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DIRECTORS' DUTIES TO CREDITORS

Introduction

1 The purpose of this paper is to provide a general overview of the duties owed under Australian law by company directors regarding creditors and corporate solvency.

General comments regarding directors' duties under Australian law

2 Under the law of Australia, directors of incorporated companies owe a myriad of duties.

3 These duties arise pursuant to the *Corporations Act*, and pursuant to other pieces of Federal or State Legislation; at common law; and in equity. Breach of duty may expose a director to criminal sanction, civil liability, regulatory investigation, and disqualification from office. Proceedings against a director for breach of duty may be brought in appropriate cases, by the company or its liquidator, by creditors, or, increasingly, by the corporate regulator, the Australian Securities and Investments Commission (**ASIC**).

4 Under Australian law, there are traditionally three types of duty which a director (or officer) of a company owes to it, and for breach of which the director might face sanction. These duties are as follows:

4.1 The duty to exercise due care and diligence;

4.2 The duty to act in good faith, and for proper purposes; and

4.3 The duty to avoid conflicts of interest.

5 The proper discharge of each of these 'traditional' directors' duties will, in particular instances, oblige a director closely to monitor the solvency of the company, and in particular instances, to consider the interests of creditors. This will be further discussed below.

6 In addition to the 'traditional' category of directors' duties, over the past 15 years or so there has been a marked trend in Australia for 'newer' categories of duty to be imposed on directors, typically via legislation.

7 The most important of these 'newer' style obligations imposed on company directors is the statutory duty of directors to prevent insolvent trading. This duty is presently contained in section 588G of the *Corporations Act*[1]. Breach of the duty in section 588G of the *Corporations Act*, subjects a director to a range of possibly sanctions, including criminal conviction, and personal liability of the director for the company's debt. This personal liability for the debt may be recovered by the liquidator of the company, or by a creditor should the liquidator decline to act, or by ASIC.

8 Given the importance of section 588G of the *Corporations Act* in relation to the directors' duty to prevent insolvent trading, we shall provide a summarised overview of this section of the *Corporations Act* prior to discussing, in general terms, the insolvency and creditor obligations imposed on directors pursuant to the more traditional directors' duties.

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[1] The duty to prevent insolvent trading was originally imposed by section 556 of the *Companies Code*, then replaced by section 592 of the *Corporations Law*. The present version confines the insolvent trading duty to directors but not officers.

Statutory duty to prevent insolvent trading

9 The relevant provisions of section 588G of the *Corporations Act* read as follows:

> '1 This section applies if:
>
> (a) a person is a director of a company at the time when the company incurs a debt; and
>
> (b) the company is insolvent at that time, or becomes insolvent by incurring that debt, or by incurring at that time debts including that debt; and
>
> (c) at that time, there are reasonable grounds for suspecting the company is insolvent, or would so become insolvent as the case may be; and
>
> (d) that time is at or after the commencement of this Act.
>
> 2 By failing to prevent the company from incurring the debt, the person contravenes this section if:-
>
> (a) the person is aware at that time that there are such grounds for so suspecting; or
>
> (b) a reasonable person in a like position in a company in the company's circumstances would be so aware.
>
> 3 A person commits an offence if:
>
> (a) a company incurs a debt at the particular time; and
>
> (aa) at that time, a person is a director of the company; and
>
> (b) the company is insolvent at that time, or becomes insolvent by incurring that debt, or by incurring at that time debts including that debt; and
>
> (c) the person suspected at the time when the company incurred the debt that the company was insolvent or would become insolvent as a result of incurring that debt or other debts (as in paragraph 1(b)); and
>
> (d) the person's failure to prevent the company from incurring the debt was dishonest'.

Elements of contravention of section 588G

10 A purported contravention of section 588G(2) of the *Corporations Act* therefore involves an examination of the following:

10.1 Whether there was a debt of the company and when that debt was incurred;

10.2 Whether a person was a director at that time;

10.3 Whether the company was insolvent at that time;

10.4 Whether there were reasonable grounds for suspecting this at that time; and

10.5 If yes, to each of the above, whether the director has contravened section 588G(2) by:

(a) failing to prevent the incurring of the debt by the company; where

(b) the director, or a reasonable person, would have been aware of grounds for suspecting insolvency.

