Breaches of freezing order and payment of substantial dividends relevant to whether stay of enforcement ordered

In January this year we reported on the decision of Stevenson J in *Fitz Jersey Pty Limited v. Atlas Construction Group Pty Limited (in liquidation) & Ors* [2021] NSWSC 1692 in which the Court held that:

- an amount received by Atlas pursuant to an adjudication determination under the *Building and Construction Industry Security of Payment Act 1999* (NSW) was required to be recognised in Atlas' accounts as revenue, with a corresponding liability recorded as "deferred revenue";
- the actions of Atlas' directors in declaring and paying dividends using the amount of the adjudication determination constituted an alienation of property with the intention to defraud Fitz Jersey as creditor within the meaning of s.37 of the *Conveyancing Act 1919* (NSW);
- by doing so, the directors had also breached their duties owed under the *Corporations Act 2001* (Cth) and to Atlas; and
- accordingly the dividends were to be restored by Atlas' shareholders and their related persons and entities to Atlas for distribution by Atlas' liquidator.

Stevenson J's decision has been appealed to the NSW Court of Appeal, and a hearing of that appeal has been scheduled for March 2023.

Application for stay of enforcement

Atlas' directors and various of their related parties and persons applied for a stay of enforcement of Stevenson J's judgment pending the outcome of the appeal. This application was heard by Rees J on 30 November 2022 and her Honour delivered her judgment on 14 December 2022.

The general rule is that a successful plaintiff is entitled to the fruits of the judgment notwithstanding that the judgment is being appealed. However, the defendant may be able to obtain from the Court an order that enforcement of the primary judgment be stayed until the appeal has been determined.

To obtain a stay, the applicant must show that it has an arguable case and that there are serious questions for the determination of the appellate court: *Kalafair Pty Limited v. Digitec (Australia) Pty Limited* [2022] NSWCA 383 per McColl JA. However, ultimately, the question is for the court to ask what the interests of justice require. As McColl JA explained in *Kalafair*:

> Thus the relevant principles are analogous to those which govern the grant of interlocutory relief before trial to protect the status quo. The appellant must show that the appeal raises serious issues for the determination of the appellate court and that there is a real risk that he will suffer prejudice or damage if a stay is not granted which will be redressed by a successful appeal. This requirement will be satisfied if the appeal will be rendered abortive or nugatory unless a stay is granted. If these pre-conditions are established the Court will then consider the balance of convenience.

In the present case, the parties agreed that there was an arguable case for determination by the NSW Court of Appeal. Therefore, the Court turned its attention to the applicant defendants' financial positions and whether justice required that a stay be ordered.

The applicant defendants had first requested that Fitz Jersey consent to a stay of enforcement in April 2022, shortly before Stevenson J made the complex orders that would give effect to his earlier judgment. Fitz Jersey had requested security in the amount of the judgment be provided by the applicant defendants and then ensued six months of voluminous correspondence between the parties' lawyers. In this correspondence the applicant defendants had provided details of their financial positions.

However from this correspondence and documentation provided, it became apparent that in 2021 and again in 2022 one of the directors and his wife had heavily mortgaged a house in Avalon Beach that was the subject of a freezing order made by the Court in 2020, and the director and his wife were now unable to offer any satisfactory security.

The mortgages over the Avalon house had been provided as security for guarantees provided by the director and his wife with respect to the refinancing (in two tranches) of an apartment development being carried out at Alexandria. The amounts refinanced had been for $99.3 million and $90.7 million respectively. The financial documents included cross-collaterisation arrangements which had the effect that, in the event of a default of the loans, the lenders could take possession and sell the Avalon house to satisfy up to the total of the loan outstanding, rather than the lesser amount permitted under the terms of the freezing order. Therefore, it appeared that on both occasions the director and his wife had breached the freezing order and by doing so had deprived Fitz Jersey of the benefit of the security provided by the freezing order.

Fitz Jersey therefore refused consent to a stay and the applicant defendants instead approached the Court.

The director's evidence

In Court, the director who part-owned the Avalon property was cross-examined on the mortgage transactions which now encumbered that property.

