**Reforming insolvent trading to encourage restructuring: safe harbour or sleepy hollows?**

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The threat of personal liability for insolvent trading is often cited as a limitation on Australia developing a thriving culture of business restructuring and turnaround. Despite several prior calls from the business community to reform Australia’s draconian insolvent trading laws previous governments have resisted the push for law reform. The current government has agreed to adopt the Productivity Commission’s recommendations from 2015 to introduce a new safe harbour defence for company directors during a period of restructuring outside of formal insolvency. This paper critically examines the Government’s proposed models for potential reform (Model A and Model B) and compares Australian law on this issue with director liability regimes operating in England and New Zealand, which have (in the author’s view) provisions that strike an appropriate balance between managerial risk taking and creditor protection. This paper argues that the new safe harbour defence has a potential to be a sleepy hollow if not drafted carefully.

**I Introduction**

The Federal Government’s Innovation Statement of 7 December 2015 brought news of potential law reform of director liability for insolvent trading.[[1]](#footnote-1) This was based on a recommendation by the Productivity Commission in its report ‘Business set-up, transfer and closure’ which was also released on 7 December 2015.

Insolvent trading liability for company directors has been a topic of considerable interest and debate for several years now, with prior reviews by the Senate in 2010,[[2]](#footnote-2) 2014[[3]](#footnote-3) as well as a prior consultation by Commonwealth Treasury on a safe harbor for insolvent trading in 2010.[[4]](#footnote-4) The issue of reforming insolvent trading law has been strongly advocated by the Australian Institute of Company Directors,[[5]](#footnote-5) and ARITA.[[6]](#footnote-6)

Perhaps one of the reason for the continuing debate about insolvent trading is the perception that Australia’s insolvent trading liability laws are some of the strictest in the world.[[7]](#footnote-7) Indeed, the United States has no concept of insolvent trading for company directors, which causes US-based distressed debt funds (who are becoming an increasingly common participant in restructuring in Australia) to adapt to the stricter laws when negotiating workouts and restructuring with directors who may be (quite justifiably) concerned about personal liability during times of financial distress.

Various models for potential law reform have been suggested by professionals and industry associations. These models mostly focus on the need for a new defence to insolvent trading that will provide a ‘safe harbour’ for directors that will give them greater confidence to participate in good faith in debt restructuring efforts during times of financial distress. The goal is to encourage directors to try to save businesses where they can be saved, because this should provide a greater economic return than simply shutting down the company and selling the assets in liquidation.

In the author’s view, these attempts at a new defence are more likely to be a ‘sleepy hollow’[[8]](#footnote-8) than a safe habour because the proposed defences are, it is respectfully submitted, overly complex with too many necessary elements so that directors will not in fact enjoy greater comfort but rather continue to suffer uncertainty about whether participating in a workout attempt may lead them down the road to penury if the workout fails the company is found to have been insolvent. In the author’s view, the only way to adequately address this concern is to reform the insolvent trading liability provision itself by reshaping the scope of s 588G of the Corporations Act 2001 (Cth) so that it does not capture good faith restructuring efforts.

**II Liability for insolvent trading**

*Background*

Insolvent trading liability for company directors has been a feature of Australian corporate law since 1961.[[9]](#footnote-9) The original form of liability was based on a director being ‘knowingly a party to the incurring of a debt’ at a time when there was ‘no reasonable or probable expectation’ of the company being able to pay the debt. A contravention of this prohibition did not give creditors rights to seek compensation, nor did it give liquidators the power to sue directors who contravened the provision. Directors were not made personally liable for insolvent trading debts, but could be subject to criminal prosecution.[[10]](#footnote-10) Subsequent amendments did impose personal civil liability on directors, but only following criminal prosecution.[[11]](#footnote-11)

The criminal focus of insolvent trading changed in the early 1980s with the introduction of the Companies Codes, which provided for personal civil liability for directors who allowed companies to incur debts where there were ‘reasonable grounds to expect that the company would not be able to pay all its debts when they become due.’[[12]](#footnote-12)

*Elements*

Liability for insolvent trading is imposed under s 588G of the Corporations Act 2001 (Cth). Readers of the *Journal* are likely to be familiar with the basic operation of the provision so a short outline here should suffice.