11 There have been a number of prominent cases involving the insolvent trading prohibition, under section 588G and predecessor legislation. These cases include litigation arising from the collapse in the late 1980s of the National Safety Council of Victoria, and high profile litigation against Australian businessman John Elliott and others arising from the Water Wheel collapse.

Debt

12 As to what is a 'debt' for the purposes of section 588G, the cases suggest that a debt involves an obligation to pay a liquidated amount, which is a fixed amount that can be calculated positively. Thus, unliquidated damages are not 'debts' within the meaning of the section.[2] However, the statutory meaning is broader than what would be encompassed in an action for debt at common law, and therefore would extend to include an action in money had and received for the return of

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[2] See *Box Valley Pty Limited v Kidd* (2006) 24 ACLR 471; and *Shepherd v ANZ Banking Corp Limited* (1997) 15 ACLC 1802

funds paid to a company in error.[3] It is also clear that the meaning of a 'debt' for the purposes of section 588G is not confined to voluntary and consensual obligations of a company. So, for example, an obligation imposed on a company to pay tax, although non-voluntary, nonetheless would constitute a debt for the purposes of the section.[4]

13 As to when a debt is 'incurred' for the purposes of Section 588G, the law in this area was surveyed by Barrett J in *ASIC v Edwards*.[5] His Honour concluded 'case law indicates in my view that 'incurring' is the act, omission or other circumstance which causes the company to owe the debt'. In ASIC v Plymin[6] Mandie J held:

> 'The question when the debt is incurred within the meaning of the section does not depend upon strict legal analysis but turns on when, in substance and commercial reality, the company is exposed to the relevant liability …'

14 Thus, quantum meruit debts for progress work done by a building contractor are 'incurred' within the meaning of section 588G when recognisable work is completed and certified. Under a contract for the sale of goods where delivery times are left for future orders or instructions, as a matter of substance and commercial reality a debt will be incurred for the purpose of Section 588G on each occasion when a delivery is ordered. And a contingent debt in the nature of a guarantee may be incurred when the guarantee is entered.[7] A notice of assessment issued by the Commissioner of Taxation under the *Income Tax Assessment Act* 1936 creates a debt incurred when the period for payment in the notice elapses, even if the assessment is genuinely and reasonably disputed.[8]

Insolvency

15 As to the meaning of 'insolvency' for the purposes of section 588G the position has been summarised as follows:

> 'The definition of 'insolvency' is found in section 95A of the *Corporations Act*… Courts will look at the circumstances of the company as a whole when determining its financial status. This includes a consideration of the commercial realities affecting the company, for example, number of assets, current or future liabilities and ability to secure financing if needed, when determining the question of insolvency under section 588G: *Standard Chartered Bank of Australia Limited v Antico* (1995) 38 NSWLR 290… It should be noted however, that the 'commercial realities' seems to carry greater weight in New South Wales than it does in other states: see *Emmanuel Management Pty Limited v Fosters Brewing Group Limited* (2003) 178 FLR 1; *Powell v Fryer* (2001) 159 FLR 433…'[9]

16 Pursuant to sections 95A(1) and (2) of the *Corporations Act* a person is insolvent if they are not able to pay all their debts as and when they become due and payable. A consideration of this issue requires a cash flow test more so than a balance sheet test[10], although the state of the balance sheet is still relevant.[11]

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[3] See *Commonwealth Bank of Australia v Butterell* (1994) 14 ACSR 43 and 347

[4] See *Shepherd v Australia and New Zealand Banking Group Limited*; *ASIC v Plymin (No.1)* (2003) 175 FLR 124 per Mandie J

[5] (2005) 220 ALR 148 at pages 171-2

[6] (2003) 46 ACSR 126, these being the insolvent trading proceedings against the businessman John Elliott and other directors of the insolvent wheat and rice milling company, Water Wheel.

