Pilbara Bakeries was meeting its tax obligations (albeit that there had been some difficulties and payment plans agreed), on 4 August 2016 Mr Kingsbury received a statutory demand from the ATO for an unpaid amount of $318,325.57. The demand was served at Mr Kingsbury’s home address. About two thirds of the liability was attributed to unpaid superannuation charges, as well as interest and penalties on those unpaid charges, dating all the way back to the quarter commencing 1 July 2011, just after the Business commenced operations.

29 In the heated discussions that followed between Mr Kingsbury and Mr Catlin, the latter admitted to concealing this liability from Mr Kingsbury for fear that he would withdraw his financial support for the Business, and on the view that it was Mr Catlin’s responsibility to ensure such matters were addressed. Indeed, as a consequence of this deception, having lost all confidence in Mr Catlin’s ability to run the Bakery, Mr Kingsbury resigned as a director of Pilbara Bakeries on 19 August 2016.

30 By November 2016, Mr Catlin considered it was no longer viable for the Bakery to continue trading. In February 2017, the ATO issued further statutory demands which resulted in the company’s liquidation. Mr Cribb was appointed the liquidator of Pilbara Bakeries on 13 June 2017 (the **Appointment Date**). The relation back day in the liquidation is 25 April 2017. The relation back period for any unreasonable director-related transactions to Malaga and/or Mr Kingsbury is from 26 April 2013 to 19 August 2016 (the **Relevant Period**).

31 During the Relevant Period, Pilbara Bakeries paid the total sum of $1,072,735.76 to Malaga and Mr Kingsbury. Over the course of the Bakery’s operation to 31 December 2016, Malaga and Mr Kingsbury advanced amounts totalling around $248,000 and during the Relevant Period, Pilbara Bakeries repaid at least $66,098 of that amount.

# THE PLAINTIFFS’ CASE

32 Through a number of different claims, the plaintiffs seek to recover the substantial amounts that Pilbara Bakeries paid to Malaga and Mr Kingsbury pursuant to the various agreements entered into over the course of the Bakery’s operation. The principal claim is that the company was insolvent from as early as 30 June 2012 (**Claimed Insolvent Period**).

33 The plaintiffs assert that the evidence establishes that during the entire Claimed Insolvent Period, Pilbara Bakeries had:

(a) a ‘current ratio’, as defined by the liquidator, of less than one;

(b) a ‘quick asset ratio’, as defined by the liquidator, of less than one;

(c) insufficient available cash to meet its creditor liabilities that were due and payable, with a deficiency in funds of $59,511.60 as at 30 June 2012 which significantly deteriorated over the Claimed Insolvent Period to be $339,606.69 as at 30 September 2016; and

(d) a manifest deficiency of assets to meet all liabilities which fluctuated between $76,334.54 and $311,465.10.

34 The plaintiffs say that throughout the Claimed Insolvent Period, Pilbara Bakeries had an inability to pay its creditors as and when the debts fell due; Pilbara Bakeries did not suffer from a temporary lack of liquidity. Rather, it suffered from endemic insolvency.

35 On this basis, the plaintiffs raise a claim for insolvent trading against the defendants pursuant to s 588G of the ***Corporations Act*** *2001* (Cth). The quantum of that claim was the subject of an amendment application on the first day of trial which is addressed below.

36 The plaintiffs also contend, and it is accepted, that during the Relevant Period, Pilbara Bakeries made payments from its bank account to Malaga and Mr Kingsbury totalling $1,072,735.76, as follows:

(a) $508,750.00 for Rent Payments, of which:

(i) $375,000 was paid to Mr Kingsbury’s bank account;

(ii) $133,750 was paid to Malaga’s bank accounts;

(b) $94,920.20 for Variable Outgoing Payments, of which:

(i) $85,644.98 was paid to Mr Kingsbury’s bank account;

(ii) $9,275.22 was paid to Malaga’s bank accounts;

(c) $194,849.85 for Fit-Out Payments, of which the full amount was paid to Mr Kingsbury’s bank account;

(d) $7,496.15 for Equipment Payments;

(e) $200,621.56 for Vehicle Payments; and

(f) $66,098.00 for repayment of amounts advanced to the company by Malaga (the Malaga Payments).

37 The plaintiffs seek recovery of each of these amounts as unreasonable director-related transactions that are voidable pursuant to s 588FE and s 588FF of the *Corporations Act*.

38 Alternatively, the plaintiffs raise a claim in debt for a significant proportion of the above amount on the basis that payments were made by Pilbara Bakeries directly to Mr Kingsbury for amounts that were in fact owing to Malaga. The plaintiffs say this sum of $943,952.90 should be treated as an undocumented loan of funds to Mr Kingsbury that is repayable immediately on demand: *VL Finance Pty Ltd v Legudi* [2003] VSC 57; (2003) 54 ATR 221. The payments the subject of this claim are referred to as the **Kingsbury Loans**.

39 Finally, the plaintiffs allege that Mr Kingsbury breached both his statutory and fiduciary duties to Pilbara Bakeries.

40 Accordingly, the plaintiffs seek the following relief:

(a) an order that Mr Kingsbury pay Pilbara Bakeries the sum of $943,952.90, being the sum of the Kingsbury Loans;

(b) a declaration under s 1317E of the *Corporations Act* that Mr Kingsbury has contravened ss 180, 181, 182 and 183 of the *Corporations Act*;

(c) a compensation order under s 1317H of the *Corporations Act* payable by Mr Kingsbury in respect of contraventions of ss 180, 181, 182 and 183 of the *Corporations Act*;

(d) a compensation order under s 1317H of the *Corporations Act* payable by Malagain respect of Mr Kingsbury’s contraventions of ss 180, 181, 182 and 183 of the *Corporations Act*;

(e) a declaration that Mr Kingsbury and/or Malaga held the payments received as a result of Mr Kingsbury’s breaches of his fiduciary duties as constructive trustee for Pilbara Bakeries;

(f) an order for equitable compensation payable by Mr Kingsbury and/or Malaga as a result of Mr Kingsbury’s breaches of his fiduciary duties;

(g) a declaration that Mr Kingsbury has contravened s 588G(2) of the *Corporations Act*;

(h) an order pursuant to s 588M of the *Corporations Act* that Mr Kingsbury pay to Pilbara Bakeries an amount equal to the loss or damage suffered by Pilbara Bakeries’ creditors because of its insolvency;

(i) an order pursuant to s 588FF of the *Corporations Act* that Malaga pay Pilbara Bakeries an amount equal to the value of the unreasonable director-related payments (as defined in the further amended statement of claim); and

(j) in the alternative, an order pursuant to s 588FF of the *Corporations Act* that Mr Kingsbury pay Pilbara Bakeries an amount equal to the value of the unreasonable director-related payments.

41 Each of these claims, and the defendants’ response is addressed in turn.

# INSOLVENT TRADING CLAIM

42 A company is solvent if and only if the company is able to pay all of its debts as and when they fall due and payable: s 95A of the *Corporations Act*. This is a question of fact to be determined in all the circumstances, including a consideration of the nature of a company’s assets and business and commercial reality. This test of solvency incorporates a ‘cash flow test’ as opposed to a ‘balance sheet test’. In determining insolvency, the Court takes into account the financial position of a company having regard to ‘commercial reality’.

43 The plaintiffs have adduced evidence which purports to highlight that during the period from 30 June 2012 up until the Appointment Date (the Claimed Insolvent Period), Pilbara Bakeries was insolvent. Principally, the evidence has been set out in detail in the liquidator’s report as to solvency exhibited to his affidavit affirmed on 30 October 2019. The liquidator, an expert insolvency accountant, has examined the relevant books and records and performed a cash flow analysis of Pilbara Bakeries. The liquidator concludes that Pilbara Bakeries was insolvent on a cash flow analysis at all relevant times. He has also performed a balance sheet analysis of Pilbara Bakeries and concludes that it was balance sheet insolvent at all relevant times.

44 Further, the plaintiffs contend that a number of the usual *indicia* of insolvency manifested at the time, relying on the well-known factors in *Australian Securities and Investments Commission v* ***Plymin*** [2003] VSC 123;(2003) 175 FLR 124 (at [386]). From 30 June 2012, Pilbara Bakeries had continuing losses, liquidity ratios of below one, outstanding Commonwealth taxes and creditors unpaid outside trading terms. From 3 July 2012, Pilbara Bakeries made some payments to creditors of rounded figures which are irreconcilable to specific invoices. From 9 June 2015, Pilbara Bakeries had special arrangements with selected creditors. From 22 September 2015, Pilbara Bakeries had dishonoured payments and from 1 August 2016, Pilbara Bakeries had demands issued against it. The presence of all of these *indicia* confirms, the plaintiffs say, Pilbara Bakeries’ insolvency at all relevant times.

45 Section 588G of the *Corporations* *Act* applies where a person is a director at the time when the company incurs a debt, the company is insolvent at that time, or becomes insolvent by incurring that debt, and at the time, there are reasonable grounds for suspecting that the company is insolvent, or would so become insolvent, as the case may be: s 588G(1). A person contravenes s 588G by failing to prevent the company from incurring the debt if the person is aware at that time that there are such grounds for so suspecting, or a reasonable person in a like position would be so aware: s 588G(2) of the *Corporations Act*.

46 During the Relevant Period, it is accepted that Pilbara Bakeries incurred debts totalling $1,409,219.95 to the following creditors which remain unpaid as at the Appointment Date, as follows:

(a) $253,061.16 to the ATO for unpaid superannuation guarantee contributions;

(b) $67,487.73 to the ATO for running balance account;

(c) $15,687.06 to Byford Flour Mill Pty Ltd (**Millers**);

(d) $248,000 to Malaga for Malaga Payments;

(e) $428,434 to Malaga for Rent, Variable Outgoings, Fit-Out and Vehicle Payments; and

(f) $396,550 to Malaga for the balance of Rent Payments under the Lease.

47 Mr Kingsbury was a director during the entire Relevant Period. The plaintiffs say that Pilbara Bakeries was insolvent for the entirety of the Relevant Period.

48 At the time the debts were incurred, the plaintiffs say:

(a) there were reasonable grounds for suspecting that Pilbara Bakeries was insolvent or would become insolvent as a result of incurring the debts;

(b) Mr Kingsbury, or a reasonable person in his position as director of Pilbara Bakeries, would have been aware of those matters, which provide reasonable grounds for suspecting that Pilbara Bakeries was insolvent or would become insolvent, thereby satisfying the requirements of s 588G(2) of the *Corporations Act*; and

(c) creditors have suffered loss and damage because of Pilbara Bakeries’ insolvency, as the debts remain owing, each of the debts was wholly unsecured when the loss and damage was suffered, and Pilbara Bakeries is being wound up, thereby satisfying the requirements of s 588M.

49 With respect to the amounts said to be owing to Malaga set out at [46(d)-(f)] above, counsel for the plaintiffs sought leave to amend the statement of claim on the first morning of the trial to include these amounts. After some initial opposition, it was resolved that the amendments could be allowed, with the defendants’ counsel electing to adduce some further evidence in chief from Mr Kingsbury beyond his affidavits. Ultimately, nothing turned on this amendment in light of the conclusions reached.

50 The defendants resist the insolvent trading claim on two grounds. First, they contest that Pilbara Bakeries was insolvent at the date contended for by the plaintiffs. Indeed, the defendants say Pilbara Bakeries was not insolvent until (or just before) Mr Kingsbury resigned as a director and withdrew his financial support on 19 August 2016. They say a company will not be insolvent if the Court is satisfied that, as a matter of commercial reality, the company has a resource available to pay all its debts as they become payable. In such a case, it will not matter that the resource is an unsecured borrowing or a voluntary extension of credit by another party: *Lewis v Doran* [2005] NSWCA 243; (2005) 219 ALR 555 (at [109]-[110]) and *Scott v Duncan* [2007] FCAFC 30 (at [38]).

51 Reliance is placed on the decision in ***Westgem*** *Investments Pty Ltd v Commonwealth Bank of Australia Ltd (No 6)* [2020] WASC 302 per Tottle J (at [1053]), citing Muir JA in *Williams v Scholz* [2008] QCA 94 (at [110]):

**The commercial reality of a company’s situation may include the availability of financial support and unsecured borrowings from shareholders or directors.** In *Williams v Scholz*, Muir JA said:

Unsecured borrowings are also relevant, provided that they do not give rise to obligations which the company is unable to meet. Where the Court has the benefit of assessing insolvency with the advantage of hindsight, as is the case here, it will tend to be in a better position to evaluate the true bearing of unsecured borrowings on the Company’s ability to meet its financial obligations. **There is some authority for the proposition that unsecured loans by directors cannot be taken into account. There should, however, be no objection in principle to regarding such financial support as relevant where the evidence establishes that the directors are likely to continue it**. Loans by related corporations have been regarded as relevant to the determination of solvency. And **there is no reason in principle why a loan from directors should be treated any differently to loans from companies controlled by directors. *The most important consideration is the degree of commitment to the continuation of financial support.***(emphasis supplied) (footnotes omitted)

(Emphasis added, citations omitted.)