Insolvent trading laws provide for both civil liability (s 588G(2)) and criminal liability (s 588G(3)).[[13]](#footnote-13) Civil liability can be imposed where a directors ‘fails to prevent the company from incurring the debt’ when certain facts exist. Those facts are specified in both s588G(1) and s588G(2). Section 588G(1) provides that insolvent trading applies where:

(a) a person is a director of a company at the time when the company incurs a debt;[[14]](#footnote-14) 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;[[15]](#footnote-15) and

(c) at that time, there are reasonable grounds for suspecting that the company is insolvent, or would so become insolvent, as the case may be;[[16]](#footnote-16) and

(d) that time is at or after the commencement of this Act.

If these elements are established, liability will be imposed where the director:[[17]](#footnote-17)

(a) … 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.

The provision therefore only applies to directors, not to executive officers who are not on the board or who would not fit within the broad definition of director under s 9, which includes de facto and shadow directors. A company may be a shadow director for this purpose.[[18]](#footnote-18)

The requirement in s 588G(1)(a) that a debt be incurred can be established by the operation of deemed debts in s 588G(1A) or by applying the common law test as stated in the leading decision in *Hawkins v Bank of China* (1992) 26 NSWLR 562:

A debt is incurred when a company enters into a contract by which it subjects itself to an unavoidable obligation to pay a sum of money at a future time, even if that obligation is conditional.

Liability for insolvent trading therefore applies where a company is insolvent and the director is aware of grounds to suspect insolvency (or a reasonable person in their position would be so aware) and their failure to stop the company from incurring debts at that time. A suspicion of insolvency has been explained as follows:[[19]](#footnote-19)

‘A suspicion that something exists is more than a mere idle wondering whether it exists or not; it is a positive feeling of actual apprehension or mistrust, amounting to "a slight opinion, but without sufficient evidence", as Chambers's Dictionary expresses it. Consequently, a reason to suspect that a fact exists is more than a reason to consider or look into the possibility of its existence [it is] something which in all the circumstances would create in the mind of a reasonable person in the position of the payee an actual apprehension or fear.’

The degree of culpability required by directors is clearly set at a very low level. Indeed directors may have no control over the incurring of debts and yet still be liable.[[20]](#footnote-20) This leaves directors in the invidious position of having to either shut the company down or resign, and even resigning won’t be sufficient for any insolvent trading that may have occurred prior to the resignation. At present there is no defence for good faith restructuring.

There is the potential of relief against liability under s 1317S of the Corporations Act, which requires honest conduct and in the circumstances ‘the person ought fairly to be excused for the contravention’. This provision is rarely applied, and even where it is applied the courts have held that the director should still be liable for costs, even where they have acted reasonable and as the community would expect despite allowing the company to trade whilst insolvent.[[21]](#footnote-21)

*Justification for insolvent trading laws*

There are a variety of arguments that have been raised both for and against insolvent trading.[[22]](#footnote-22) Some of the arguments against insolvent trading liability include:

* the strictness and extent of the liability discourage people from becoming directors;
* it may cause directors to become more cautious and risk adverse which detracts from entrepreneurial risk taking and increases transaction costs as directors delay and hesitate when making decisions whenever solvency may be in question;
* it may encourage premature commencement of formal insolvency regimes; and
* creditors should take responsibility for protecting themselves.

One of the significant difficulties with insolvent trading is that it presumes that determining insolvency can be easily done by directors, which is certainly not the case.[[23]](#footnote-23) If only a mere suspicion of insolvency is sufficient to attract liability (assuming the company is in fact insolvent and a reasonable person would be aware of the grounds for suspecting insolvency) then any difficulty with determining actual insolvency may result in directors not willing to risk potentially ruinous personal liability to put the company into early administration.

