Brad's on Tap Plumbing Pty Ltd v The Owners – Strata Plan No 56443 - [2016] NSWSC 512

Supreme Court

New South Wales

Medium Neutral Citation:	**Brad's on Tap Plumbing Pty Ltd v The Owners – Strata Plan No 56443 [2016] NSWSC 512**
Hearing dates:	08 April 2016
Date of orders:	08 April 2016
Decision date:	08 April 2016
Jurisdiction:	Equity - Commercial List
Before:	McDougall J
Decision:	Order plaintiff to provide security for the defendant's costs by instalments. Proceedings to be stayed if security not given.
Catchwords:	PRACTICE AND PROCEDURE – security for costs – discretion to order security for costs enlivened – no relevant delay - security for costs order made – quantum - UCPR r 42.21 – s 1335(1) Corporations Act 2001 (Cth)
Legislation Cited:	Corporations Act 2001 (Cth) Strata Schemes Management Act 1966 (NSW) Uniform Civil Procedure Rules 2005 (NSW)
Category:	Procedural and other rulings
Parties:	Brad's on Tap Plumbing Pty Ltd (Plaintiff) The Owners – Strata Plan No 56443 (Defendant)
Representation:	Counsel: EA Walker (P) DD Knoll AM (D) Solicitors: Barraket Stanton Lawyers (P) Grace Lawyers (D)
File Number(s):	2015/251082

Judgment

1. **HIS HONOUR:** I am concerned today with an application for security for costs.

Background

2. The defendant (the Owners Corporation) is the owners corporation of a large strata title complex in Pitt Street, Sydney. It is said to be the largest such complex in this country.

3. The plaintiff (Brad's) says that it entered into a contract with the Owners Corporation under which, for a fixed period of five years, Brad's undertook to provide plumbing and handyman services to the Owners Corporation. There was a stipulated annual fee for each of those services and a stipulation for the fee to increase by four per cent annually.

4. Brad's says between January 2014 and February 2015 it invoiced the Owners Corporation for about $190,000 worth of work, but that it was not paid.

5. On 12 June 2015, Brad's notified the Owners Corporation, purportedly pursuant to cl 7.1(b) of the contract, that the Owners Corporation was liable to pay the amounts in question. The Owners Corporation did not do so and accordingly Brad's purported to terminate the contract.

6. Under the contract, if it were terminated in circumstances such as those just described, the Owners Corporation was liable to pay the balance of the fees for each of the services calculated up until the end of the contract. Brad's claims about $2 million for future fees, and in addition about $190,000 for the unpaid invoices. Brad's also claims on a quantum meruit basis for other services that it says it provided.

7. The Owners Corporation says there was no contract or no enforceable contract. That is so, it says, because the contract on which Brad's sued was a caretaker agreement as defined in s 40A of the *Strata Schemes Management Act 1966* (NSW) and, not having been authorised in general meetings, is unenforceable.

8. Alternatively, and in relation to the claim for the balance of fees from the date of termination for the rest of the life of the contract, the Owners Corporation says that the relevant contractual provision is void as being a penalty. There are other arguments raised, including that it was the Owners Corporation itself which validly terminated the contract and hence that in any event (if the contract were otherwise enforceable) there is no obligation to pay the fees following termination.

Application for security for costs

9. The application is brought pursuant to s 1335(1) of the *Corporations Act 2001* (Cth) and UCPR r 42.21 . The first question is, adapting the language of the former provision, whether there is credible evidence that Brad's, were ordered to pay the Owners Corporations' costs, it would be unable to do so.

10. If that question is answered in favour of the Owners Corporation, then it becomes necessary to pay attention to such discretionary considerations as are relevant, bearing in mind that the discretion to order security for costs requires the Court to determine what, if any, order should be made.

11. Finally, if it appears that some order should be made, there is the question of quantification.

12. I set out those unremarkable propositions to explain why each step is disputed in this case.

13. The case for the Owners Corporation commences with the undoubtedly correct proposition that Brad's has a paid-up capital of $1 and is, in fact, a one man company, the alter ego of its controller and director, Mr Brad Fotheringham. It points to the fact that Brad's owns no real estate and, at least at the level of reality as opposed to bookkeeping entries, has precious little in the way of other assets.