(see also ***Mulherin*** *v Bank of Western Australia Ltd* [2006] QCA 175 (at [113)-[115).)

52 A broader statement of the proposition was expressed in ***Chan*** *v First Strategic Development Corporation Ltd (in liq)* [2015] QCA 28 per Morrison JA (at [42]-[44], and with whom Gotterson and Boddice JJA agreed at [1] and [124] respectively):

42 The learned primary judge also referred to the statement of Giles JA in *Lewis v Doran* 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.”

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.

(Emphasis added, citations omitted.)

53 The defendants submit that at all times up to 19 August 2016, Mr Kingsbury had every intention of funding Pilbara Bakeries to enable it to pay its debts. Indeed, they say that Mr Kingsbury clearly acted in line with that intention. In addition to injections of funds when needed, Mr Kingsbury deferred Pilbara Bakeries’ liabilities to Malaga as and when needed with a view to improving cash flow and the company’s position over time.

54 The expert evidence of Ms Low, as discussed below, is to the effect that in those circumstances and in the circumstances of all the *indicia*, on the primary cash flow test of solvency, Pilbara Bakeries was solvent.

55 At the time when Mr Kingsbury discovered the true state of affairs of Pilbara Bakeries and Mr Catlin’s failure to provide him with accurate information regarding the true trading results of Pilbara Bakeries and the extent of Pilbara Bakeries’ liabilities, in particular to the ATO, Mr Kingsbury immediately resigned as a director of Pilbara Bakeries and withdrew his support.

56 Because of Mr Catlin’s concealment of the true state of affairs, the defendants say that:

(a) Mr Kingsbury had reasonable grounds to believe Pilbara Bakeries was solvent until August 2016;

(b) in those circumstances, Pilbara Bakeries became insolvent at the time Mr Kingsbury withdrew his support and resigned as a director on or about 19 August 2016; and

(c) it is significant that at the time the ATO issued its statutory demand, Pilbara Bakeries had payment plans in place for payment of both its business activity statements and superannuation guarantee payments.

57 As to the specific claim under s 588G, the defendants noted that the onus of establishing a contravention of s 588G of the *Corporations Act* lies on the party asserting the contravention: *Playspace Playground Pty Ltd v Osborn* [2009] FCA 1486 (at [43]) and *Smith v Boné* [2015] FCA 319; (2015) 104 ACSR 528 (at [23]).

58 By s 588H(2) of the *Corporations Act*, it is a defence to proceedings for a contravention of s 588G(2) if it is proved that, at the time the debt was incurred, the person had reasonable grounds to expect, and did expect, that the company was solvent at that time and would remain solvent even if it incurred that debt and any other debts that it incurred at that time. The inquiry relevant to s 588G(1)(c) of the *Corporations Act* is not an inquiry concerning a particular director whose conduct is under scrutiny. It is an inquiry into the objectively formed state of mind of a person of ordinary competence: *Australian Securities and Investments Commission v Edwards* [2005] NSWSC 831; (2005) 54 ACSR 583 (at [249]).

59 On the available evidence and financial information to Mr Kingsbury, as well as his ability to access funds, the defendants say there were reasonable grounds for a director of ordinary competence to suspect Pilbara Bakeries was solvent.

60 The defendants say that:

(a) despite the alleged period of insolvency, Mr Kingsbury had reasonable grounds to expect, or did expect that Pilbara Bakeries was solvent. He injected funds into Pilbara Bakeries and continued to make arrangements to ensure Pilbara Bakeries was well equipped and resourced with new equipment and vehicles to conduct the Bakery Business. Due to the setup of the bakery structure, Mr Kingsbury was to a large extent dependent on information supplied to him by Mr Catlin. Mr Kingsbury took reasonable steps to satisfy himself that Mr Catlin was a competent and reliable person and as such would provide him with reliable and adequate information regarding Pilbara Bakeries’ trading and financial position. Mr Kingsbury received monthly management statements and had access to view Pilbara Bakeries’ bank account online;

(b) Mr Catlin deliberately concealed from Mr Kingsbury the accruing ATO debt and superannuation liability of Pilbara Bakeries;

(c) Prior to August 2016, Mr Kingsbury reasonably understood and believed that the ATO debt and superannuation liabilities were up-to-date and being paid;

(d) Mr Kingsbury took an active role in communicating with Mr Catlin regarding the payment of the Woolworths account which was a significant customer of the Business;

(e) during the period April 2016 to August 2016, Mr Kingsbury and Malaga demonstrated substantial ongoing commitment to provide adequate funding and finance to Pilbara Bakeries by advancing funds, purchasing new equipment including cool rooms, motor vehicles and trucks;

(f) during this period Mr Kingsbury and Malaga were willing and able to sufficiently fund Pilbara Bakeries if cash flow problems arose, and to deal with any liabilities Mr Kingsbury was aware were being incurred by Pilbara Bakeries; and

(g) in all of those circumstances Mr Kingsbury had reasonable grounds to believe, and did believe, that Pilbara Bakeries was solvent and that remained the position until he learned of Mr Catlin’s deception and resigned as a director and withdrew his financial support.

# UNREASONABLE DIRECTOR-RELATED TRANSACTIONS

61 The transactions referred to at [36] above were payments made by Pilbara Bakeries to Mr Kingsbury as a director of Pilbara Bakeries and/or to Malaga on behalf of, or for the benefit of, Mr Kingsbury. The plaintiffs contend that each of these payments was an unreasonable director-related transaction pursuant to s 588FDA of the *Corporations Act* which relevantly provides as follows:

**588FDA Unreasonable director related transactions**

(1) A transaction of a company is an ***unreasonable director related transaction*** of the company if, and only if:

(a) the transaction is:

(i) a payment made by the company;

…

(b) the payment, disposition or issue is, or is to be, made to:

(i) a director of the company;

…

(iii) a person on behalf of, or for the benefit of, a person mentioned in subparagraph (i) or (ii); and

(c) it may be expected that a **reasonable person in the company’s circumstances would not have entered into the transaction, having regard to**:

(i) **the benefits (if any) to the company of entering into the transaction; and**

(ii) the detriment to the company of entering into the transaction; and

(iii) the respective benefits to other parties to the transaction of entering into it; and

(iv) **any other relevant matter**.

…

(Emphasis added.)

62 Transactions that satisfy the criteria in s 588FDA are voidable pursuant to s 588FE(6A) which brings the conduct within the purview of s 588FF, pursuant to which the Court may relevantly make:

 (a) an order directing a person to pay to the company an amount equal to some or all of the money that the company has paid under the transaction;

…

(h) an order declaring an agreement constituting, forming part of, or relating to, the transaction, or specified provisions of such an agreement, to have been void at and after the time when the agreement was made, or at and after a specified later time;

…

63 It is accepted that the Rent Payments, Fit-Out Payments, Variable Outgoings Payments, Equipment Payments, Vehicle Payments and Malaga Payments satisfy the criteria at s 588FDA(1)(a) and s 588FDA(1)(b). The ground of dispute is whether it may be expected that a reasonable person in the company’s circumstances would not have entered into those transactions having regard to the matters set out at subs (c)(i) and (c)(iv). Those factors are expressed in the same terms as those that relate to uncommercial transactions under s 588FB and the same principles apply: *Super Art Australia Pty Ltd v Foden* [2014] FCA 1168; (2014) 9 BFRA 702 per Davies J (at [59]); *Ziade Investments Pty Ltd (in liq) v Welcome Homes Real Estate Pty Ltd* [2006] NSWSC 457 per Gzell J (at [91]).

64 In *Capital Finance Australia Ltd v Tolcher* [2007] FCAFC 185; (2007) 164 FCR 83, the Full Court set out the relevant principles for the test under s 588FB (at [129]):

(1) as the express words of s 588FB make clear, it is an objective standard to determine if a transaction is uncommercial: see also *Lewis (as liquidator of Doran Constructions Pty Ltd (in liq)) v Doran* (2005) 219 ALR 555 at [156] and *Tosich Construction Pty Ltd (in liq) v Tosich* (1997) 78 FCR 363 at 366-367;

(2) four criteria are to be considered — the benefits enjoyed by the company (s 588FB(1)(a)), the detriment to the company (s 588FB(1)(b)), the respective benefits others received (s 588FB(1)(c)) and any other relevant matters (s 588FB(1)(d));

(3) the objective criteria are not considered in some vacuum but by reference to “the company’ circumstances” which must include the state of knowledge of those who were the directing mind of the company, such as its controlling director or directors: *Tosich Construction* 78 FCR at 367; and

(4) for a transaction to be “uncommercial” it must result in “the recipient receiving a gift or obtaining a bargain of such magnitude that it [cannot] be explained by normal commercial practice” or where “the consideration … lacks a ‘commercial quality’: see *Peter Pan Management Pty Ltd (in liq) v Capital Finance Corporation* (2001) 19 ACLC 1,392 at [43]; *Lewis v Cook* (2000) 18 ACLC 490 at [45]-[46] and *Demondrille Nominees Pty Ltd v Shirlaw* (1997) 25 ACSR 535 at 548 and the Explanatory Memorandum, *Corporate Law Reform Bill 1992* (Cth) at [1044].

65 The plaintiffs say there was no benefit to Pilbara Bakeries by making the payments because:

(a) the payments did not give rise to any increase in Pilbara Bakeries’ assets or reduction in Pilbara Bakeries’ liabilities, as evidenced by Pilbara Bakeries’ financial statements; and

(b) it had no interest in the Premises, equipment or vehicles to be protected or acquired by making the payments.

66 The plaintiffs say the payments were of significant detriment to Pilbara Bakeries because:

(a) the payments deprived Pilbara Bakeries of significant funds, which it could have used for the purposes of the Business, and ultimately, the payment of its creditors; and

(b) in particular, if Pilbara Bakeries had not made the payments, Pilbara Bakeries would have had sufficient funds to pay the ATO and would not have been wound up, given the payments exceeded the amount in the statutory demand served by the ATO.

67 The plaintiffs say the defendants benefited from the payments because:

(a) the payments benefited the CBA, as a creditor of Malaga;

(b) more significantly, the payments benefited Mr Kingsbury, who was the sole shareholder of Malaga, to the extent that they discharged Malaga’s obligations to the CBA;

(c) Malaga was relieved of the obligation to make the payments from its own funds; and

(d) the payments had the effect of preferring Malaga’s creditor, the CBA, over the major creditor of Pilbara Bakeries, the ATO.

68 The plaintiffs contend another relevant matter is that from 30 June 2012, just over one year after Pilbara Bakeries’ incorporation, up until the Appointment Date, Pilbara Bakeries was insolvent. Once Pilbara Bakeries was insolvent and began accruing significant liabilities to the ATO, a reasonable person in Pilbara Bakeries’ circumstances would have considered whether the payments should continue to be made. The fact that Pilbara Bakeries continued to operate for another five years is a further relevant matter that demonstrates the unreasonable period of time that Pilbara Bakeries continued to make the payments, the plaintiffs say. Having regard to the benefits and detriments to Pilbara Bakeries, the benefits to Malaga and the other relevant matters referred to above, the plaintiffs contend that a reasonable person in Pilbara Bakeries’ circumstances would not have entered into the transactions.

69 The defendants say that:

(a) Pilbara Bakeries made payments to Malaga and Mr Kingsbury (through a general banking account of Mr Kingsbury) for Rent, Variable Outgoing, Fit-Out and Equipment and Vehicle Payments. Those funds were paid to or allocated by Mr Kingsbury’s accountant to the relevant entity (which included Mr Kingsbury’s super fund);

(b) the Premises, equipment and motor vehicles were entirely necessary for the operation of the Business;

(c) there is no suggestion the various payments were at anything other than a commercial and reasonable rate; and

(d) at the time the payments were made, it was reasonable that Pilbara Bakeries made payments to Malaga and Mr Kingsbury in the ordinary course of business so as to ensure that the Bakery operations could continue.

# CLAIM IN DEBT

70 Under their claim in debt, the plaintiffs contend that the various payments made by Pilbara Bakeries directly to Mr Kingsbury (purportedly in discharge of liabilities owing to Malaga) should be characterised as advances under a loan that are immediately repayable by Mr Kingsbury. During the Relevant Period from 8 May 2013 to 17 February 2017, Pilbara Bakeries ‘advanced’ the sum of $943,952.90 to Mr Kingsbury’s bank account, as follows:

(a) $418,500 for Rent Payments;

(b) $98,844.98 for Variable Outgoing Payments; and

(c) $209,838.30 for Fit-Out Payments.