On the other hand, some of the arguments in support of insolvent trading liability include:

* it is unreasonable to expect creditors to protect themselves by contract as this in itself will increase transaction costs, may not be feasible due to bargaining inequality and contracting is always incomplete anyway;
* insolvent trading sends an appropriate signal to directors to actively monitor the company’s financial affairs and hence encourages a sense of commercial morality;
* it may address the moral hazard that exists during times of insolvency where directors may be incentivized to take ever riskier bets in the hope of recovering some equity value which puts returns to creditors at risk; and
* the provision does not unduly limit managerial decision-making but rather encourage active monitoring of financial performance which supports sustainable business practice.

An important point in this debate concerning whether insolvent trading is justifiable is the very different position of directors of small and medium enterprises compared with directors of large companies. While the latter are likely to be heavily influenced by reputational factors and are likely to have teams of professional advisors to draw on, the former typically have much less resources and may have less skill and experience in monitoring financial performance at a forensic level to identify looming signs of legal insolvency. Furthermore, directors of SMEs are more likely to have been required by external creditors (such as banks) to give personal guarantees over the company’s debts. This means that while directors of larger companies may have an economic incentive to place the company into administration early or resign, directors of SMEs have an economic incentive to trade on into insolvency because if they place the company into insolvent administration their personal guarantees will be triggered and they may be pushed into bankruptcy. The threat of potential liability for insolvent trading some years into the future is likely to be much less than the near certainty of financial ruin if the company closes down and the bank enforces its security under a personal guarantee.[[24]](#footnote-24)

In the author’s view, insolvent trading is unlikely to be removed from the statute books in the near future as governments try to reduce the risk of being portrayed as doing favours for the ‘big end of town’ following a 2016 Federal Election where criticism of large businesses, and particularly banks and financial institutions became pervasive. Therefore, the remainder of this paper will examine the options for reforming the current provision and its defences.

**III Particular difficulties when negotiating a restructuring plan**

*Overview*

Readers of the Journal will no doubt be familiar with debt restructuring and workouts, however a brief overview may be useful.[[25]](#footnote-25) Debt restructuring and workouts refer to a situation where a company has become over-leveraged with debt and needs to alter the nature of some or all of the debt obligations so as to facilitate the company to return to profitability at some point in the future. Restructuring usually occurs in multiple stages, with the early stage involving an attempt to simply identify the root cause of the company’s problems and to stablise the business to allow for the investigation of potential options for addressing the business’ difficulties. The medium term of a restructuring is aimed at restructuring of the company’s balance sheet, which may include asset sales, cost reduction, sale and lease back of equipment and an injection of new capital. Debt for equity swaps are a common tool used to implement a financial restructuring.

After addressing immediate and pressing financial problems, a period of operational restructuring will usually be necessary, which will involve revising and refocusing the company’s strategy and future business plans, often to focus on a core business unit and to simplify and streamline the company’s operations to reduce costs and improve profitability.

The time during which the business is attempting to develop a restructuring plan can be highly uncertain. Ongoing negotiations with key stakeholders (particularly senior secured lenders) will be taking place in an environment where the company may well be vulnerable to enforcement action by revenue authorities or to individual creditors issuing statutory demands and then seeking the winding up of the company. A standstill agreement with senior lenders may be introduced and this can provide some degree of comfort for directors through undertakings not to take enforcement action and perhaps waive or suspend certain loan covenant breaches.[[26]](#footnote-26) However, if lenders are reluctant to standstill and/or provide for further working capital to keep lower ranked creditors in the capital structure paid, then directors may be unsure as to whether the company is actually insolvent, particularly where loan covenants may be breached or close to being breached which may convert senior loans into repayable on demand and therefore a current liability.