14. Mr Knoll of counsel, who appeared for the Owners Corporation, very properly pointed to evidence which showed that whilst Brad's itself had little in the way of assets, Mr Fotheringham was shown in the real estate records of this State as the owner as tenant in common of property at Canada Bay, which was the subject of a mortgage to the Commonwealth Bank of Australia. It may be noted that the bank in question provides banking facilities to Brad's.

15. After numerous requests and much prodding, Brad's provided some financial records to the Owners Corporation. Those financial records were given to an accountant, Mr Pascoe. Mr Pascoe assessed, on the basis of what had been given to him, that Brad's likely future maintainable cash flow was of the order of $83,000 per annum.

16. Mr Walker of counsel, who appeared for Brad's, did not, as I understand it, dispute the arithmetical basis upon which Mr Pascoe came to that conclusion. He did, however, submit that it was irrelevant to the question with which I am presently dealing.

17. There is other evidence bearing on the jurisdictional question. In 2013 and 2014, the Deputy Commissioner of Taxation brought applications to wind up Brad's. Mr Knoll submitted that Brad's was forced to "fend off" those applications. Mr Walker submitted that this was an unfair characterisation of what had happened.

18. There can be no doubt that, as at mid-2014, Brad's was recorded as owing very substantial sums of money to the Tax Office. On the evidence, that position appears to have resulted, at least in part, from some bookkeeping or accounting errors in the way that Brad's' records were kept. Those errors resulted in a significant over-statement of Brad's' liabilities under its Business Activity Statements. The mistake was discovered in about September 2015, amended statements were submitted, and the erroneous entries were reversed out.

19. However, as Mr Knoll submitted, that did not entirely deal with the situation. In October 2014, that is to say when the erroneous statements had been submitted and at a time when they had not been corrected, the liability of Brad's was said to be of the order of $562,000.

20. On 6 October 2014 (or it may be a few days earlier) Brad's made three payments totalling $350,000. When one goes to the detail of the Tax Office records, it is clear that the amount reversed by reason of the incorrect Business Activity Statements was not anything like the total of $562,000. It was, rather, of the order of $200,000.

21. In other words, even making allowance in Brad's favour for the consequences of its own bookkeeping inadequacies, the clear inference from the documents is that to stave off winding-up, it owed and was forced to pay at least $350,000. It is not, I think, coincidental that it was only after those payments were made that the winding-up proceedings then current were dismissed.

22. I should note in this context that the notice of motion had been listed for hearing in February. It was adjourned so that, among other things, Brad's could put on expert evidence. In the circumstances there is a readily available inference that it would be unlikely to have assisted in the present application.

23. I return to the tax situation. Although it is correct to say that, as at August 2015 or thereabouts, the amount that Brad's owed to the Tax Office was one way or another discharged, the evidence is clear that in the intervening eight months Brad's has accumulated further tax liabilities. Its own records show a steadily mounting debt arising from its Business Activity Statements (not said to be incorrect), and insufficient payments to meet those liabilities. Thus, as at 21 October 2015, there was a liability in excess of $26,000 that increased, although not in a completely linear fashion, until two days ago when the liability was shown as $104,000. There is no explanation of the failure to pay the amounts that are due, nor any explanation as to why the tax debt has grown again.

24. In addition, Brad's, as an employer, is bound to pay superannuation contributions on behalf of its employees. The evidence satisfies me that as at today's date there is approximately $31,000 owing but unpaid for those superannuation liabilities.

25. Although the application for security for costs was presaged in 2015 and filed in December 2015, and although it is being dealt with in April 2016, the only up-to-date financial records that Brad's has been able to produce, apart from its management accounts, are its financial statements as at 30 June 2014. There is no explanation as to why Brad's has been unable to produce more up to date accounts.

26. However, working off what we have, that is to say the accounts which are now almost two years old, one significant feature of them is that they show that the amount owed to creditors (apart from the Tax Office) increased from $193,000 as at 20 June 2013, to $719,000 as at 30 June 2014. This could indicate that Brad's was in effect funding its requirement for working capital by delaying payment of creditors. Whether this is correct is, however, a matter on which the evidence is silent.