71 The Rent Payments, Variable Outgoing Payments and Fit-Out Payments were pursuant to the Lease between Pilbara Bakeries as lessee, and Malaga as lessor.

72 The plaintiffs contend that Mr Kingsbury was not entitled to receive the Rent Payments, Variable Outgoing Payments or Fit-Out Payments. The payments to Mr Kingsbury were not accounted for in the books and records of Pilbara Bakeries. Accordingly, the payments to Mr Kingsbury should be characterised as monies advanced by Pilbara Bakeries to Mr Kingsbury. They have been described as the Kingsbury Loans.

73 The plaintiffs say they are repayable immediately. Mr Kingsbury has not repaid the amounts advanced and accordingly, Mr Kingsbury is said to be indebted to Pilbara Bakeries in the amount of the Kingsbury Loans.

74 In response, the defendants deny the existence of any loan agreement between the parties and say the payments that were made by Pilbara Bakeries directly to Mr Kingsbury related to Rent Payments, Variable Outgoing Payments and Fit-Out Payments due under the Lease. Further, they say that funds received directly by Mr Kingsbury entered a home loan account that Mr Kingsbury used to receive funds generally and the relevant funds were thereafter attributed appropriately to the bank accounts of Malaga. There is said to be no evidence to support a finding of a loan agreement and that it is inconceivable to suggest that there would be such a loan without any written understanding to that effect in circumstances where the payments were clearly made by Pilbara Bakeries in discharge of liabilities properly incurred under its agreements with Malaga.

# ALLEGED BREACHES OF MR KINGSBURY’S DUTIES AND MALAGA’S KNOWING INVOLVEMENT

## Mr Kingsbury’s alleged breaches

75 Under s 1317H of the *Corporations Act*, the Court may order a person to compensate a corporation for damage suffered by the corporation where the person contravened a civil penalty provision and damage resulted from the contravention. Contraventions of ss 180, 181, 182 and 183 are civil penalty provisions, and the plaintiffs contend that Mr Kingsbury has contravened each of these provisions. They relevantly provide as follows:

**180 Care and diligence—civil obligation only**

*Care and diligence—directors and other officers*

(1) A director or other officer of a corporation must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they:

(a) were a director or officer of a corporation in the corporation’s circumstances; and

(b) occupied the office held by, and had the same responsibilities within the corporation as, the director or officer.

Note: This subsection is a civil penalty provision (see section 1317E).

*Business* judgment rule

(2) A director or other officer of a corporation who makes a business judgment is taken to meet the requirements of subsection (1), and their equivalent duties at common law and in equity, in respect of the judgment if they:

(a) make the judgment in good faith for a proper purpose; and

(b) do not have a material personal interest in the subject matter of the judgment; and

(c) inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and

(d) rationally believe that the judgment is in the best interests of the corporation.

The director’s or officer’s belief that the judgment is in the best interests of the corporation is a rational one unless the belief is one that no reasonable person in their position would hold.

Note: This subsection only operates in relation to duties under this section and their equivalent duties at common law or in equity (including the duty of care that arises under the common law principles governing liability for negligence)—it does not operate in relation to duties under any other provision of this Act or under any other laws.

(3) In this section:

***business judgment*** means any decision to take or not take action in respect of a matter relevant to the business operations of the corporation.

**181 Good faith—civil obligations**

*Good faith—directors and other officers*

(1) A director or other officer of a corporation must exercise their powers and discharge their duties:

(a) in good faith in the best interests of the corporation; and

(b) for a proper purpose.

Note 1: This subsection is a civil penalty provision (see section 1317E).

Note 2: Section 187 deals with the situation of directors of wholly‑owned subsidiaries.

(2) A person who is involved in a contravention of subsection (1) contravenes this subsection.

Note 1: Section 79 defines ***involved***.

Note 2: This subsection is a civil penalty provision (see section 1317E).

**182 Use of position—civil obligations**

*Use of position—directors, other officers and employees*

(1) A director, secretary, other officer or employee of a corporation must not improperly use their position to:

(a) gain an advantage for themselves or someone else; or

(b) cause detriment to the corporation.

Note: This subsection is a civil penalty provision (see section 1317E).

(2) A person who is involved in a contravention of subsection (1) contravenes this subsection.

Note 1: Section 79 defines involved.

Note 2: This subsection is a civil penalty provision (see section 1317E).

**183 Use of information—civil obligations**

*Use of information—directors, other officers and employees*

(1) A person who obtains information because they are, or have been, a director or other officer or employee of a corporation must not improperly use the information to:

(a) gain an advantage for themselves or someone else; or

(b) cause detriment to the corporation.

Note 1: This duty continues after the person stops being an officer or employee of the corporation.

Note 2: This subsection is a civil penalty provision (see section 1317E).

(2) A person who is involved in a contravention of subsection (1) contravenes this subsection*.*

Note 1: Section 79 defines ***involved***.

Note 2: This subsection is a civil penalty provision (see section 1317E).

76 Mr Kingsbury’s obligation as a director of Pilbara Bakeries under s 180(1) of the *Corporations Act* was to perform his duties with reasonable care and diligence. The standard of care required is objective, but account must be taken of the corporation’s circumstances and the person’s office and particular responsibilities within the corporation. In order for an act or omission of the director to be capable of constituting a contravention of s 180, there must be reasonably foreseeable harm to the interests of the company caused thereby: ***Vrisakis*** *v Australian Securities Commission* (1993) 9 WAR 395 (at 449-450).

77 The principles developed by courts concerning the duty imposed by s 180(1) of the *Corporations* *Act* have been conveniently summarised in *Australian Securities and Investments Commission v Maxwell* [2006] NSWSC 1052 (at [100]-[101]):

100 In determining whether a director has exercised reasonable care and diligence, as s 180(1) expressly contemplates, the circumstances of the particular corporation concerned are relevant to the content of the duty. These circumstances include the type of company, the provisions of its constitution, the size and nature of the company’s business, the composition of the board, the director’s position and responsibilities within the company, the particular function the director is performing, the experience or skills of the particular director, the terms on which he or she has undertaken to act as a director, the manner in which responsibility for the business of the company is distributed between its directors and its employees, and the circumstances of the specific case *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407, 427; (Romer LJ); *Commonwealth Bank of Australia v Friedrich* (1991) 5 ACSR 115, 125 (Tadgell J); *ASC v Gallagher* (1993) 11 WAR 105; 10 ACSR 43; 11 ACLC 286; *Daniels v Anderson*, 504-505; *ASIC v Adler*, [372]; *Explanatory Memorandum to the CLERP Bill* 1999 para 6.75.

101 Directors are not required to exhibit a greater degree of skill in the performance of their duties than may reasonably be expected for persons of commensurate knowledge and experience, in the relevant circumstances …. And while directors are required to take reasonable steps to place themselves in a position to guide and monitor the management of the company…, they are entitled to rely upon others, at least except where they know, or by the exercise of ordinary care should know, facts that would deny reliance *Re City Equitable Fire Insurance Co;* *Biala Pty Ltd v Mallina Holdings Ltd (No 2)* (1993) 11 ACSR 785, 856–8; 11 ACLC 1082; (1994) 15 ACSR 1, 60–2; *Daniels v Anderson* (1995) 37 NSWLR 438, 502-504; 16 ACSR 607, 665–6; *Re Property Force Consultants Pty Ltd* (1995) 13 ACLC 1051 (QSC).

78 In considering whether the s 180(1) duty has been breached, the Court seeks to balance ‘the foreseeable risk of harm against the potential benefits that could reasonably have been expected to accrue to the company from the conduct in question’: *Vrisakis* (at 450) and *Australian Securities and Investments Commission v Cassimatis (No 8)* [2016] FCA 1023 (at [465] and [479]). That is because the mere fact that a director participates in conduct which carries with it a foreseeable risk of harm to the interests of the company will not necessarily mean that the director has failed to exercise a reasonable degree of care and diligence in the discharge of his or her duties.

79 What directors must do to satisfy their obligation to consider the interests of creditors will vary according to the context. The steps required to be taken by directors will depend upon a number of factors, and these factors will vary from company to company. The factors will include the financial position of a company; the number of creditors the company has; the types of creditors the company has and the amount owed to each creditor; and the potential impact on the creditors of any transactions being considered by the directors: *Ford, Austin and Ramsay’s Principles of Corporations Law* (16th edition) (at [8.100.12]) and *Termite Resources NL (in liq) v Meadows (No 2)* [2019] FCA 354 (at[208]).

80 Mr Kingsbury had an obligation under s 181 of the *Corporations Act* to exercise his powers and discharge his duties in good faith in the best interest of Pilbara Bakeries, and for a proper purpose. An allegation of breach of s 181 involves both subjective and objective elements. Subjective in the inquiry as to the director’s subjective purpose, and objective in the assessment of whether that purpose was improper: *ASIC v Flugge & Geary* [2016] VSC 779; (2016) 342 ALR 1 (at [1976]). Similarly to s 180, the Court seeks to balance the foreseeable risk of harm against the potential benefits that could reasonably have been expected to accrue to the company from the conduct in question: *Vrisakis* (at 450).

81 Mr Kingsbury’s obligation under s 182 of the *Corporations Act* was to not improperly use his position as a director to gain an advantage for himself or someone else, or cause detriment to Pilbara Bakeries.

82 Mr Kingsbury’s obligation under s 183 of the *Corporations* *Act* was to not improperly use information obtained as a director to gain an advantage for himself or someone else, or cause detriment to Pilbara Bakeries. The test of whether conduct is improper is objective.

83 The plaintiffs contend that Mr Kingsbury did not perform his duties with reasonable care and diligence in that he:

(a) did not make independent enquiries of Pilbara Bakeries’ accountants;

(b) failed to inform himself of the fact that Pilbara Bakeries had significant unpaid superannuation obligations and tax obligations;

(c) failed to inform himself of the fact that Pilbara Bakeries had failed to lodge business activity statements and instalment activity statements;

(d) despite having access to Pilbara Bakeries’ bank account, failed to identify that Pilbara Bakeries was making regular lump sum payments to the ATO, periods during which Pilbara Bakeries failed to make any payments at all to the ATO, and was suffering from an endemic cash flow shortage; and

(e) would request management accounts to be supplied on a regular basis from Mr Catlin which included Pilbara Bakeries’ profit and loss statements, aged payables and aged receivables, but did not request on a regular basis copies of Pilbara Bakeries’ balance sheets, statements of cash flows or information in respect of Pilbara Bakeries’ tax position.

84 The plaintiffs say the relevant context in which Mr Kingsbury’s conduct must be viewed includes that, from the very first time Mr Kingsbury met Mr Catlin, he was aware from his real estate agent that Mr Catlin had a ‘chequered history’. Soon after the Agreement was signed and the initial equipment had been ordered and paid for, Mr Kingsbury became aware that Mr Catlin had previously operated another bakery business that had been wound up in insolvency. They also point to the arrival of the first ATO garnishee notice in September 2012, and that from 2012 to 2014 Mr Catlin’s attention was focussed on caring for his wife and included a number of months in which Mr Catlin left the Bakery to be operated by his sons.

85 The plaintiffs contend that each of those facts should have caused Mr Kingsbury to adopt a heightened state of awareness regarding the position of the company and Mr Catlin’s assurances. They submit that based on Mr Kingsbury’s knowledge of Mr Catlin’s previous failed bakery business, his inability to comply with Pilbara Bakeries’ statutory obligations to the ATO from as early as September 2012, and the fact that Mr Catlin was allowing his sons to operate the Business on a day-to-day basis from 2012 to 2014, it was not reasonable for Mr Kingsbury to rely on the information provided to him by Mr Catlin.

86 The defendants firmly contend that Mr Kingsbury did not breach his duty owed to Pilbara Bakeries in that he, *inter alia*:

(a) regularly made inquiries with Mr Catlin about the financial position and performance of Pilbara Bakeries;

(b) discussed with Mr Catlin, Mr Catlin’s interactions with Pilbara Bakeries’ accountants;

(c) relied on information provided to him by Mr Catlin and in relying on information provided by Mr Catlin did so in good faith and after making an independent assessment of that information having regard to his knowledge of Pilbara Bakeries;

(d) put a system in place whereby Mr Catlin provided to him monthly management accounts of Pilbara Bakeries, which he received and reviewed for the period May 2011 until June 2016;

(e) ensured that when Pilbara Bakeries experienced cash flow shortages and was unable to make a payment to a creditor he would step in and provide financial support to Pilbara Bakeries, either by deferring a payment owed by Pilbara Bakeries to Malaga or by advancing funds to Pilbara Bakeries;

(f) took steps to ensure that Malaga did not exercise its rent review entitlement and interest entitlement under its agreements with Pilbara Bakeries;

(g) took steps as soon as he discovered that Mr Catlin had misled him about Pilbara Bakeries’ taxation position to ensure that the situation was rectified, including personally paying the tax debt of Pilbara Bakeries under a garnishee order;

(h) implemented a reporting system to satisfy himself that he was aware of ATO debts and payments;

(i) from time to time took legal advice on behalf of Pilbara Bakeries regarding the garnishee order, tax liability and supply agreements.