Of course, this tension can help bring the parties together to enter into a restructuring agreement, with numerous examples in recent years of high profile consensual restructurings occurring on the eve of formal insolvency proceedings such as Centro and Fitness First.[[27]](#footnote-27)

The key point is that a restructuring effort is a delicate balance that needs as much certainty as possible, with directors and executive management focused on the restructuring effort.

*Problems for directors*

When trying to implement a restructuring, the company, its officers and advisors face a range of potential liabilities that make restructuring difficult. In some cases, potential liabilities can derail a rescue attempt with the result that the company fails and enters liquidation, with little return to creditors.

A restructuring plan tends to be formulated over a period of time prior to a formal insolvency appointment, and usually on a confidential basis so that key suppliers, customers and employers do not become concerned about the future viability of the company and withdraw their support. If the restructuring plan is successful it may be that a formal insolvency appointment is not needed. However, an informal restructuring is based on maintaining consensus amongst key lenders (usually senior secured lenders) and therefore carries a risk that one or more holdouts can prevent the implementation of the restructuring plan. It is also possible that returning the business to financial strength will require that certain obligations (such as loss making leases or significant tax debts) be left behind in the corporate shell while the business assets are transferred to a new (solvent) entity in order to maximize returns for all creditors and to preserve jobs. This may necessitate a formal insolvency to cram down dissenting creditors or to obtain legislative sanction for asset or shares transfers, or to implement a debt for equity swap with key lenders across a class of creditors that includes a dissenting minority.[[28]](#footnote-28)

One of the biggest risks that exists during a restructuring effort is that the company may be found (usually years later following expensive litigation) to have continued trading while it was insolvent. This may leave the directors of the company at risk of significant personal liability for all unsecured debts that are incurred by the company during the period. At present there is no defence for insolvent trading where directors are engaging in good faith restructuring efforts,[[29]](#footnote-29) although the courts have granted relief from liability in a small number of cases reasonable restructuring efforts were made to try and save the business.[[30]](#footnote-30) This liability can also extend to advisors and financiers, if they can be found to be de facto or shadow directors under the Corporations Act.[[31]](#footnote-31)

*Other liability risks for directors*

Where the company is a disclosing entity (such as a listed company) then there is also the requirement that the company keep the market up to date with material information under continuous disclosure obligations.[[32]](#footnote-32) A failure to comply with continuous disclosure obligations gives rise to liability for the entity but may also extend to personal liability for persons involved in the contravention.[[33]](#footnote-33) In recent years, alleged failures by listed companies to keep the market informed of material information has led to investor class actions and this is a real risk for a company involved in restructuring efforts. It is likely however that the restructuring proposal will involve confidential negotiations and will fall within the carve outs to continuous disclosure under the ASX Listing Rules (ASX LR 3.1A) as the restructuring negotiations are an incomplete proposal and a reasonable person would not expect them to be publicly disclosed. If the carve out applies, then there is no liability under s 674. However, if the restructuring is leaked to the media then the carve out will be lost.[[34]](#footnote-34)

Furthermore, it is possible that directors may be faced with the threat of personal liability for taxation liabilities under the Director Penalty Notice regime if the company has failed to comply with its reporting obligations to the ATO and has failed to remit PAYG amounts.[[35]](#footnote-35)

Lastly, there is the spectre of the duty of directors to consider creditors when the company is insolvent. This was examined in detail in the Bell litigation.[[36]](#footnote-36) The precise scope of this duty is still unclear, although it is clear that it is not a duty owed directly to creditors,[[37]](#footnote-37) it is one of considering their interests and potentially (if Drummond JA’s view in the *Bell* case is accepted) to protect the broad interests of creditors.[[38]](#footnote-38) A failure to comply with this duty can result in breaches of s 181 of the Corporations Act and breaches of fiduciary duties at general law. This can also give rise to potential accessorial liability under the rule in *Barnes v Addy* where restructuring efforts involve the directors failing to act in the best interests of their company by failing to consider the interests of creditors.[[39]](#footnote-39) Third parties liable can include advisors and potentially financiers (as occurred in the Bell litigation). The current business judgment rule defence in s 180(2) only covers liability for breaches of the duty of care in s 180(1) and the equivalent general law duty, but neither of these carry accessorial liability.[[40]](#footnote-40)