[7] *Hawkins v Bank of China* (1992) 26 NSWLR 562

[8] Unless the Commissioner has agreed to defer time of payment or a stay of enforcement has been obtained from the court: see *Hall v Poolman* [2007] NSWSC 1330, per Palmer J.

[9] See Corporations Legislation 2007, annotations by J Harris, at page 1795

[10] *Manpac Industries Pty Limited v Ceccattini* (2002) 20 ACLC 1304; *ASIC v Plymin (No 1)*.

[11] *Lechmere Financial Corp v Aspermont Limited* (2003) FCA 1138 at 22 per Nicholson J.

17 The key case concerning the determination of solvency and insolvency for the purposes of section 95A (and, therefore, for the purposes of section 588G) is *Southern Cross Interiors Pty Limited (in liquidation) v Deputy Commissioner of Taxation*.[12] In that case, Palmer J set out the relevant principles for determining solvency as follows:

> '(i) whether or not a company is insolvent for the purposes of CA ss95A, 459B, 588FC or 588G(1)(b) is a question of fact to be ascertained from a consideration of the company's financial position taken as a whole;
>
> (ii) in considering the company's financial position as a whole, the court must have regard to commercial realities. Commercial realities will be relevant in considering what resources are available to the company to meet its liabilities as they fall due, whether resources other than cash are realisable by sale or borrowing upon security, and when such realisations are achievable;
>
> (iii) in assessing whether a company's position as a whole reveals surmountable temporary illiquidity or insurmountable endemic illiquidity resulting in insolvency, it is proper to have regard to the commercial reality that, in normal circumstances, creditors will not always insist on payment strictly in accordance with their terms of trade but that does not result in the company thereby having a cash or credit resource which can be taken into account in determining solvency;
>
> (iv) the commercial reality that creditors will normally allow some latitude in time for payment of their debts does not, in itself, warrant a conclusion that the debts are not payable at the times contractually stipulated and have become debts payable only upon demand;
>
> (v) in assessing solvency, the court acts upon the basis that a contract debt is payable at the time stipulated for payment in the contract unless there is evidence, proving to the court's satisfaction that:
>
> - there has been an express or implied agreement between the company and the creditor for an extension of the time stipulated for payment; or
> - there is a course of conduct between the company and the creditor sufficient to give rise to an estoppel preventing the creditor from relying upon the stipulated time for payment; or
> - there has been a well established and recognised course of conduct in the industry in which the company operates, or as between the company and its creditors as a body, whereby debts are payable at a time other than that stipulated in the creditor's terms of trade or are payable only on demand;
>
> (vi) it is for the party asserting that a company's contract debts are not payable at the times contractually stipulated to make good that assertion by satisfactory evidence.'

Reasonable grounds for suspecting

18 As to when there are 'reasonable grounds for suspecting' that a company is insolvent for the purposes of section 588G, the courts apply an objective test according to the standards of a director of ordinary competence who is expected to have the capacity of reaching an informed understanding of the financial capacity of the company, and whether the company is able to pay its debts as and when they fall due.[13]

Proving contravention

19 Assuming that a debt has been incurred by a company at a time when the company was insolvent, and at a time when there were reasonable grounds to suspect this fact, a director will contravene section 588G of the *Corporations Act* by failing to prevent the company from incurring the debt, if the director, or a reasonable person in a like position, was aware that there were grounds for suspecting the insolvency: see section 588G(2).

20 If a director, subjectively or objectively, had grounds for suspecting the insolvency of the company, then section 588G(2) would be contravened where the director failed to prevent a debt

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[12] (2001) 53 NSWLR 213 at 224-225 per Palmer J.

[13] See *Ford's Principles of Corporations Law* at paragraph 21.120.

from being incurred by the company. It has been held that this will be so even where there is no proof that the director knew that each of the impugned debts were to be incurred, and even where there is no proof that the director had power to authorise or deny the making of the debt: see *Elliott v ASIC*. In effect this means, then, that where a director has a reasonable suspicion that the company is insolvent, then the director must ensure that the board prevents the company from incurring any further debts whatsoever. Otherwise, the director must resign from the board: see *Morley v Statewide Tobacco Service Limited* per Ormiston J[14].