## Malaga’s knowing involvement

87 A person involved in a contravention of ss 180, 181, 182 or 183 of the *Corporations Act* contravenes those sections. A person is involved in a contravention if they have been in any way directly or indirectly knowingly concerned in the contravention: s 79(c) of the *Corporations Act*. In order to be knowingly involved in a contravention, a person must have intentionally participated, having knowledge of the essential matters constituting the contravention: *Yorke v Lucas* [1985] HCA 65; (1985) 158 CLR 661 (at 670).

88 The plaintiffs contend that by reason of the fact that Mr Kingsbury at all material times was the sole director of Malaga, it intentionally participated in Mr Kingsbury’s contraventions and had direct knowledge of the matters constituting the contravention. It is uncontentious that any breach found against Mr Kingsbury would also be attributable to Malaga.

# ISSUES TO BE RESOLVED

89 The issues to be resolved are:

(1) At what date did Pilbara Bakeries become insolvent?

(2) Was Pilbara Bakeries insolvent at the time some or all of the debts were incurred, or did it become insolvent as a result of the incurring of some or all of the debts.

(3) Was Mr Kingsbury or a reasonable person in a similar position, aware at the time the debts were incurred that there were reasonable grounds for suspecting that Pilbara Bakeries was insolvent?

(4) At the time the debt was incurred, did Mr Kingsbury have reasonable grounds to expect, and did expect, that Pilbara Bakeries was solvent and would remain solvent even if it incurred the debt and any other debts incurred at that time?

(5) At the time the debts were incurred, did Mr Kingsbury have reasonable grounds to believe, and did believe, that a competent and reliable person was responsible for providing to him adequate information about whether Pilbara Bakeries was solvent, and had reasonable grounds to believe, and did believe, that the person was fulfilling that responsibility, and expected, on the basis of information provided to him by the person, that Pilbara Bakeries was solvent at the time the debts were incurred and would remain solvent even if it incurred the debts and any other debts?

(6) Whether it may be expected that a reasonable person in Pilbara Bakeries’ circumstances would not have entered into the transactions, the subject matter of the unreasonable director-related transactions claims? Put another way, would a reasonable person in Pilbara Bakeries’ circumstances have entered into the transactions, the subject matter of the unreasonable director-related transactions claims?

(7) Were any payments made by Pilbara Bakeries to Mr Kingsbury loans in respect of which Pilbara Bakeries is entitled to be repaid, and if so, what were the terms of the loan arrangements?

(8) Are any of the amounts claimed as loans statute barred by reason of the *Limitation Act 2005* (WA)?

(9) Did Mr Kingsbury breach any of his statutory duties or any fiduciary duties he owed to Pilbara Bakeries?

(10) Did any breach of the duties referred to in (9) above cause Pilbara Bakeries to suffer loss, and if so, what compensation is to be ordered?

(11) In relation to the claim for breach of statutory duties or any fiduciary duties, is any part of that claim statute barred by reason of the *Limitation Act 2005* (WA)?

(12) Was Malaga in any way directly or indirectly knowingly involved in (for the purposes of s 79 of the *Corporations Act*) any or all of Mr Kingsbury’s contraventions of his statutory duties?

(13) Are Malaga and Mr Kingsbury entitled to rely on a set-off and if, so in what amounts?

90 In light of the conclusions reached on some issues, not all the above questions need to be specifically addressed. Similarly, the defendants no longer rely on any of the limitations arguments which are contemplated by (8) and (11) above.

# EVIDENCE

91 It is convenient to deal first with the lay evidence and then the expert evidence. As to the expert evidence, Mr Cribb for the plaintiffs and Ms Low for the defendants, gave extensive evidence and were both cross-examined. As foreshadowed above, Ms Low’s evidence is generally preferred.

92 Mr Kingsbury was also cross-examined, however, Mr Catlin was not. There is no reason to doubt either directors’ evidence, which together creates a clear picture of a relationship that was, from its outset, clouded by the dishonesty and deception of Mr Catlin with respect to Pilbara Bakeries’ taxation and superannuation liabilities. That said, both men were clearly committed to the Business and attempted, over a number of years, to establish it as a profitable venture. Mr Kingsbury committed substantial funds to the purchase of assets and the injection of cash into the Business. Ultimately however, that support was given under the false pretence that Mr Catlin had been upholding his side of the bargain by keeping Mr Kingsbury reasonably updated as to the company’s position.

## Mr Catlin

93 Mr Catlin by his affidavit confirmed the background facts summarised above. He confirmed that he told Mr Kingsbury that he was a baker by profession, but that he did not have the financial resources or ability to purchase the necessary equipment to commence conducting a business. Agreement was reached in the manner summarised above. Mr Catlin engaged all staff necessary to conduct the Business. Other than himself and his two sons, the Business employed overseas backpackers from time to time.

94 Monthly management accounts were provided by Mr Catlin to Mr Kingsbury who would phone Mr Catlin during most weeks to discuss the Business. Mr Kingsbury would enquire of Mr Catlin about how the Business was trading and about the payment of creditors and other financial matters concerning the Business. Mr Catlin engaged an accountant to prepare the annual financial statements for Pilbara Bakeries and provided the accountant with all the information necessary to prepare the annual financial statements.

95 In relation to the company’s debt to the ATO in 2012 which resulted in the garnishee notice, Mr Catlin says that whilst he was aware of the liability, he deliberately did not inform Mr Kingsbury about those arrears as he considered that it was his responsibility to sort out all matters relating to the conduct of the Business, including dealings with the ATO. Mr Catlin confirms that from time to time Mr Kingsbury would ask if Pilbara Bakeries had met its tax obligations, which Mr Catlin would confirm were in order even though he knew the answer to be incorrect. I accept this and all of Mr Catlin’s relevant evidence which was unchallenged, plausible and given against his own interests.

96 Mr Catlin reveals that the much larger liability to the ATO discovered by Mr Kingsbury in 2016 arose by reason of Pilbara Bakeries failing to pay superannuation to the ATO for its casual overseas employees as Mr Catlin was under the impression, ‘after being incorrectly informed’, that no amount was payable for casual employees. His practice, he said, was to pay casuals an additional 9% calculated on their salaries in lieu of superannuation. In about 2015, the ATO undertook an audit of compliance by Pilbara Bakeries with superannuation guarantee obligations owing to the ATO. Mr Catlin did not tell Mr Kingsbury about the audit. Following the audit, the ATO issued an assessment in relation to the superannuation guarantee liability owing by Pilbara Bakeries in the amount of $158,603. That amount substantially comprised interest and penalties for the period from 2012 to 2015.

97 More relevantly to this case, Mr Catlin says that once again he decided not to inform Mr Kingsbury of this tax liability owing by Pilbara Bakeries to the ATO in view of the previous garnishee by the ATO. He says that he considered it was his duty to resolve those matters with the ATO.

98 Mr Catlin entered into a number of payment plans with the ATO to pay the amount outstanding. Again, he deliberately did not tell Mr Kingsbury about the details of the payment plans. Whenever he could not keep to an arrangement made with the ATO he would contact the ATO, inform them of the inability of Pilbara Bakeries to meet its agreement and a new plan would be agreed to by the ATO.

99 On 9 February 2016, Mr Catlin informed Mr Kingsbury, in response to Mr Kingsbury’s request for information as to the amount owing to the ATO, that $23,563.20 was the total debt despite the fact that Mr Catlin knew the amount was incorrect and the liability to the ATO was much greater. Mr Catlin also made provision in the monthly management accounts provided to Mr Kingsbury for superannuation guarantee payments. However, those statements did not reflect the actual extent of the liability of Pilbara Bakeries to the ATO, which Mr Catlin deliberately concealed.

100 The events of early 2016 demonstrate the extent of Mr Catlin’s deception, under which Mr Kingsbury continued to support the company with new purchases while the ATO liability was left to accrue. In April 2016, Mr Catlin said to Mr Kingsbury that it was crucial for the operation of the Business to have safe and functioning equipment. New equipment that he recommended at the time was ordered in the amount of $380,000 by Malaga, which hired it to the company.

101 In about April 2016, Pilbara Bakeries was experiencing a cash flow shortage due to debts not paid on time. Mr Catlin approached Mr Kingsbury and informed him that due to slow payment by customers, Pilbara Bakeries required funds to pay creditors. Mr Kingsbury agreed, through Malaga, to lend Pilbara Bakeries $150,000. That sum was used to pay salaries, suppliers and the ATO. About $56,000 of the money was paid back to Malaga for Variable Outgoings and Equipment Payments.

102 In about May 2016, Mr Catlin formed the view that Pilbara Bakeries needed a new cool room and informed Mr Kingsbury about this. Mr Kingsbury agreed to pay the cost of the cool room which was purchased by Malaga from a refrigeration company.

103 In about August 2016, Mr Catlin told Mr Kingsbury that two further vehicles were required for Pilbara Bakeries as one vehicle had been damaged in an accident and a further vehicle was necessary to enable the Business to provide delivery to customers. Mr Catlin persuaded Mr Kingsbury that the Business could not operate without the two vehicles. The vehicles were purchased by Malaga and hired to Pilbara Bakeries.

104 Prior to August 2016, Pilbara Bakeries was in default and in arrears with a number of its payment plans with the ATO. Mr Catlin did not disclose this fact to Mr Kingsbury. He considered that Pilbara Bakeries could trade its way out of its difficulties caused by slow payment by debtors and a dispute with one major customer.

105 Mr Catlin was also concerned that if he informed Mr Kingsbury of the true position about the extent of the liability of Pilbara Bakeries to the ATO, Mr Kingsbury would not have put in any more loan funds or arranged for Malaga to purchase additional equipment and vehicles and would have withdrawn his financial support for Pilbara Bakeries.

106 Mr Catlin remains of the view that Pilbara Bakeries had substantial potential and the issues being experienced were the usual types of issues associated with establishment of a new business. In August 2016, however, the ATO served a statutory demand on Pilbara Bakeries claiming more than $300,000.

107 Mr Catlin confirms that all payments made to Malaga in respect of Rent, Fit-Out, Variable Outgoings, Equipment and Vehicle Payments were authorised by him. The monies were either paid directly to the account of Mr Kingsbury or Malaga when he was of the view that Pilbara Bakeries was in a position to do so or when Mr Kingsbury contacted him to ask him whether Mr Catlin could access the company’s bank account to drawdown monies owing to Malaga. Mr Catlin confirms that at no stage did Mr Kingsbury, on his own, cause Pilbara Bakeries to pay monies to Malaga or himself.

108 Mr Catlin was not cross-examined. I have no doubt as to the correctness of his relevant evidence, which was given against his own personal interests.

## Mr Kingsbury

109 Mr Kingsbury’s evidence confirms the state of affairs, and in particular, the extent of the deception admitted by Mr Catlin. Mr Kingsbury was also cross-examined on those matters.

110 Mr Kingsbury, realistically in my view, said that as the Business was a start-up, he did not expect it to be immediately profitable. He was pragmatic and realistic about the fact that it was likely to take some time to make the Bakery profitable. He considered it was a long-term venture. He thought it would only turn a profit four to five years after commencing operation. Although he did not say as much to Mr Catlin, he was prepared if need be to continue to support the Business financially in that period.

111 Consistently with this, Mr Kingsbury was in touch with Mr Catlin regularly by telephone and email. Mr Kingsbury says he would talk to Mr Catlin at least a few times a week about the Business in the early stages, more about business commencement topics and later on money matters.

112 Mr Kingsbury received the management accounts usually two to three weeks after the end of the relevant month and would generally review them to discuss any issues or concerns with Mr Catlin. He would also travel to Karratha from time to time and spend time with Mr Catlin discussing the Business to satisfy himself that Mr Catlin was running the Business viably.

113 Mr Kingsbury was a signatory to Pilbara Bakeries’ bank account and had internet access to the bank account. As confirmed by Mr Catlin, Mr Catlin authorised all payments from the account to Malaga and Mr Kingsbury.

114 There were occasions on which Mr Catlin would phone Mr Kingsbury to request holding off payment of Rent and other payments to Malaga until funds become available. Mr Kingsbury saw no reason not to agree to such requests from time to time. He gives examples of such reprieves.

115 Mr Kingsbury said that it was always of concern that the Business adhere to its tax obligations and he conveyed this to Mr Catlin. He would enquire of Mr Catlin from time to time as to compliance with those obligations. Mr Catlin informed him that the company was up to date.