*Conclusion*

One important point to take from this is that any attempt to alleviate concerns by directors to participate in good faith restructuring efforts needs to consider the full range of potential liabilities that may currently be imposed based on the conduct during that restructuring. This is not to say that directors (or their advisors) should be given a free pass during restructuring, but rather to highlight the limitations in assuming that a new defence to s 588G will turn Australia into a restructuring nirvana. In the author’s view the current framework of legal incentives (or rather disincentives) only serves to discourage directors from good faith restructuring. As will be argued below, this is because s 588G is too strict. Its strictness lay in the fact that it is literally *insolvent trading*. If a director allows the company to trade while it is insolvent then they risk personal liability, even where they have no further culpability other than merely being a director at the time.

Bearing this liability framework in mind, we will now consider how insolvent trading issues are dealt with in other similar jurisdictions.

**IV Comparative analysis**

*England*

The English *Insolvency Act* 1986 provides for fraudulent trading (s 213) and wrongful trading (s 214). Both of these provisions allow a liquidator to apply to the court for orders that a person make a contribution to the assets of a company in liquidation.[[41]](#footnote-41) It is possible for both provisions to be contravened by the same conduct.[[42]](#footnote-42) Company directors are also subject to potential disqualification where the company becomes insolvent and the court finds that the person is unfit to be a director.[[43]](#footnote-43) This has been held to be broader than wrongful trading claims, so that conduct which does not meet the wrongful trading requirement may still demonstrate unfitness for the purposes of disqualification.[[44]](#footnote-44)

Fraudulent trading applies to carrying on a business with intent to defraud creditors and the business eventually enters liquidation.[[45]](#footnote-45) Fraudulent trading allows the court to order that any person who knowingly engages in fraudulent trading to make a contribution to the company’s assets in liquidation as determined by the court.[[46]](#footnote-46)

Wrongful trading only applies to directors[[47]](#footnote-47) or former directors of a company that enters insolvent liquidation.[[48]](#footnote-48) The provision is engaged when (s 214(2)(b)):

‘at some time before the commencement of the winding up of the company, that person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation’

The person must have been a director at the relevant time.[[49]](#footnote-49)

There is a defence in s 214(3):

The court shall not make a declaration under this section with respect to any person if it is satisfied that after the condition specified in subsection (2)(b) was first satisfied in relation to him that person took every step with a view to minimizing the potential loss to the company’s creditors as (assuming him to have known that there was no reasonable prospect that the company would avoid going into insolvent liquidation) he ought to have taken.

The reference to minimizing losses to creditors is to the creditors as a whole and not to individual creditors.[[50]](#footnote-50)

In ascertaining whether the director had the requisite knowledge and whether they have taken reasonable steps to minimize loss, the court is to take into account both subjective factors (i.e. the actual knowledge and skills the director had)[[51]](#footnote-51) and objective factors (i.e. what a reasonable director should have known[[52]](#footnote-52) and what reasonable skills the director should have had) by reference to the role and responsibilities undertaken by the director and by those entrusted to the director.[[53]](#footnote-53) Thus, the reasonable steps requirement depends on the director acting as a reasonable person would in the circumstances. [[54]](#footnote-54) This takes into account that directors of large companies will have different knowledge and skills from those running small businesses.[[55]](#footnote-55) Minimum standards such as maintaining adequate financial records are recognized.[[56]](#footnote-56)

The liquidator bears the onus of proving that the company was insolvent and that the director had the requisite knowledge (i.e. that there was no reasonable prospect of avoiding liquidation). Directors who demonstrate willfully blind optimism or whose optimism is reckless can be said to have the requisite knowledge.[[57]](#footnote-57)