Defences to an insolvent trading claim

21 It should be noted that section 588H of the *Corporations Act* sets out a number of statutory defences available to directors in insolvent trading proceedings for contravention of section 588G(2)[15].

22 The statutory defences apply where directors can prove:

22.1 They had reasonable grounds to believe the company was solvent at the time it incurred the debt, including because they were relying on a competent and reliable person to provide adequate information about whether the company was insolvent;

22.2 They did not take part in the management of the company at the time the debt was incurred because of illness or some other good reason;

22.3 They took all reasonable steps to prevent the company from incurring the debt.

23 The defence of reasonable presumption of solvency because of a director's reliance upon a competent and reasonable person to provide adequate information about whether the company was insolvent, has been held not to be available where a director consistently failed to obtain from management:

> 'A list of debtors and creditors by age and amount (including the age and amount of off-balance sheet finance), regular profit and loss and cash flow statements and reports on negotiations (if any) with creditors whose debts were outside trading terms.'[16]

24 It would also seem that a director cannot rely on the defence of illness or 'some other good reason' for not participating in the management of the company, if the director failed to actively participate in the affairs of the company or simply relied on other directors to look after the company's business. It would seem to follow from this that the failure of a company director to participate in the management of a company, or to rely on other directors – such as may occur where a spouse accepts appointment as a director but leaves the company's affairs entirely in the hands of their husband or wife – will be insufficient to activate the section 588H defences: see *Ford's Principles of Corporations Law*[17].

Sanctions for breach of section 588G

25 A director who breaches the duty in section 588G of the *Corporations Act* to prevent insolvent trading by a company faces a range of potential sanctions. These include:

25.1 Conviction of an offence if the provisions of section 588G(3) are operative, with the maximum penalties being a fine of $220,000 or five years imprisonment or both;

25.2 A declaration at the suit of ASIC of contravention under section 1317E of the *Corporations Act*, and a pecuniary penalty order made under section 1317G of up to $200,000 and a disqualification order under section 206C;

25.3 An order to compensate the company under section 588J or section 1317H, at the suit of ASIC or the company;

25.4 An order to compensate the company under section 588K, where a court finds an offence committed under section 588G(3); and

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[14] (1993) 1 VR 423 at 439.

[15] It is not clear if these defences are available in criminal proceedings for an offence under section 588G(3). This seems to be because a criminal prosecution for insolvent trading involves proof of additional elements in any event, including proof of dishonesty on the party of the director: see section 588G(3)(d).

[16] Per Mandie J in *ASIC v Plymin* (No 1).

[17] At paragraph 20.140, and the cases cited, including *DTC v Clark* (2003) 57 NSWLR 113.

25.5 Recovery proceedings under section 588M, brought by the liquidator of the company, or by the creditor in circumstances outlined in sections 588R to U. Generally speaking, the rights of the creditor to sue a company's director for insolvent trading are deferred to those of the company or its liquidator, and the creditor is prevented from suing where, for example, the company's liquidator has commenced proceedings.

26 Amongst other things, it follows from the discussion in the previous paragraph that a director may be found personally liable to pay debts incurred by a company, if they were incurred at a time when the company was insolvent, and the director knew or should have known this fact.

Traditional director's duties

27 As mentioned, Australian law imposes a statutory duty on directors of incorporated companies to prevent insolvent trading, as set out in section 588G of the *Corporations Act*. This is a relatively new statutory obligation. The older, more 'traditional' duties imposed on company directors by Australian law always had – and still have – a role to play in the creditor and insolvency area. However, the presence of section 588G of the *Corporations Act* has tended to overshadow the more traditional obligations.

28 For completeness we shall briefly comment on the more traditional directors' duties created by Australian law which have an impact on insolvency issues.

Duty to exercise care and diligence

29 Under the law of Australia company directors and officers owe a duty to exercise care and diligence in the discharge of their duties to the company. This obligation arises at common law, in equity, and pursuant to statute.