116 In September 2012, however, he did receive the garnishee notice from the ATO for Pilbara Bakeries which was addressed to Mr Kingsbury personally. He immediately contacted Mr Catlin and requested an explanation. Mr Catlin said that the account was in arrears for payment of PAYG. The arrears situation had not previously been disclosed to Mr Kingsbury by Mr Catlin and was not apparent, Mr Kingsbury said, from the monthly management statements which he received. He was very upset by this and demanded Mr Catlin keep him notified of the ATO situation on an ongoing basis. Mr Kingsbury told Mr Catlin he would pay the tax debt under the garnishee order on the understanding that going forward Mr Kingsbury wanted to be fully informed of Pilbara Bakeries’ compliance with all ongoing tax obligations to the ATO. At a later time, Mr Catlin informed Mr Kingsbury that he had entered into a tax payment plan with the ATO, assuring Mr Kingsbury that Pilbara Bakeries was able to comply with the arrangements made with the ATO.

117 Mr Kingsbury heard nothing untoward from Mr Catlin regarding any ATO tax debt or tax liability until 4 August 2016.

118 In the meantime, in the financial year 30 June 2013, although the bakery had a turnover figure of $1,672,000 it suffered a loss of $56,225.

119 Mr Kingsbury became agitated that the performance of the Business based on the monthly management statements provided to him by Mr Catlin and the profitability was not as anticipated. He had concerns that the Business was not achieving the projected turnover which in turn impacted on the profitability of the Business. He raised with Mr Catlin on numerous occasions his disappointment and frustration about the performance of the Business. There were ongoing discussions about possible solutions.

120 Mr Kingsbury says he made allowance for Mr Catlin’s personal circumstances when his wife fell ill, believing that the Business was viable in the long-term even though the trading figures were below budget. He was also conscious of a deterioration in mining activity in the Pilbara region in about 2014 and a dispute with a key customer of Pilbara Bakeries. In more detail than necessary to record in these reasons, Mr Kingsbury received detailed explanations and responses from Mr Catlin about the cause, and likely outcome, of financial difficulties with Pilbara Bakeries. Such explanations made no mention of the company’s increasing tax and superannuation liabilities.

121 Suffice to say, I am satisfied that Mr Kingsbury was in regular contact with Mr Catlin, had a genuine concern about the financial affairs of Pilbara Bakeries and, until a key point in time, was reasonably satisfied with the information and responses given by Mr Catlin.

122 Mr Catlin returned to Karratha to run Pilbara Bakeries after the death of his wife and in early 2016 Mr Catlin explained that Pilbara Bakeries needed new equipment, which Mr Kingsbury believed was a reasonable request and duly supplied additional capital as referred to above.

123 On 4 August 2016 when Mr Kingsbury received the statutory demand from the ATO, he immediately contacted Mr Catlin and made enquiries about it. Mr Catlin told Mr Kingsbury that he was aware of the liability, but had not disclosed it to Mr Kingsbury as Mr Catlin was afraid that Mr Kingsbury would withdraw his support for Pilbara Bakeries. Mr Kingsbury said that he was staggered and upset with what had happened and demanded Mr Catlin send him all relevant documents. He was particularly angry because he had stressed to Mr Catlin previously the need to keep on top of the tax obligations and that he had done so much to support Mr Catlin in his difficult personal circumstances.

124 Mr Catlin sent Mr Kingsbury a printout of the ATO tax portal reflecting an amount of $87,478.73 which did not include the superannuation liability. Mr Kingsbury subsequently ascertained that the ATO caused the statutory demand to be issued notwithstanding that Pilbara Bakeries was complying with the payment plan that was in place at the time.

125 Mr Kingsbury says that when the ATO issued its statutory demand, he was in a financial position to personally satisfy the debt owing to the ATO and considered doing so after taking advice. He made a decision however to resign as a director due to Mr Catlin’s failure to disclose the ATO liability to him, which, in the circumstances, amounted to a complete loss of confidence and trust in Mr Catlin.

126 Generally, in relation to payments made to Malaga, Mr Kingsbury says as far as he was aware, at no stage were payments made to Malaga in preference to payments due to other creditors, excluding (unknowingly) the ATO for the reasons stated above. Mr Kingsbury said he had no reason, as a director of Pilbara Bakeries, to suspect that it was not solvent when the payments were made because Pilbara Bakeries was continuing to trade and he was prepared to continue funding it from his own resources.

127 In his third affidavit, Mr Kingsbury confirms that, to assist Pilbara Bakeries, he decided Malaga would not exercise rent review entitlements under the Lease and did not insist on or claim any interest entitlements that were due to him or Malaga under the various agreements.

128 Mr Kingsbury says that all dealings and communications with the external accountant of Pilbara Bakeries were in the hands of Mr Catlin and Mr Catlin would occasionally report to him about particular discussions. Mr Kingsbury would take legal advice from its solicitor from time to time including around the time of the garnishee order served on Pilbara Bakeries. Mr Kingsbury did, on a few occasions, meet with suppliers of the Business. Over the period from 2011 to 2015, he spent a considerable amount of time learning the operation of the business of a bakery and the challenges associated with such a business. Those acquired skills, together with his experience as a former banker and businessman were applied to make assessments about the future direction of Pilbara Bakeries.

129 Mr Kingsbury attributed the fact that Mr Catlin deliberately withheld information from him about the true state of affairs of Pilbara Bakeries as being the cause of the company’s difficulties. Mr Kingsbury says that if he had been apprised of the true facts and financial status of Pilbara Bakeries and had not had critical matters hidden from him by Mr Catlin, he would have acted on that information and taken immediate steps in 2015 and 2016 to ensure that further funding was provided to build up the bakery or, alternatively, have taken steps to have it cease trading.

130 Mr Kingsbury was cross-examined, but I have no reason to doubt the truth of the matters deposed to in his affidavits as summarised above. I accept his evidence.

131 Mr Kingsbury’s cross-examination also traversed a number of additional matters in the factual background. It was put to, and accepted by Mr Kingsbury, that there were a number of steps that were available to him at the relevant times which would have revealed Mr Catlin’s concealment of the tax obligations at an earlier stage. While accepting this to be the case, Mr Kingsbury maintained that he may still have continued to support the company as he did after the garnishee notice in September 2012. He said that he would have assessed the circumstances and Mr Catlin’s explanation before reaching a decision, which is precisely what he did in August 2016.

132 Although some correspondence relating to the company was sent to Mr Kingsbury’s home address, it seems the vast majority of correspondence from the ATO was sent only to Pilbara Bakeries’ accountants. Mr Kingsbury accepts that he did not have any contact with those accountants despite correspondence addressed to him being sent to them. Mr Kingsbury says that this aspect was left to Mr Catlin and he relied on his assurances. Mr Kingsbury accepted that the correspondence would have come to his attention if he had ensured that a system was put in place for all correspondence to be forwarded to him from the accountants.

133 Similarly, Mr Kingsbury was taken to the monthly management accounts which he received from Mr Catlin and was asked to compare them to the company’s year-end financial statements prepared by the accountants. It was relatively clear on the face of the documents that there were discrepancies in the monthly management accounts, and Mr Kingsbury accepted that he would have discovered Mr Catlin’s concealment if, at the end of each year, he had compared the two sets of statements.

134 Finally, after a review of the company’s bank statements, it was accepted that the company did not make any payments to the ATO between September 2013 and April 2015. Mr Kingsbury accepted that he was not alerted to any issue by this, despite checking the bank statements from time to time. Mr Kingsbury opined that he might have assumed it was due to the ATO granting a ‘payment holiday’ to the company in circumstances where Mr Catlin continuously assured him that the company was up to date.

## Mr Cribb

135 The plaintiffs rely on five affidavits affirmed by Mr Cribb. It is unnecessary to repeat many of the facts to which he deposes. They have already been referred to above. Additionally, the key aspects of his expert advice have either been touched upon above or are discussed when considering the evidence of Ms Low below. Mr Cribb’s evidence is primarily directed to the date of insolvency.

136 Mr Cribb says that in his opinion, Pilbara Bakeries was insolvent from at least 30 June 2012.

137 He produces financial statements revealing the losses that Pilbara Bakeries was experiencing, set out in tabular form as follows:

|  | **30 June 2012 ($)** | **30 June 2013 ($)** | **30 June 2014 ($)** | **30 June 2015($)** |
| --- | --- | --- | --- | --- |
| Profit/(loss) | (93,056.89) | (56,255.97) | (30,067.54) | (91,351.00) |
| Current Assets | 180,739.12 | 209,636.44 | 245,864.11 | 198,138.00 |
| Current Liabilities | 187,075.66 | 202,228.95 | 275,196.09 | 308,820.00 |
| Net current assets/(liabilities) | (6,336.54) | 7,407.49 | (29,331 .98) | (110,682.00) |
| Current ratio | 0.96 | 1.04 | 0.89 | 0.64 |
| Net total assets/(liabilities) | (76,334.54) | (132,590.51) | (163,079.98) | (254,431 .00) |

138 He says that Pilbara Bakeries suffered an endemic shortage of working capital from its inception and that although it was able to pay its employees (other than superannuation), suppliers and obligations to Malaga (albeit late), it was not able to meet obligations to the ATO.

139 Upon review of the company’s balance sheets, Mr Cribb concludes that the company was balance sheet insolvent from August 2011 and that its current ratio first dropped below one in December 2011 when it recorded net liabilities of $2,666.06. Similarly, the balance sheets for 2016 disclose that:

(a) as at 30 June 2016, the company had net total liabilities of $300,474.38; and

(b) by 31 December 2016, the net total liabilities had increased to $322,799.28.

140 Mr Cribb produces a bundle of ATO documents which disclose that the company:

(a) was audited by the ATO in July 2015 for outstanding superannuation guarantee amounts because it had not been paying its superannuation obligations since April 2012;

(b) from 2 September 2015, entered into numerous payment plans (at least eight) over the next 18 months with the ATO for unpaid superannuation guarantee charges and running balance account debts;

(c) defaulted on each and every one of its payment plans in that it both failed to pay instalment amounts due under the plans and also failed to meet its continuing lodgement and payment obligations; and

(d) failed to meet lodgement obligations from August 2016 onwards up until the Appointment Date.

141 Similarly, from the initial proof of debt lodged by the ATO in the company’s winding up, Mr Cribb says that the company failed to pay any of its employer superannuation guarantee obligations commencing from 1 April 2012 to at least 30 September 2016. The unpaid contributions total $307,806.49. The company’s financial statements do not record the amounts owing by the company for unpaid superannuation contributions and therefore, Mr Cribb says, they overstate the financial position. Mr Cribb says further that Pilbara Bakeries:

(a) suffered continuing losses for the years ending 30 June 2012 to 30 June 2015;

(b) only made a modest profit of $23,886.35 during its first few months trading (up to 30 June 2011) because Malaga agreed to waive any payments for Rent, Fit-Out and Equipment Payments during this period;

(c) had net current liabilities for every year except 2013 in the Relevant Period;

(d) had a current ratio of less than one for every year except 2013 in the Relevant Period; and

(e) was insolvent on a balance sheet basis for the entire Relevant Period.

142 He says that therefore the transactions between Pilbara Bakeries and Malaga are voidable as unreasonable director-related transactions from 26 April 2013 to 19 August 2016.

143 He expresses the view that a reasonable person in Pilbara Bakeries’ circumstances would not have made the payments given that it was insolvent.

144 Mr Cribb also expressed the view that Mr Kingsbury failed to discharge his duties with the degree of care and diligence that a reasonable person would exercise if they were a director of a company in the circumstances of Pilbara Bakeries and that Malaga was knowingly involved in the breaches by Mr Kingsbury of his duties to Pilbara Bakeries as Mr Kingsbury was the directing mind and will of Malaga.

145 In his third affidavit, Mr Cribb produces a report of 29 October 2019 prepared for the purpose of providing his expert opinion on the solvency of Pilbara Bakeries (**Solvency Report**). In that Report, he repeats his view that Pilbara Bakeries was insolvent from 30 June 2012 to the Appointment Date because it was insolvent under the cash flow test of solvency for the entire period. It was also insolvent under the balance sheet test of solvency for the entire period. It had insufficient cash reserves available to pay its liabilities that were immediately due and payable at all times during the period and it displayed ‘irrefutable’ indicators of an insolvent company during that period.

146 During cross-examination, Mr Cribb was questioned as to the absence in the Solvency Report of any recognition that Malaga is a substantial creditor of the company, nor any consideration of the availability of funding support from Mr Kingsbury in assessing solvency. Mr Cribb stated that the Solvency Report reflected the information contained in the company’s financial statements. He also maintained that, despite any proven ability and ‘track record’ on the part of Mr Kingsbury to financially support the company as and when needed, this was not a significant factor in assessing solvency because the company did not have those funds under its control or ‘at its command’. Mr Cribb accepted that there was no consideration of the funding support from Mr Kingsbury in the Solvency Report. He also accepted that a start-up company such as this one can often face difficulties raising finance and obtaining loan funds and that there is nothing to suggest that the company’s dealing with Malaga were on anything other than commercial terms. Finally, following a review of Ms Low’s summary of the monthly management accounts, Mr Cribb accepted that, absent further inquiry, the monthly accounts provided to Mr Kingsbury indicated that there was always sufficient funds to pay creditors as receivables exceeded payables.