27. I referred a moment ago to the management accounts. To the extent that the management accounts can be compared with external accounts, that is to say for the year ending 30 June 2014, there are significant discrepancies. Net profit before tax is stated in the management accounts to be $290,000 and in the external accounts it is $665,000. Likewise, in the management accounts salaries and wages are said to be $511,000, whereas in the external accounts they are $1,189,000. Those discrepancies are unexplained. They give me no comfort in the veracity of such financial information as Brad's has produced that has not been the subject of external analysis.

28. Mr Walker submitted this was all very interesting, but that what was required was a broad-brush assessment based on the real world position that would be likely to prevail in, say, 2017 when any hypothetical costs order in favour of the Owners Corporation might become payable. He pointed to evidence given by Mr Fotheringham as to the rosy prospects for further work that, in Mr Fotheringham's view, were open before Brad's. Whether "rosy" is an appropriate description, or whether "blue sky" is better, is a matter of opinion.

29. Mr Fotheringham said that Brad's had a number of commercial contracts on foot which generated substantial revenues, that it intended to re-negotiate those contracts, and that it was confident of doing so. He gave no basis that would enable the Court to assess the extent to which that view was (or was not) well founded.

30. More importantly, however, he gave no information at all that would enable the Court to assess the extent of the profitability of those contracts or even of their ability to generate free cash flow. Thus, I do not regard that aspect of Mr Fotheringham's evidence as carrying any weight on the present application.

31. I add that the four commercial contracts Mr Fotheringham identified generated about 20 to 25 per cent of Brad's "business", by which I take it he meant revenues. If that is so, and if those contracts have been in place for some time, one might enquire why trade creditors could have increased so dramatically from 2014 to 2015 if the contracts were truly profitable, or if they generated significant free cash flow.

32. Mr Walker pointed also to what he said was Brad's enviable cash at bank position. He produced bank account statements for the months from (and including) July 2014 to February 2016. Those statements show that the account was always in credit, with balances ranging from a high of $380,000 to a low of $27,000. As at the end of February 2016 there was an amount of $78,000 standing to Brad's credit. However, as Mr Pascoe said in a supplementary report, that closing balance was insufficient to pay Brad's then known current liabilities. That is manifestly correct, if only by reference to what I have said as to Brad's' liabilities to the Tax Office and in respect of superannuation payments.

33. Thus, although I have no doubt that the money from time to time standing to the credit of the bank account could be employed in satisfaction of whatever creditor is pushing hardest for payment, I do not regard it as being sufficient to displace what seems to me to be the strong inference available from the evidence on which Mr Knoll relies as I have summarised it. I accept, of course, as Mr Walker submitted, that the question needs to be answered in the future. I accept that the further one moves into the future, the less it is safe to rely on unreliable past data as a source of inference.

34. However, in circumstances where current data suggests that Brad's is having trouble once again in meeting its debts, and where that inference is consistent with past experience, I consider that the totality of the material can be relied upon to assess the statutory test.

35. If the recoverable costs were of the order of $130,000 (and I shall return to this question), Mr Pascoe's evidence shows that Brad's would be unlikely to have the free cash flow to meet them. Of course, it could have recourse to whatever was standing in its bank account, but that would only mean that one creditor, hypothetically the Owners Corporation, was being paid in priority to others. In relation to the bank balance, there is a matter of some significance that was not really explored in the evidence but which I raised with counsel in the course of submissions. That is, of course, that the bank balances are being used amongst other things to pay Brad's legal expenses, and that presumably, as those expenses increase, whatever free cash flow there is will be directed to those expenses also.

36. In those circumstances, I think Mr Pascoe's analysis (which in itself is not favourable to Brad's) represents merely a best case scenario that in the real world is unduly optimistic from Brad's perspective.

37. Looking at all of the material, and bearing in mind in particular the unexplained failure of Brad's to meet its current statutory obligations, I conclude that the statutory test has been satisfied and that the discretion to order for security for costs has been enlivened.