30 The statutory prescription of the duty is set out in section 180(1) of the *Corporations Act* as follows:

> '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 the 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.'

31 The standard of care expected of a company director under Australian law is an objective one measured by reference to the ordinary prudent person in the position of the director. The standard, or its content in specific instances, may vary depending on the size and business of the particular company; the company's circumstances; and the director's position and responsibility within the company.

32 It is clear that the objective standard required of a director at least extends to taking reasonable steps to guide and monitor the management of the company: see *Daniels v Anderson*[18]. As explained by Santow J in *ASIC v Adler*[19], this means that:

> '(a) a director should become familiar with the fundamentals of the business in which the corporation is engaged;
>
> (b) a director is under a continuing obligation to keep informed about the activities of the corporation;
>
> (c) directorial management requires a general monitoring of corporate affairs and policies, by way of regular attendance at board meetings; and
>
> (d) a director should maintain familiarity with the financial status of the corporation by a regular review of financial statements. Indeed, he or she will be unable to avoid liability for insolvent trading by claiming that they had never learned to read financial statements: *Commonwealth Bank of Australia v Friedrich* (1991) 5 ACSR 115 at 125.'

33 Thus, a director who negligently permits a company to incur a debt whilst the company is insolvent, may also face a claim for breach of the duty of care and diligence. This claim, however,

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[18] (1995) 37 NSWLR 438, per Clarke and Sheller JJA at 501.

[19] (2002) 168 FLR 253 per Santow J.

would be brought by the company itself (and possibly by ASIC), and not by the creditors of the company.

Duty to act in good faith and for proper purposes

34 The second 'traditional' duty owed by company directors and officers under the law of Australia is the duty (or duties) to act in good faith and for proper purposes. This duty arises at general law (principally in equity) and pursuant to section 181 of the *Corporations Act*. Under Australian law the relationship between a director and officer of a company is a fiduciary relationship, which imposes on the director a high standard of loyalty. The 'positive' aspect of this fiduciary obligation involves the duty to act in good faith and for proper purposes. The 'negative' aspect of this fiduciary obligation involves a duty to avoid conflicts of interest and to restore secret profits (discussed later).

35 The statutory prescription of the duty to act in good faith and for proper purposes is set out in section 181(1) of the *Corporations Act* as follows:

> 'A director or other officer of the 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.'

36 There is a considerable amount of Australian jurisprudence concerning the content of the good faith and proper purpose duty (or duties), and those matters which a director must consider when discharging the obligation to act 'in the best interests of the corporation'.

37 For present purposes, however, the relevant issue is whether the 'interests of the company' include the interests of the creditors, and therefore whether directors must take into account the position of creditors when discharging their good faith obligations.[20]

38 It should be noted that this issue is separate and distinct from the statutory duty of directors to prevent insolvent trading as set out in section 588G of the *Corporations Act*. The present position of the law of Australia on the identification of creditor interests with the interests of the company is stated by Gummow J in *Sycotex Pty Limited v Baseler*[21] as follows:

> 'It is clear that the duty to take into account the interests of creditors is merely a restriction on the right of shareholders to ratify breaches of the duty owed to the company. The restriction is similar to that found in cases involving fraud on the minority. Where the company is insolvent or nearing insolvency, the creditors are to be seen as having a direct interest in the company and that interest cannot be overwritten by the shareholders. This restriction does not, in the absence of any conferral of such a right by statute, confer upon creditors any general law right against former directors of the company to recover losses suffered by those creditors ...
>
> The result is that there is a duty of imperfect obligation owed to creditors, one which the creditors cannot enforce save to the extent that the company acts on its own motion or through a liquidator.'

39 In discharging the duty to act in good faith and for proper purposes, including the statutory prescription of this duty in section 181(1) of the *Corporations Act*, it follows, then, that pursuant to Australian law the director of a company will have an obligation to consider the interest of creditors, when exercising powers to act in the best interests of the corporation, at least when the company is insolvent or nearing insolvency. This duty will arise, for example, pursuant to section 181(1)(a) of the *Corporations Act*. However, it appears that a remedy for breach of this duty lies with the company itself, and is not enforceable by creditors per se.