## Ms Low

147 Ms Low is a chartered accountant, who prepared an expert report expressing opinions on the date from which Pilbara Bakeries was insolvent; whether Mr Kingsbury, as a director had reasonable grounds to believe that it was solvent; and up to what point in time it was reasonable for Mr Kingsbury to consider that Pilbara Bakeries was not insolvent and related matters discussed below.

148 Ms Low observes that except for the first five months of trading, Pilbara Bakeries incurred losses each financial year until 2016. She tabulates the reported balance sheet position in the financial statements as follows:

|  | **2016****$** | **2015****$** | **2014****$** | **2013****$** | **2012****$** | **2011****$** |
| --- | --- | --- | --- | --- | --- | --- |
| **Assets** **Trade Debtors** **Inventories** **Other** | n.k. | 149,15129,04419,943 | 175,68325,74044,441 | 145,20028,50035,115 | 121,71810,00049,021 | 97,186-13,256 |
|  | 282,942 | 198,138 | 245,864 | 208,815 | 180,739 | 110,442 |
| **Liabilities** **Trade creditors** **PAYG liability** **Superannuation** **liability** **Malaga liability** **Other** | n.k. | 47,198114,384127,089123,74940,148 | 70,35898,64799,451123,74916,739 | 78,82749,14661,644129,99921,789 | 84,46956,92933,80859,99921,868 | 57,100(3,296)12,75210,00017,164 |
|  | 583,416 | 452,568 | 408,944 | 341,405 | 257,073 | 93,720 |
| **Net assets/(liabilities)** | (300,474) | (254,430) | (163,080) | (132,590) | (76,334) | 16,722 |

149 These amounts generally align with Mr Cribb’s analysis of the financial statements.

150 Ms Low emphasises that importantly, Mr Kingsbury and Malaga intended to support and fund the company until it was profitable and no longer had cash flow problems. Mr Kingsbury and Malaga’s commitment to support was objectively evidenced by their actions. Given that Malaga and Mr Kingsbury had more than adequate resources to fund the trading losses, Ms Low considered that as long as they were willing to and did adequately support Pilbara Bakeries, the company was solvent under the primary cash flow test.

151 However, when Mr Kingsbury discovered Mr Catlin’s deception regarding the true trading results of Pilbara Bakeries and the true extent of its liabilities, in particular to the ATO, he immediately resigned as a director of Pilbara Bakeries and withdrew his ongoing financial support for it (but nevertheless honoured the outstanding payments for capital expenditure already committed to).

152 Thus in Ms Low’s opinion, Pilbara Bakeries became insolvent when Mr Kingsbury withdrew his support and resigned as a director on or around 19 August 2016.

153 Ms Low next addresses the question of whether Mr Kingsbury, as a director of Pilbara Bakeries, had reasonable grounds to believe that it was solvent. As I have stated in the introduction, this is essentially a question for the Court, but I have regard to the views expressed by each of the experts and on this topic I prefer the views of Ms Low, which I consider are more realistic and compatible with the actual circumstances that prevailed.

154 Ms Low notes that Mr Catlin was based at the Business in Karratha and Mr Kingsbury was based in Perth, that Mr Catlin was in charge of all the day-to-day financial and operational aspects of the Business and Mr Kingsbury was largely dependent on the information supplied by Mr Catlin. There is little doubt that this is correct.

155 As to the reasonableness of Mr Kingsbury’s conduct, Ms Low’s view is based on the fact that Mr Kingsbury unfortunately believed (a belief I accept) that his fellow director, Mr Catlin, was a competent and reliable person and as such was providing adequate information regarding Pilbara Bakeries’ trading and financial position as well as true information. Mr Kingsbury regularly received from Mr Catlin monthly management statements. The statements usually comprised a:

(a) monthly profit and loss statement with year-to-date figures;

(b) monthly profit and loss statement compared to budget;

(c) list of aged receivables; and

(d) list of aged payables.

156 Ms Low took into account that Mr Kingsbury was not supplied with a monthly balance sheet from the company’s MYOB system, however he did have access to view Pilbara Bakeries’ bank account position and history online. Ms Low has assumed the correctness, as I do, of Mr Kingsbury’s claims that Mr Catlin consistently failed to advise him of the accruing ATO debt and superannuation liabilities. Her examination of the monthly management statements reveals that Mr Catlin reported better results than the true position and that losses were only subsequently reported in the end of year financial statements.

157 A comparison analysis of the profit results from the financial statements to those in the monthly management statements were set out by Ms Low in tabular form as follows:

| **Financial****Year** | **Financial statements** | **Management statements** |
| --- | --- | --- |
| **Profit/(loss)****$** | **Superannuation expense****$** | **Profit/(loss)****$** |
| 2011 | 23,886 | 2,792 | 32,260 |
| 2012 | (93,057) | 31,026 | (62,060) |
| 2013 | (56,256) | 45,564 | (12,361) |
| 2014 | (30,489) | 37,457 | (16,392) |
| 2015 | (91,351) | 29,638 | (36,874) |
|  | (247,267) | 146,477 | (95,427) |
| 2016 | (46,304) | n.k. | (12,451) |
|  | (293,571) | n.k. | (107,878) |

158 Ms Low observed for the period 2011 to 2015 (excluding in 2016 as she is unaware of the superannuation expense for that year), the variance between the reported profit (or loss) in the financial statements to that in the monthly management statements was largely explained by the unreported superannuation expense. She provides a global calculation of this discrepancy as follows:

|  |  |
| --- | --- |
|  | $ |
| Accumulated losses 2011 to 2015 |  |
|  Financial statements | (247,267) |
|  Management statements | (95,427) |
| Difference | 151,840 |
| Superannuation expense 2011 to 2015 | (146,477) |
| Unexplained variance | 5,363 |

159 Ms Low also accepts, as I have, for the purpose of expressing her reasonableness opinion that Mr Kingsbury regularly enquired of Mr Catlin as to the liability of Pilbara Bakeries to the ATO. Mr Catlin continually misreported the true position to Mr Kingsbury. She produces corroborating evidence of that, although it is hardly necessary given Mr Catlin’s frank admissions. She notes and takes into account, the fact that Mr Kingsbury and/or Malaga advanced funds to Pilbara Bakeries as needed, particularly at the commencement of operations and latterly in April 2016. By that time, Malaga had advanced $248,000 to Pilbara Bakeries spread over the financial years of 2011 through to 2016. During that period, Mr Kingsbury and Malaga demonstrated a substantial ongoing commitment to provide adequate funding to Pilbara Bakeries in order to address cash flow problems reported by Mr Catlin and to meet its needs for equipment and vehicles. She expresses the view, which I accept, that the substantial cash flow funding, capital, equipment and vehicle purchases for the Business of Pilbara Bakeries in this period evidence Mr Kingsbury’s belief in and support for Pilbara Bakeries at that time.

160 Ms Low then addresses Mr Cribb’s conclusions about some of the 14 indicators of insolvency referred to in *Plymin*.

161 As to continuing losses, she recognises that Mr Kingsbury was aware of continuing losses, but not aware of the extent of the losses as subsequently reported in the year-end financial statements.

162 As to the liquidityratios being below one, she notes that Mr Kingsbury was being supplied with inaccurate and incomplete information by Mr Catlin and the monthly management statements supplied to Mr Kingsbury showed that at all times aged receivables exceeded payables and until the date of his resignation, that adjusted receivables exceeded the aged payables. The information Mr Kingsbury was receiving was that the ATO liability and all employee entitlements were up-to-date and being paid in a timely manner.

163 As to taxes, it is clear that Pilbara Bakeries was overdue in its payment obligations to the ATO, but in that regard Ms Low notes that Mr Kingsbury regularly queried with Mr Catlin Pilbara Bakeries’ position and Mr Catlin deliberately misinformed Mr Kingsbury as to the liability to the ATO and the accruing superannuation liability. As to creditors being unpaid outside trading terms, Ms Low notes that Mr Cribb observed Pilbara Bakeries had outstanding creditors beyond 30 days at all times during the period from June 2012 to September 2016. However, Ms Low says that the Mr Cribb’s analysis shows that in the period to 2013, 92% or more of the outstanding creditors were aged 60 days or less. In 2014 and 2015 almost all (greater than 99%) of the outstanding creditors were aged 30 days or less; only at 30 June 2016 and 30 September 2016 was there a significant level of long outstanding creditors which was around the time, or after the time, when Mr Kingsbury became aware for the first time of the ATO debt and resigned as a director. I accept this analysis.

164 As to the question of dishonoured payments, Ms Low notes that Mr Cribb concluded that there were numerous instances of dishonoured payments within the period of 22 September 2015 to 7 June 2017. However, she notes that in summary there were only 11 dishonoured payments in the period of the operation of Pilbara Bakeries while Mr Kingsbury was a director. The majority, by both number and value, of dishonoured payments occurred after his resignation. The average amount per day increased significantly after he resigned. The three largest dishonoured payments occurred after his resignation and to the extent that these payments were to creditors that did not exist at the date of liquidation, these creditors were substantially paid prior to the liquidation. Again, I accept this analysis.

165 As to special arrangements with selected creditors, the only special arrangements were those entered into with the ATO. But Mr Kingsbury was being supplied with inaccurate, incomplete and false information in relation to this from Mr Catlin.

166 As to letters from solicitors, Ms Low notes that three examples were noted by Mr Cribb in his Solvency Report, but two of them were received after the resignation of Mr Kingsbury and the third was the ATO’s 2016 statutory demand, subsequent knowledge of which caused Mr Kingsbury to resign. This analysis is also correct.

167 As to payments to creditors of rounded figures which are not reconcilable to specific invoices, Ms Low notes that Mr Cribb identified in his report five payments to various creditors including the ATO of rounded sums as early as 3 July 2012. However, Ms Low observes that the majority, that is, 90% of the rounded payments related to the ATO, one supplier and Malaga. All other supplier creditors were paid by specific invoice amounts. She observes that because he was providing the funds to address them, Mr Kingsbury knew that Pilbara Bakeries had cash flow problems (although not their full extent), and therefore he would not be surprised that Malaga itself received occasional rounded payments on account. Of the rounded payments to the one supplier creditor, Millers, it is noted that most of these occurred at the commencement of trading in 2012 and early 2013 which was perhaps to be expected in the early days of the Business, and then later in July to August 2016, which was around the time the ATO issued the statutory demand and Mr Kingsbury resigned.

168 With regards to payments to the ATO, Mr Kingsbury’s evidence was that he was aware of the 2012 garnishee order issued by the ATO as a consequence of which he lent monies to Pilbara Bakeries at that time to deal with the issue. Additionally Mr Kingsbury says, and I accept, that subsequently Mr Catlin informed him that the ATO liability had been dealt with and the position was up-to-date and Mr Kingsbury had no detailed knowledge of any formal repayment plan with the ATO until after receipt of its statutory demand in August 2016. As noted, Ms Low observes, and I accept, that Mr Kingsbury was regularly enquiring of Mr Catlin as to the position with the ATO, and that Mr Catlin provided constant reassurance to him that the ATO liability was being properly managed. These assurances were not correct. Mr Kingsbury was unaware of the ATO 2015 superannuation audit because Mr Catlin did not inform him of it. This resulted in an assessment for Pilbara Bakeries of the superannuation guarantee liability of $158,603, which was a substantial portion of the claim by the ATO.

169 I have accepted the evidence of Mr Kingsbury that had he been aware of the financial circumstances of Pilbara Bakeries as they truly were rather than as reported to him, he would have withdrawn his support much earlier, or at least seriously reconsidered his position. I have also accepted that he was prepared to continue to financially support Pilbara Bakeries in the circumstances as explained to him by Mr Catlin if those circumstances continued.

170 In the expert conclusion of Ms Low, she considers that relevant to the reasonableness of Mr Kingsbury’s actions and beliefs were the factors that Mr Kingsbury deliberately and proactively checked with Mr Catlin as to the financial performance and position of Pilbara Bakeries, but otherwise, Mr Kingsbury took reasonable steps to adequately inform himself of Pilbara Bakeries’ financial performance and position. Mr Kingsbury was aware that Pilbara Bakeries was making losses, but not to the extent of the losses as subsequently reported. He understood and believed that the ATO debt and superannuation liabilities were up to date and being paid. In particular, after 2012, following receipt of the ATO garnishee order, Mr Catlin repeatedly assured Mr Kingsbury that the ATO liability and employee entitlements were up to date and being paid. A substantial portion of Pilbara Bakeries’ superannuation liability at the date of liquidation was as a result of the ATO’s 2015 superannuation audit, which Mr Catlin deliberately did not inform Mr Kingsbury about.

