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Termite retains its bite: Termite Resources NL (in liq) v Meadows [2016] FCA 1171

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In the case of *Termite Resources NL (in liq) v Meadows* [2016] FCA 1171, the Federal Court dismissed an application to strike out a statement of claim for not pleading a cause of action. **Partner, Ian Nathaniel, Senior Associate, Ben Hartley**, and **Law Graduate, John Evans**, discuss further.

Termite Resources NL (Termite) had operated the Cairn Hill Mine in South Australia from 2010. As a wholly owned subsidiary of Outback Iron Pty Ltd (Outback), Termite operated the mine as an incorporated joint venture between IMX Resources (IMX) and Taifeng Yuanchuang International Development Co Ltd (Taifeng).

By the middle of 2012, IMX and Taifeng had advanced close to $49 million to Outback (JV loans) and Outback had in turn, advanced that money by loan to Termite (Outback loan). The liquidators of Termite argued that the JV loans and the Outback loan were subordinate debts of Termite and Outback and only repayable when the other creditors of Termite and Outback had been paid out in full. This was because the loans were interest free, unable to be demanded by the respective lenders prior to expiration of the term.

In relation to the series of loans, a distribution policy was agreed to by the directors of all the companies. In essence, the management of Termite would distribute to Outback a monthly repayment of the Outback loan. Outback would then forward that payment to IMX and Taifeng as repayment of the JV loans. The situation left Termite with a relatively low cash reserve in a situation where it was solely liable for its future liabilities as it had no recourse to make any cash call on Outback, IMX or Taifeng and had no credit banking facilities beyond its operational account.

The liquidators of Termite claimed that its former directors knew or ought to have known that if Termite was so reliant on its cash reserves it would risk insolvency in the event of business shocks or the crystallisation of liabilities.

The director defendants sought to have the liquidator's claim struck out on the basis that they were under no general duty to preference one creditor over another (any duty ground). In addition, they argued that the liquidators had failed to allege any facts that could constitute damage. This was, the directors argued, because any damage was suffered by individual creditors and not by Termite (no damage ground). Finally, the directors argued that the liquidators had not alleged that Termite was insolvent or near insolvency at the time the payments were made (no insolvency ground).

Under the Federal Court Rules, the liquidators were able to file an Amended Statement of Claim; however, this did not affect the basis on which the defendants made the application.
White J utilised the established principles of strike outs and proceeded on the basis that the Court will not look to the prospects of success, but will assess whether the allegations raised in the pleadings are fairly arguable.

No duty ground
His honour disagreed with the directors that the liquidator's case relied on Termite's actions in paying Outback over other creditors. White J held that the central claim of the liquidators was that the decision to repay the loans when they were not due led Termite to being at risk of insolvency. Termite's claim was that the directors breached duties to Termite by doing so as it placed Termite in a worse position.

No damage

The directors also claimed that any loss was suffered by Termite's creditors and not Termite. The liquidators argued that had Termite not repaid the loans, it could have traded through to the end of the Cairn Hill Mine project and as per the loan agreements, liabilities to some creditors would never have crystallised and liability to pay the Outback loan would have been forgiven. White J held that there may be some dispute about the causal links at trial and there was at least a reasonably arguable case presented by the pleadings.

No insolvency

White J held that this ground also failed. The liquidators had at least an arguable claim that the directors were under a duty to consider the interests of the creditors at the time of the distribution policy. His honour considered various authorities which discussed when such a duty arises. It was clear that the factual circumstances (which would require a trial to expound) were critical and for this reason his honour did not strike out the pleaded allegation.

Clients should be aware that strike out applications are a useful tool in challenging statements of claim which are devoid of properly pleaded causes of action. As this case shows however, the low threshold of reasonably arguable pleadings will pose a difficult hurdle to get over.