40 If the duty to act in good faith and for proper purposes has been breached, under the law of Australia a director faces a variety of potential sanctions or remedies. These include the risk of criminal conviction (if the breach was done with intentional dishonesty or recklessness); and a range of civil remedies similar to those discussed previously in connection with section 588G.

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[20] See, for example, *Walker v Wimborne* (1976) 137 CLR 1 at 7; *Linton v Telnet Pty Limited* (1999) 30 ACSR 465; *Kinsella v Russell Kinsella Pty Limited (in liquidation)* (1986) 4 NSWLR 722; and *Spies v R* (2000) 201 CLR 603.

[21] (1994) 13 ACSR 766.

Duty to avoid conflict of interest

41 The third traditional duty owed by company directors and officers to the company is the duty (or related duties) to avoid conflicts of interest, secret profits and the usurpation of corporate opportunities.

42 The law in this area is quite extensive. It includes a number of specific statutory provisions (such as those set out in sections 182 and 183 of the *Corporations Act*), together with a number of common law and equitable doctrines.

43 In relation to creditor and insolvency aspects, the major issues which would arise in this area would be where a director of a company was also a creditor of that company, and took steps to secure payments of debts in preference to other creditors.

Discretionary defences

44 If a director has breached the duty to prevent insolvent trading in section 588G of the *Corporations Act*, or has breached the 'traditional' directors' duties of application in an insolvency situation, sections 1317S and 1318 of the *Corporations Act* give the court a discretionary power to relieve the director from liability, either wholly or in part.

45 The relevant sections read as follows:

> '**1317S Relief from liability for contravention of civil penalty provision**
>
> (1) [**Definition**] in this section:
>
> **eligible proceedings**:
>
> (a) means proceedings for a contravention of a civil penalty provision (including proceedings under section 588M, 588W, 1317H or 1317HA); and
>
> (b) does not include proceedings for an offence (except so far as the proceedings relate to the question whether the court should make an order under section 588K, 1317H or 1317HA)
>
> (2) [**Where person may be relieved from liability**] If:
>
> (a) eligible proceedings are brought against a person; and
>
> (b) in the proceedings it appears to the court that the person has, or may have, contravened a civil penalty provision but that:
>
> (i) the person has acted honestly; and
>
> (ii) having regard to all circumstances of the case (including, where applicable, those connected with the person's appointment as an officer or employment as an employee of a corporation or of a Part 5.7 body), the person ought fairly to be excused for the contravention;
>
> the court may relieve the person wholly or partly from a liability to which the person would otherwise be subject, or that might otherwise be imposed on the person, because of the contravention.
>
> **1318 Power to grant relief**
>
> (1) [**Where court may grant relief**] If, in any civil proceedings against a person to whom this section applies for negligence, default, breach of trust or breach of duty in a capacity as such a person, it appears to the court before which the proceedings are taken that the person is or may be liable in respect of the negligence, default or breach but that the person has acted honestly and that, having regard to all the circumstances of the case, including those connected with the person's appointment, the person ought fairly to be excused for the negligence, default or breach, the court may relieve the person either wholly or partly from liability on such terms as the court thinks fit.'

46 Both sections 1317S and 1318 of the *Corporations Act* invoke the same considerations. Namely where a contravening director has acted honestly, and if the court considers the director ought fairly to be excused for the contravention, as a matter of discretion the court may relieve the director either wholly or partially from liability on such terms as the court thinks fit.

47 Historically, it has been relatively rare for courts to grant discretionary relief to otherwise liable directors under sections 1317S or 1318 (or their predecessors). However, in the recent decision

of *Hall v Poolman*[22] Palmer J of the Supreme Court of New South Wales exercised the discretion in favour of directors to provide them with partial relief from an insolvent trading liability under section 588G of the *Corporations Act*.

48 The case in question involved a publically listed wine group, the Reynolds Group. In April 2001 the Group received notices of assessment from the ATO totalling $14.8million. The Group disputed the assessments and filed notices of objection to them. If the tax liability had to be paid in full, the Reynolds Group was insolvent as of the due date for payment (this being a specified number of days after issue of the assessments).