171 Ms Low notes that Mr Kingsbury understood and believed that he was adequately financing Pilbara Bakeries’ losses, working capital requirements and asset requirements.

172 Ms Low expresses the view, which I accept, that the purportedly irrefutable indicators of an insolvent company noted in Mr Cribb’s Solvency Report in this instance, and from the perspective of Mr Kingsbury, are refutable. Because of Mr Catlin’s deception, Mr Kingsbury was unaware of those indicators of insolvency while he was a director of Pilbara Bakeries. Further, Ms Low opines, with which I agree, that Mr Kingsbury had reasonable grounds to believe, and did believe, that Pilbara Bakeries was solvent and would remain solvent as long as he was prepared to continue his financial support. That was the case until he learned of Mr Catlin’s deception and resigned as a director.

173 In all of those circumstances, Ms Low also considers that it was reasonable for Mr Kingsbury to consider that Pilbara Bakeries was solvent until he learnt of Mr Catlin’s deception, resigned as a director and withdrew his ongoing financial support which all occurred virtually simultaneously. Mr Kingsbury, or any other reasonable person in his position, would have concluded only for the first time that Pilbara Bakeries was insolvent in August 2016.

174 A further topic on the which Ms Low opines was the extent to which Mr  Kingsbury was able to and did financially support Pilbara Bakeries. It was clear that Mr Kingsbury supported it directly from his personal financial resources and indirectly through his related entity, Malaga. She notes there were substantial resources both of Mr Kingsbury and of Malaga to support Pilbara Bakeries.

175 As to Malaga, it advanced money to Pilbara Bakeries, particularly at the commencement of operations and latterly in April 2016. By 30 June 2016, Malaga had lent $248,000 to Pilbara Bakeries and from April 2016 to August 2016 purchased significant new equipment and vehicles for use by Pilbara Bakeries. In addition, it extended credit to Pilbara Bakeries for the charges for Rent Payments, Variable Outgoing Payments, Fit-Out Payments, Equipment Payments and Vehicle Payments. Of the significant new bakery equipment ordered in 2016 totalling $384,666, which was agreed with a supplier to be paid in instalments, $78,250 was paid by Malaga after Mr Kingsbury resigned. As to funds lent to Pilbara Bakeries by Malaga ($248,000), Mr Kingsbury had agreed with Mr Catlin that the funds did not have to be repaid until Pilbara Bakeries’ cash flow permitted repayment. Malaga did not intend to, and did not, charge interest on funds lent to Pilbara Bakeries. The debt due to Malaga at the date of liquidation totalled $1,081,042.

176 Ms Low expresses the view that the consequences of Mr Catlin’s concealment were significant and fundamental to Mr Kingsbury’s knowledge and understanding of Pilbara Bakeries’ performance and financial position. As a result of Mr Kingsbury’s trust and confidence in Mr Catlin being in charge of the business operations, the financial information provided by Mr Catlin to Mr Kingsbury over a long period was substantially incorrect and presented a more ‘rosy’ account than was justified by reporting falsely that the state of the ATO and superannuation liabilities were up-to-date. Mr Catlin was aware at all times that Mr Kingsbury was relying on Mr Catlin as a competent and reliable person and took advantage of the situation with Mr Kingsbury. On this basis, Ms Low says Mr Kingsbury had reasonable grounds to believe that Pilbara Bakeries was solvent until August 2016.

177 Ms Low was also asked to express a view as to whether in all of the circumstances it was reasonable for Pilbara Bakeries to have paid Malaga for vehicles and equipment. She contends, and I accept, that Malaga provided to Pilbara Bakeries the appropriate business premises, fit‑out and necessary bakery equipment as specified pursuant to hire agreements and necessary motor vehicles as required. There is no suggestion that the Premises fit-out, equipment or vehicles were unnecessary or supplied at an uncommercial cost to the Business.

178 The plaintiffs make no claim that any of the payments were other than at a commercial or reasonable rate and it would have been unrealistic for Pilbara Bakeries to have had the use and benefit of Malaga’s Premises and assets without paying for their use. On that basis, she concludes, and I accept, that it was reasonable for Pilbara Bakeries to make the payments in the ordinary course of business for rent, vehicles and equipment.

179 None of Ms Low’s analysis, or her conclusion as to the date of insolvency was challenged in cross-examination. The questioning was directed substantially to the reasonableness of Mr Kingsbury’s conduct. Ms Low’s answers mirrored much of what was said by Mr Kingsbury in terms of certain steps that he could have taken to uncover Mr Catlin’s deception at an earlier time. Ms Low confirmed that a comparison of the monthly management accounts with the year-end financial statements discloses a discrepancy, which might have caused a reasonable director to have conducted further enquires if they could not satisfy themselves from their own knowledge of the business. Ms Low accepted that such enquiries could have included speaking to the company’s accountants. It was reiterated however that the financial statements were typically received some months after the year’s end.

180 In Ms Low’s view, it is entirely reasonable for there to be a division of responsibilities in the operation of a small business, with it being common for one director to control the bank account and lodge business activity statements and the like, with the other director reviewing such matters after the fact. She considered that it would be prudent for both directors to sign off on a company’s tax returns.

181 With regard to the proposition that Mr Kingsbury should have ensured a system was in place for him to receive correspondence addressed to him received by the company’s accountants, although Ms Low accepted that a prudent director might take such a course, she considered that most directors would simply rely on and expect their accountants to bring relevant correspondence to their attention.

# CONSIDERATION

182 Turning first to the date of insolvency, the principles are not in dispute and have been set out above. The fundamental difference between the parties is the weight or significance to be placed on the claim that Mr Kingsbury was able and willing to support the company financially to enable it to pay its debts as and when they fell due prior to his resignation.

183 The plaintiffs point out that there was no contractual obligation on Mr Kingsbury or any of his related companies to provide financial support or accommodation to Pilbara Bakeries. That may be so, but is clearly not determinative on the authorities: *Chan* (at [43]). I accept the evidence given by Mr Kingsbury that he was prepared until receipt of the ATO statutory demand in August 2016 to financially support Pilbara Bakeries. I accept that it is clear that he had the capacity to do so. Mr Kingsbury’s evidence was not challenged on this point.

184 The ability and intention of Mr Kingsbury and Malaga to continue to support Pilbara Bakeries is a central plank of the defendants’ case which, in my view, has been ignored in the analysis by Mr Cribb. The independent analysis by Ms Low is to be preferred. It is supported by the actual facts of significant financial support being given to Pilbara Bakeries by Mr Kingsbury and Malaga. Ms Low was not significantly cross-examined as to her opinions going to the date of insolvency. The cross-examination went largely to the question of what a reasonable director would have done in the circumstance. Her evidence as to the date of insolvency effectively being unchallenged accords with my own view as to the date of insolvency, but having regard primarily to the ongoing actual and intended support by Mr Kingsbury and Malaga which he controlled.

185 As noted in *Chan* (at [40]), in assessing the relevant date of insolvency the company’s position must be considered not only as 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. There was no challenge to the capacity of Mr Kingsbury or Malaga to provide financial support if needed on an ongoing basis. I find that his willingness to continue to support Pilbara Bakeries was established on his evidence.

186 With regard to the reasoning in *Chan* and the decisions in *Westgem* and *Mulherin* cited by the defendants, the plaintiffs misapprehend the test to the extent they suggest that the company must have a legal right to funds from a third party or that those funds be ‘under its control’ or ‘at its command’. All that is required is a necessary degree of *assuredness* that funding support will be provided. That standard is highly fact dependent and requires careful consideration of the commercial realities of the case. I recently considered this issue in *Carna Group Pty Ltd v The Griffin Coal Mining Company (No 6)* [2021] FCA 1214, albeit in a very different commercial context in which a mining company was reliant on its parent company and broader corporate group to pay its debts. At [228] I said:

In the 2014 calendar year, both Mr Roy and Mr Riordan estimated Griffin received about $50 million in parent funding. But as has been made plain, not only did Griffin have absolutely no control over when or if parent funding would arrive, the reality was that such funding consistently failed to arrive on time. The letters of support from Lanco do nothing to overcome this fact. This repeated in-principle commitment does not reflect what actually occurred. **I find both that Griffin was primarily reliant on its parent to pay its debts when they fell due and that *in practice*, Griffin did not have the necessary degree of assuredness that financial support would be forthcoming**: *Chan* (at [43]). **On numerous occasions Mr Roy contacted the parent, and when that failed, the parent’s financing bank, requesting urgent assistance and giving details of numerous debts that required immediate payment. The evidence suggests those requests went unanswered, at least within the time required.**

(Emphasis added.)

187 By contrast, the evidence here demonstrates that Mr Kingsbury had the financial capacity to support the company throughout his directorship and, most importantly, he repeatedly provided that support through various mechanisms when requested by Mr Catlin in a timely manner. Indeed, it is extremely telling that the only significant creditor of the company besides Malaga itself was the ATO, whose debt was the subject of Mr Catlin’s sustained and extensive concealment from Mr Kingsbury. The evidence clearly demonstrates that Mr Kingsbury acted to support the company to meet all of its other debts.

188 In addition to the absence of any consideration of this crucial fact in the Solvency Report, the consideration of the other factors going to insolvency advanced by the liquidator in my view, have been exaggerated. Further and despite being aware of the very significant deception by Mr Catlin, the plaintiffs have largely diminished that factor in their assessment. A similar difficulty with provision of the expert evidence by the liquidator, rather than an independent expert was discussed in *Hussain v CSR Building Products Ltd* [2016] FCA 392; (2016) 246 FCR 62 where Edelman J said (at [1] and [111]):

1 This litigation was unfortunate and uncommercial. It involved a claim by the liquidators of FPJ Group Pty Ltd (FPJ Group) to recover payments from CSR Building Products Pty Ltd (CSR) in circumstances in which, as they were told from early directions hearings, their legal costs to trial were extremely likely to exceed any possible recovery. If the liquidators’ own time and costs were added to the legal costs then it must have been clear from the inception that this would eclipse any possible recovery. In some circumstances the public interest in recovery proceedings being brought by a liquidator might justify a risk being taken that legal costs might exceed recovery. But that public interest diminishes substantially where, as here, some of the liquidators’ claims are ambitious.

…

111 Although there was significant cross-examination about Mr Ross’ independence and impartiality, **I am satisfied that he approached his evidence honestly. But Mr Ross was not independent. Nor was he impartial. He properly accepted that he was not merely a plaintiff in these proceedings, in his capacity as liquidator, but also that he had done considerable work which would not be remunerated if the liquidators were unsuccessful in the proceedings. Although Mr Ross was honest, and although he was aware of his obligations as an expert, the conflict which he faced as both expert and party was apparent at times in his evidence.**

(Emphasis added.)

189 The position here is similar.

190 In conclusion on the date of insolvency, it may be that the objectively assessed date of insolvency was somewhat before the date of resignation of Mr Kingsbury, when he first learned of the ATO debt. It was certainly not anywhere near as early as the plaintiffs suggest because Mr Kingsbury was prepared for a considerable number of years to continue to finance Pilbara Bakeries. His resignation was caused, not so much by the existence of the ATO debt, but because of its existence when he had been repeatedly assured by Mr Catlin that arrangements with the ATO were in hand. It was discovery of the deception which was the main problem. In those circumstances, I am unable to find that the plaintiffs have proven that the necessary support would not have continued so as to enable Pilbara Bakeries to meet its debts as and when they fell due.

191 However, assuming that I am wrong with regards to the date of insolvency, and in considering the reasonableness of Mr Kingsbury’s conduct in relation to the directors’ duties claim, I do not consider Mr Kingsbury should reasonably have suspected that the company was insolvent at some time prior to his resignation. Nor do I consider that it was unreasonable for him not to have taken the courses of action urged by the plaintiffs to have uncovered Mr Catlin’s deception at an earlier time. Although the garnishee notice did raise a ‘red flag’, in my assessment Mr Kingsbury reasonably relied upon the explanation provided in relation to that circumstance and did put in place further protections from that time to ensure that he received proper information. He also financed payment of the debt. The plaintiffs effectively contend that Mr Kingsbury should have distrusted Mr Catlin from the moment that the first garnishee notice came to his attention, and continuously checked these aspects of the company’s financial position completely independently of Mr Catlin into the future.

192 It is easy with hindsight to be critical of a person’s lack of suspicion of a co-director, but for most people in business with a person whom they have trusted and on whom they have placed fiscal reliance, it is not in the nature of things to suspect plain deception and dishonesty about reports, let alone repeated and extensive dishonesty over a number of years. Viewing things in hindsight is a great advantage. Although a number of possibilities were put to Mr Kingsbury in cross-examination as to the further steps he might have taken to satisfy himself as to the correctness of the information, it is easy with the benefit of hindsight in a courtroom and the accumulation of much more knowledge than was available at the relevant time to be critical of the willingness to accept the financial reporting which was being made.