Discretionary factors

38. The discretionary factors on which submissions were focused included, from Brad's perspective, what was said to be the strength of its case and what was said to be delay in bringing the application.

39. From the Owners Corporation's perspective, the relevant discretionary factors were said to be the absence of any undertaking from Mr Fotheringham to stand behind Brad's and the swiftness with which the application was presaged.

Strength of the case

40. The strength of the case is a matter often referred to in applications of this nature. It is really not possible, except in the clearest of cases, to say much about that. Mr Knoll did not suggest that the proceedings have not been brought in good faith, and I accept they have been brought in good faith.

41. However, as to the claim to recover the contractual measure of damages on termination in the circumstances on which Brad's relies, I will observe that in my view there is much to be said for the proposition that the relevant contractual provision is a penalty. It would give to Brad's the entire balance of the fee that would accrue, increased annually by four per cent, over the remaining life of the contract had it not been terminated. It makes no provision for the reduction of that to a net present value. More significantly, it makes no allowance for the cost of provision of the services that, otherwise, must have been provided to earn the fee. I do find it difficult to see how any such stipulation could be characterised as being otherwise than in terrorem of the

Owners Corporation: a very sharp spur indeed to induce the making of payments under the contract.

42. Thus, as to that aspect of Brad's' case, I think that there may be significant difficulty.

43. Of course, if Brad's is entitled, one way or the other, to loss of bargain damages, that does not mean that those damages might not be substantial. That is an entirely different matter. Whether they fall to be assessed by reference to loss of profit, or by reference to loss of earnings less the direct costs of achieving those earnings, is a matter that can be deferred to some unhappy trial judge if the matter ever goes to a hearing.

44. However, there is a significant point underlying this. That point is relevant when one turns, as I shall do in a moment, to the assessment of any amount that is required.

Delay

45. The other principal discretionary matter that was in issue between Brad's and the Owners Corporation is whether the application was brought promptly. Mr Walker raised that in particular because the amount for which security is sought included about $24,000 for past costs. He submitted that the Owners Corporation should have sought security earlier than it did. As I have foreshadowed, Mr Knoll submitted that the Owners Corporation had moved sufficiently swiftly.

46. The summons was filed on 27 August 2015. The first directions hearing took place on 11 September 2015. Presumably, the summons and the list statement were served at some time between those two dates.

47. On 11 September 2015, directions were given for particulars and for the Owners Corporation to file its list response.

48. On 29 September 2015, the Owners Corporation's lawyers wrote to Brad's' lawyers noting certain matters relating to Brad's' financial position, including its paid-up share capital and lack of obvious assets, and the existence of prior winding-up applications. The letter sought financial information from Brad's, and foreshadowed that if the Owners Corporation's concerns as to Brad's' ability to meet its costs were not resolved, an application for security for costs might be made.

49. The application was not filed until 23 December 2015. However, it is notable that between 29 September and 23 December 2015, there were numerous letters written back and forth between the respective legal advisers. Brad's did provide financial information. However, it appears, it did so slowly, unwillingly, and only in response to repeated pressure. The provision of information was not completed until late in November 2015. The Owners Corporation then sought advice from Mr Pascoe's firm. He provided that advice promptly, and once it was provided, the application for security for costs was brought promptly.

50. In my view, there was no relevant delay. To the extent that it took some time between 29 September and 23 December for the application to be filed, that appears to be attributable, substantially at least, to the delays on the part of Brad's and its legal advisers in providing the requisite financial information. I accept of course that the legal advisers could only produce that which they were instructed to produce.

51. Thus, I do not think that delay has any bearing.

Other considerations

52. It is correct to say, as Mr Knoll submitted, that Mr Fotheringham has not offered any personal undertaking. It is also correct to say (although it is not in issue so far as the submissions reveal) that no claim of stultification has been made. I mention that only because the questions of personal undertaking and stultification are often seen to be closely related.