49 The chairman of the Group became personally involved in negotiations with the ATO, designed to persuade the ATO to resolve the tax dispute on terms favourable to the Group, and to defer enforcement proceedings until the negotiations had been concluded.

50 Pursuant to the *Income Tax Assessment Act* 1936, a notice of assessment for taxation creates a debt due and payable to the Commonwealth within the time period set out in the notice. Palmer J found that, absent agreement from the Commissioner to defer time for payment of the debt until the conclusion of the tax dispute, or absent an order from a court for a stay of enforcement proceedings during that time, the assessment would create a debt within the meaning of section 588G of the *Corporations Act*. In this case, the court found that the Group and its chairman had been unable to negotiate such an agreement with the Commissioner of Taxation, and had not obtained any stay of enforcement from the court. Therefore, from the date set out in the notice of assessment, the tax debt was due and payable, and because the Group was unable to pay that debt, it was insolvent. Accordingly, the chairman and other directors of the Group were personally liable under section 588G for debts incurred by the Group after the date set out on the notice of assessment.

51 However, Palmer J found that, for a certain period thereafter, the directors of the company had acted honestly in permitting the company to continue to trade. This was because they honestly believed that the disputed amount of tax was not properly payable, and that they would be able to negotiate a resolution of the dispute with the ATO. However, from a particular date (5 February 2003) the court found that the chairman should have appreciated that there was no prospect of such a favourable resolution, as a result of a meeting between a senior official of the ATO and the chairman.

52 The court, in the exercise of its discretion under sections 1317S and 1318 of the *Corporations Act*, relieved the chairman and other directors from liability for debts incurred up to 5 February 2003, but did not relieve them from liability for debts incurred after that date.

53 It should be noted that, as part of the application for discretionary relief, the chairman (Mr Irving) submitted that it was relevant for the court to consider that he did not have D&O insurance. Palmer J rejected this submission as follows:

> 'It is said that Mr Irving does not have relevant Directors and Officers Liability Insurance for the Period so that he will have to meet any judgment debt out of his own resources. I accept that the personal and financial situation of a director may be a relevant consideration under the sections: *Kenna & Brown*. However, I have no evidence as to Mr Irving's personal financial situation. He may be able to satisfy a judgment debt comfortably out of his own assets, or he may not.
>
> The fact that a director has no insurance to meet a judgment debt arising from an insolvent trading claim cannot, without more, play a part in the consideration of discretionary defences under s.1317S and s1318. Most creditors are not insured against the insolvency of their debtors. The Court should not, in the exercise of discretion under s1317S or s1318, hold accountable only a director whose insurer will absorb the pain of a judgment.'

Summary

54 In summary, then, there are a variety of duties imposed by the law of Australia on the directors of incorporated companies in relation to creditor and insolvency issues.

55 Whilst the traditional directors' duties (being the duty to act with due care and diligence; the duty to act in good faith and for proper purposes; and the duty to avoid conflicts of interest) all have a role to play when considering the obligations which company directors owe to creditors and shareholders for solvency aspects, these duties have tended in recent times to be overshadowed

[22] [2007] NSWSC 1330.

by the specific statutory obligation on company directors to prevent insolvent trading. This latter obligation is set out in section 588G of the *Corporations Act*.

56 The statutory obligation of directors to prevent insolvent trading is, in terms, confined to creditor and solvency issues. The more 'traditional' directors' duties outlined above may apply in creditor and insolvency cases, but also have much broader scope. There are also a significant further number of 'newer' statutory duties imposed on company directors by Australian law (such as specific obligations regarding prospectuses and fund-raising documents; obligations to comply with continuous reporting duties for those companies listed on the Australian Stock Exchange; and obligations in respect of conduct contravening the misleading and deceptive conduct provisions in section 1041H of the *Corporations Act*). They may have a role to play in creditor and insolvency matters, although we consider section 588G to be the more significant provision.

21 August 2008

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