193 The plaintiffs also submitted that it was extraordinary for Mr Kingsbury to have held a directorship for as long as he did without having any contact with Pilbara Bakeries’ accountant. I am not convinced that this is so, given the conduct of the day-to-day affairs of Pilbara Bakeries were in the hands of Mr Catlin and there was no evidence to indicate that the accountants did anything more than prepare the company’s financial statements in line with its statutory obligations. Indeed, Mr Catlin’s evidence suggests the accountants’ involvement did not extend beyond this annual role. Mr Kingsbury received assurances from him with which he was satisfied. He saw documents from Pilbara Bakeries’ accountant which he assessed and took into account. One might put this submission the other way and say that if there was a circumstance which should be brought to the attention of the directors of the company, it might be expected that the company’s accountant would do so. No information of concern was conveyed to Mr Kingsbury from Pilbara Bakeries’ accountant. There was no such factor putting Mr Kingsbury on alert that he might need to check the financial affairs with Pilbara Bakeries’ accountants. This is not a factor, in my view, which detracts from the reasonableness of Mr Kingsbury’s reliance on Mr Catlin.

194 Indeed, in my view, it would be an extraordinary state of affairs if a serious notice, such as a statutory demand from the ATO addressed personally to the client of an accountant, albeit in his capacity as a director of the company, would not be brought to the attention of that director by the accountants. Even where the client was the company (i.e., Pilbara Bakeries), Mr Kingsbury would be entitled to expect that the accountants would inform him of such a notice if it was addressed to him in his name as a director. There is no more he should be required to do to ensure that occurred.

195 The plaintiffs emphasise that there was a period of some 18 months from September 2013 to April 2015 when no payments were made to the ATO, yet Mr Kingsbury’s evidence was that he was checking the bank statements to see that there were regular payments to the ATO. Mr Kingsbury said in cross-examination that there may have been a ‘payment holiday’ meaning, as I understand it, an accepted arrangement with the ATO. Again, no doubt with the benefit of hindsight, Mr Kingsbury would wish that he had explored that question more closely at the time, but given what is now known, it is hard to believe that he would have received any different information from Mr Catlin other than that payments being made to the ATO were in accordance with the arrangements reached and that Pilbara Bakeries was not in default of its obligations to the ATO.

196 Ms Low’s evidence was also to the effect that it may not be obvious to a director reviewing bank statements that there is an absence of payments that should be occurring, as opposed to the presence of payments that should not be occurring. She said however that once on notice about any issue in relation to the payment of an obligation, any prudent director could be expected to review the bank statements with an eye for such matters. In circumstances where the only previous issue with ATO payments was (to Mr Kingsbury’s knowledge) the garnishee notice in September 2012 which had been promptly resolved almost a year before the company’s 18 month hiatus from making ATO payments, I do not consider it would have been expected of Mr Kingsbury to be monitoring the bank statements for non-compliance in this regard. He was repeatedly assured by Mr Catlin that ATO payments were up to date.

197 As to payments to Malaga, there is no evidence at all that those arrangements were anything other than commercial and necessary. I am not satisfied that it has been demonstrated that the payments were unreasonable in the circumstances where Mr Kingsbury had been misled as to the state of affairs, and thus the solvency, of Pilbara Bakeries.

198 Some criticism is made by the plaintiffs of the fact that Malaga purchased certain assets in its own name and made them available to the Business. In some instances, Malaga did not do so using its own funds. It paid for the fit-out of the Premises, purchased the bakery equipment and various vehicles using funds provided by the CBA. Malaga then required Pilbara Bakeries to repay the fit-out cost in instalments which included a commercial interest rate incurred by Malaga to the CBA.

199 It is difficult to understand the complaint in this situation. Pilbara Bakeries got the benefit of these items and made payment in respect of that benefit. The benefit was provided commercially. It is not known whether it would have been possible for Pilbara Bakeries to borrow the funds directly to finance the fit-out, but it may certainly be reasonable to infer that it would have had difficulty doing so in the absence of a guarantee from Mr Kingsbury or Malaga. The plaintiffs led no evidence on this topic. A reasonable commercial solution was to provide the equipment by Malaga borrowing the funds from the CBA. The plaintiffs complain that Pilbara Bakeries did not acquire any beneficial interest in respect of the equipment because of this arrangement, but there is really no adequate evidence one way or the other as to whether it would have been possible to structure this funding arrangement in some other way which would have been financially viable. Instead, it was simply asserted that Malaga could have loaned funds to Pilbara Bakeries for it to purchase the equipment and vehicles for itself with Malaga to retain a security interest over the assets to protect its investment. That is certainly an alternative arrangement that the parties could have agreed, and one that perhaps may have been more favourable to Mr Catlin. But again, no evidence has been led in this regard and the mere hypothetical existence of an alternative business structure does not demonstrate the unreasonableness of the one agreed to, particularly where it is not challenged that the parties’ dealings were at arms-length and on commercial terms. I see no difficulty in this funding arrangement. It was logical and reasonable.

200 As to the payments which have been described as the Kingsbury Loans, receipt of some payment is acknowledged, but the plaintiffs say there is no evidence that Pilbara Bakeries owed any sum directly to Mr Kingsbury and therefore Pilbara Bakeries was not indebted to Mr Kingsbury at any time. Nor were the payments made by way of a gift. It seems clear that the amounts paid to him were in respect of amounts owed by Pilbara Bakeries to Malaga under the Lease. The plaintiffs assert that there is no evidence of any direction by Malaga to Pilbara Bakeries to pay to Mr Kingsbury these amounts. Mr Kingsbury, it is said, derived a benefit as a result of those payments because they went into his home mortgage account, despite the fact that the payments were ultimately attributed to the bank accounts of Malaga. But the plaintiffs say there was no evidence identified as to how this occurred and no basis on which the payment should have been made to Mr Kingsbury rather than to Malaga.

201 This complaint is also difficult to understand. While the payments under the Lease, for example, were due to Malaga, rather than to Mr Kingsbury, there is no debate that the payments were due. The fact that Pilbara Bakeries paid them to the controller of Malaga personally or to a related entity of Malaga (no doubt at some express or implied direction from Mr Kingsbury or Mr Catlin) has not caused any loss to Pilbara Bakeries or any proven benefit to Mr Kingsbury at the expense of Pilbara Bakeries or either of the other entities. The payment was accepted in satisfaction of Pilbara Bakeries’ obligations to Malaga. The question is whether Pilbara Bakeries has sustained some loss by those payments being made to Mr Kingsbury, rather than to Malaga. Pilbara Bakeries has not suffered any loss because these payments were due. Similarly, the fact that the payments were made to Malaga’s controller has not caused the defendants to sustain any proven benefit to which they were not entitled. But further, and obviously if the plaintiffs’ claim were correct and, in my view, it is not, Malaga would have a substantial set-off claim against Pilbara Bakeries for unpaid rental payments.

202 I accept the submission for the plaintiffs that as observed in *Australian Securities and Investments Commission v Rich* [2009] NSWSC 1229; (2009) 236 FLR 1, the minimum standard of diligence requires every director to keep informed about the company’s activities and to maintain familiarity with the financial status of the company including a review of the company’s financial statements. But it is not the case here that Mr Kingsbury simply accepted at face value everything he was told by Mr Catlin. He received a substantial quantity of financial information. Mr Catlin’s deception was so significant that the written financial information supplied was deceptive and false. I accept the evidence of Mr Kingsbury that he made regular enquiries and insisted on the provision of financial information and received that information. (After all his funds and Malaga’s funds were at risk.) I also accept the submission for the plaintiffs that reliance on assurances in the absence of more concrete proof of the financial state of affairs may be unreasonable, depending on the circumstances. But the plaintiffs extrapolate this assertion to a submission that from the date of the issue of the garnishee notice onwards there should have been distrust. With the benefit of hindsight such a submission is reasonable and it may be that some directors would have taken a more suspicious view of the information being supplied by Mr Catlin, but taking into account the steps that Mr Kingsbury did take, I cannot be satisfied that his reliance upon the information he received was unreasonable. It is true, as Ms Low said, that he could have taken, without great difficulty, additional steps which may have uncovered the concealment or deception of Mr Catlin, but this concession by Ms Low was a concession made with the benefit of hindsight and all the knowledge that has now accrued. Ms Low did not adjust her conclusion that the reliance placed by Mr Kingsbury at the time was reasonable. Nor, in my view, was she required to do so.

203 It is possible that had Mr Kingsbury compared the financial year-end statements prepared by Pilbara Bakeries’ accountant and the monthly management accountants that discrepancies may have been disclosed. But again, such scrutiny of the different financial reports of the company would have required Mr Kingsbury to harbour significant suspicions about the veracity of Mr Catlin’s monthly management accounts, in circumstances where the year-end statements were received by him often times a number of months after the end of the relevant financial year. Importantly as well, the monthly management statements always indicated to Mr Kingsbury that the company’s receivables exceed its payables.

204 I am also not satisfied that it was unreasonable that Mr Kingsbury did not request Mr Catlin for access to the ATO portal given the specific assurances that he had received from Mr Catlin. To do so in circumstances where these affairs were, by agreement, under Mr Catlin’s control, would have effectively amounted to suggesting Mr Catlin was deceiving Mr Kingsbury about the state of the tax affairs of Pilbara Bakeries. No doubt with the benefit of hindsight, Mr Kingsbury may wish he had done so at an earlier time, but I am not satisfied that such a confrontation would reasonably be expected in all the circumstances described in the evidence of this case. In any event, there was evidence from Ms Low which I accept, that accessing the ATO tax portal would not have shown the superannuation guarantee balance that was due, so that even if Mr Kingsbury had taken this step, he would not have been any the wiser with respect to easily the most significant aspect of the ATO liability.

205 It is true also that Mr Kingsbury conceded that soon after the Business commenced trading he became aware that Mr Catlin had managed a failed bakery business in the same town, but made no further inquiries about that failure. Perhaps more relevantly, it might be thought that Mr Kingsbury would be concerned that Mr Catlin had not disclosed to him such failure at an earlier stage of their business dealings. I accept that Mr Kingsbury should have been mindful of this aspect of Mr Catlin’s history when reviewing Mr Catlin’s operation of the Business. However, Mr Kingsbury had weekly communication with Mr Catlin and insisted on the provision of monthly statements of the accounts. In my view, the fact of a previously unsuccessful business venture would not put a reasonable person on notice as to the possibility of a complete concealment and deception of a significant aspect of a company’s liabilities. The two concepts are quite distinct. Again, with hindsight, perhaps Mr Kingsbury wishes he had made further enquiries as to the circumstances in which Mr Catlin’s previous business failed, but there is no evidence of those circumstances in this proceeding from which to infer that Mr Kingsbury should have been alive to the possibility that Mr Catlin would deceive him to the extent that he did.

206 There is a significant difference between a business failure on the one hand and plain, large scale deception on the other. The false information given by Mr Catlin to Mr Kingsbury was the total cause of the difficulties of Pilbara Bakeries. The extent of deception by Mr Catlin was so substantial that it would be unlikely to be anticipated or predicted by most business people. Even accumulating all the factors to which the plaintiffs point, I do not think there were sufficient red flags earlier than the date of resignation of Mr Kingsbury when the true position with the ATO came to his attention.

207 Mr Kingsbury or someone in his position would have expected that creditors were being paid because of the financial support he was giving, the assurances and documentation that he was receiving. This is certainly not a case where Mr Kingsbury sat back and did nothing and allowed Pilbara Bakeries to trade with impunity whilst creditors accrued. Nor is there any evidence of any profit by Mr Kingsbury or Malaga as a result of any contravention as asserted by the plaintiffs. Any payments made to those entities were made in good faith pursuant to commercial arm’s-length agreements.

208 For these reasons, none of the plaintiffs’ claims is established. I do not consider the company to have been insolvent for any substantial period prior to Mr Kingsbury’s resignation, nor do any of the payments made to Mr Kingsbury or Malaga meet the criteria for unreasonable director-related transactions or unwritten loan agreements. The negligent or unreasonable conduct allegations of Mr Kingsbury fall a long way short of establishing any breach of statutory or fiduciary duty.

209 In light of those conclusions, it is unnecessary to consider the claim of set-off raised by the defendants.

# CONCLUSION

210 The amended originating process will be dismissed.

211 The plaintiffs wished to be heard on costs. There is no apparent reason why costs should not follow the event. Only if the plaintiffs contend otherwise, the parties should each have five days to file submissions not exceeding five pages on costs. Unless the Court otherwise orders, costs will be determined on the papers.

|  |
| --- |
| I certify that the preceding two hundred and eleven (211) numbered paragraphs are a true copy of the Reasons for Judgment of the Honourable Justice McKerracher. |

Associate:

Dated: 11 November 2021