53. In my view, there are no discretionary factors tending against the making of an order for security for costs.

Quantification

54. I turn to the question of quantification. The Owners Corporation's solicitor, Mr Ton, estimated the total recoverable costs at $133,000. Broken down, and rounding off, there is about $24,000 in costs already incurred (at the time he swore his affidavit); something over $15,000 for the security for costs application; and about $49,000 for "discovery, preparation of evidence and directions hearings", and an allowance of $46,400 for a five-day hearing.

55. Mr Walker attacked that estimate on a number of bases. First, he submitted, there was no justification for ordering Brad's to give security for costs already incurred. That submission appears to have been based on his proposition that there had been delay in bringing the application. For the reasons I have given, I do not agree.

56. Next, Mr Walker submitted, there was no basis for ordering security for the cost of the application for security for costs. Of course, if I were to dismiss the application, that would be so, because the Owners Corporation would have no entitlement to any such costs, and instead would be ordered to pay the costs incurred by Brad's. But if I order, for example, that there should be some security for costs and that the costs of the application are to be the Owners Corporation's costs in the proceedings, then there is a very obvious basis for including the estimated sum in the amount for which security should be given.

57. In relation to the allowance for "discovery", preparation of evidence and the like, Mr Walker submitted that it was unlikely that disclosure would be ordered, because having regard to the

issues in the case it was unlikely to be necessary that there should be disclosure. He submitted, further, that the allowance for preparation of evidence (including as it did estimates for the costs of experts) was overstated.

58. If the issues were narrowly as to the entitlement to the balance of fees, the question of penalty and the like, there might be something to be said for this; although even then, bearing in mind the need to justify at least to some extent why Brad's should have the whole fee when it has not incurred the costs of earning it, I am not sure that this analysis is entirely correct. But if, as at present seems to me to be likely, the question of damages is to be assessed in the usual way (that is to say, assessing the true financial harm that the loss of the contract caused to Brad's) then the basis on which expert evidence would be necessary is, I think, obvious.

59. Further, in this context, it must be remembered that Brad's has brought a quantum meruit claim. In the ordinary way, if that claim is to be run, there will need to be evidence of the services for which remuneration is claimed and some expert evidence of the reasonable cost of providing those services.

60. Whether or not disclosure is to be ordered is a matter on which I express no view. However, particularly bearing in mind the true issues that in my view are likely to arise, I do not think it unlikely that some limited disclosure might be ordered.

61. Mr Walker's submissions in relation to the allowance for the costs of the hearing effectively encompassed what I have just dealt with. He said that he did not think it could be a five day hearing. I do not agree, because I do not agree that the question of quantification of damages (if ever one gets to that point) is as simple as Mr Walker submitted.

62. Looking at the amounts themselves, they appear to me to be modest. They encompass a very significant discount, which Mr Ton said reflected his understanding that in the ordinary way solicitors costs were assessed at about seventy per cent of the amount actually billed. Thus, in outline, I think that the amount claimed is reasonable.

63. The Owners Corporation submitted that it would be happy to have an order for security for costs made payable by instalments. In the ordinary way, that might be so. However, when some of the costs have been incurred already, and where the next round of costs (discovery and the like) will shortly be incurred, it seems to me that only two instalments would be necessary. The first of those would encompass costs to date and the estimated costs of preparation for hearing. Rounding those off, I assess that figure at $86,000.

64. Thereafter, and once a hearing date is allocated, a further sum would become payable. Again rounding off, I assess that at $46,000.

65. For those reasons I make the following orders:

1. Order the plaintiff to provide security for the defendant's costs of the proceedings.

2. Order that such security be provided in whatever form the parties may agree and otherwise in a form approved by the Registrar.

3. Order that the security be provided:

    1. as to the sum of $86,000, on or before 22 April 2016; and

    2. as to the further sum of $46,000, within seven days of the date upon which a hearing date is allocated for these proceedings.

4. Order that the proceedings be stayed if security be not provided in accordance with the preceding orders.

5. Subject to order 4, list the matter for directions on 29 April 2016.

6. Order that the costs of the application for security for costs be the defendant's costs in the proceedings.

7. Order that those costs be assessed (if necessary) on the ordinary basis up until 23 March 2016 and on the indemnity basis thereafter.

8. Direct that the exhibits on the application be handed out.

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Decision last updated: 28 April 2016