Initially, he denied knowing the details of the 2021 refinancing including the amount being advanced under the loan facility.

Then, when questioned about various of the documents, the director denied that he had either signed the document or (in other cases) that he had approved the use of his electronic signature on the document. Rees J commented thus at [6] of her judgment:

> [The director] disclaimed his signature and electronic signature on critical documents – a mortgage, statutory declaration, minutes and tax returns – including where witnessed by a solicitor … [The director] added that over the past 12 months, he had discovered a number of forged signatures and copied and pasted signatures and people that had falsely witnessed documents. [The director] declared himself to be shocked, although it was probably his legal team who was more surprised, where the suggestion of forgery was not mentioned in his affidavit or the compendious correspondence.

However, her Honour also noted at [40] and [41]:

> [I]t is inherently unlikely that a solicitor would purport to witness someone's signature when they, in fact, did not. Nor is there any suggestion in the affidavit of [the director] or the defendants' solicitors, or in the extensive correspondence exchanged between the parties, that [the director's] signature was forged or falsely witnessed. More likely, [the director's] evidence was an attempt to distance himself from documents which demonstrated his knowledge of the Avalon Beach mortgage and the size of the loan it secured.
>
> [The director] maintained that he did not know that the amount of the mortgage was to a maximum of $99 million. Whether or not [the director] executed the statutory declaration – and I should not be taken to be accepting that he did not – I expect that an experienced businessperson giving a personal guarantee in support of a $99.3 million loan would have been *at pains* to understand his and his wife's potential liability as guarantors ….[The director's] evidence to the contrary is wholly unlikely and I do not accept it.

The director had also stated that the total assets of himself and his wife, together with their corporate defendants, totalled $110,307,586, with liabilities of $93,960.721, and thus neither he nor his wife presently had the required cash to pay the judgment debt in full. Further, if the lenders under the loan facilities exercised their rights to seek power of sale orders or to appoint a receiver, then the director and his wife would be unable to fund the appeal.

However, Rees J also noted that in the last two or so years some $19 million in dividends had either been paid or proposed to be paid to parties in the corporate group of the director and his wife, and in excess of $6 million had been loaned to the director and his wife personally by one of their related entities.

The Court's decision

Her Honour stated that there were three key problems with the defendants' application for a stay:

(1) the director and his wife had clearly breached the freezing order when they had mortgaged the house in 2021, and she had no doubt that the director was aware that he and his wife were mortgaging the Avalon property as security for the $99.3 million loan.

(2) The suggestion that the director and his wife were unable to pay or to provide security for the judgment sum critically depended on the evidence of the director, on which her Honour was not prepared to rely. In this regard, the documents evidenced that director and his wife were willing and able to make substantial payments among themselves and, indeed, to anyone other than Fitz Jersey. Instead, her Honour was "left with the unshakeable impression" that the director would be able to find the necessary funds or security if he were minded to do so.

(3) Her Honour doubted that the Court had been provided with the full picture in respect of the ability of the director and his wife to provide security, and it may be that other companies or trusts within the corporate group of director and his wife may be able to provide cash or security in support of a stay.

Rees J held that in the interests of justice a stay should be ordered, but only on the condition that the parties involving director and his wife paid the amount of the judgment sum into Court as security, which she ordered be done in two tranches in the following month.

In this case, the director and his wife's breach of the freezing order, their lavish payments to themselves, and their general lack of full and frank disclosure about their financial position led to a lack of sympathy from the Court.

This case illustrates how important it is for a defendant to ongoing court proceedings to obtain advice from their solicitors before entering into financial transactions which could be potentially a contempt of court or even just be viewed as an attempt to remove funds from the reach of the plaintiff.

Queries

Eakin McCaffery Cox acted for Fitz Jersey in this case and achieved a highly successful outcome for our client.

We can provide expert and comprehensive advice about disputes with respect to construction projects, including general litigation and financial issues like those that arose in this case.

If you have any queries, feel free to contact your usual **Eakin McCaffery Cox** contact, a member of the **Eakin McCaffery Cox** Construction Team, email to info@eakin.com.au or call (02) 9265 3000.

Linda Holland 19/12/2022