The directors bear the onus of proving the defence (i.e. that they took every step to minimize potential losses).[[58]](#footnote-58) As to what taking every step involves, that will depend on the circumstances of the case but, in the recent *Brooks v Armstrong* case the following matters were identified as being relevant to the assessment (at [259]):

‘Ensuring accounting records are kept up to date with a budget and cash flow forecast; preparing a business review and a plan dealing with future trading including steps that can be taken (for example cost cutting) to minimise loss; keeping creditors informed and reaching agreements to deal with debt and supply where possible; regularly monitoring the trading and financial position together with the business plan both informally and at board meetings; asking if loss is being minimised; ensuring adequate capitalisation; obtaining professional advice (legal and financial); and considering alternative insolvency remedies.’

In *Brooks*, the court held that directors who received an adverse tax assessment did not engage in wrongful trading by continuing to trade while trying to restructure the business having regard to the fact that liquidating the business would produce a negligible return to creditors at that point. The court noted (at [63]) however that ‘the Directors needed to ensure the trading position did not deteriorate. Regular review was required…’ The company subsequently received an adverse rent review determination that would make continued profitable trading difficult and would adversely affect a sale of the business. Wrongful trading occurred because the directors failed to reasonably respond to this significant change.

It is necessary for the directors to demonstrate that they had some plan to minimize the losses to creditors, and to return the business to profitability. The lack of a realistic plan to restructure the business and a failure to respond to deteriorating financial circumstances are common features in successful wrongful trading cases. For example, in *Re Idessa (UK) Ltd (In Liq)* [2012] BCC 315, the directors of a heavily indebted company failed to take any action to reign in expenses when the company lost its major contract and source of revenue and this gave rise to wrongful trading (at [120]):

‘all of the evidence points to the fact that the respondents continued to use (and as I have found in several instances abuse) the company’s money in much the same way as they had done previously. The respondents continued to pay themselves the same salaries and continued to incur the same type of expenses as before. There was no “tightening” of the corporate belt or any evidence that they or their employees were encouraged to implement cost savings or do anything differently. In short, there is no evidence that the respondents gave any thought at all to the company’s creditors or to the impact on them of continuing to trade. There is no material at all from which I can infer that they had in place any strategy to enable the company to repay the sums owed to creditors (or for that matter, its investors).’

While consulting external advisors in an attempt to formulate a plan for restructuring or rescuing the business is useful, this of itself is not sufficient to demonstrate that the directors took ‘every step’ to minimize losses for creditors so as to come within the defence to wrongful trading. The advice given by the advisor must be viewed in the context of the directors state of knowledge about the company’s finances and the likely prospects for a successful restructure.[[59]](#footnote-59)

In contrast to the Australian insolvent trading provision (s 588G), the British wrongful trading provision is not based on the specific event of trading at a time when the company was insolvent and the director knew or should have suspected insolvency.[[60]](#footnote-60) The Australian provision imposes virtually strict liability and allows little room for restructuring attempts if the company is insolvent or likely to become insolvent.

The British wrongful trading provision is based on the culpability of the director in unreasonably continuing trading at a time when they should have known that the company would not avoid liquidation. It is not necessary to prove that the company was insolvent at a particular time, provided it eventually enters insolvent liquidation. This gives directors much more flexibility to engage in restructuring attempts. As was said recently in *Brooks v Armstrong* [2015] EWHC 2289 (Ch) at [180]:

‘There is no duty upon directors not to trade whilst insolvent or to ensure that a company does not trade at a loss. There will always be cases where companies legitimately trade at a loss because the directors anticipate profit to the benefit of the existing creditors… Therefore directors can cause the company to trade whilst commercially insolvent without being in breach of Section 214 provided the Knowledge Condition is not satisfied.’

The wrongful trading provision respects the power of the directors to decide whether it is in the best interests of the company and its creditors to continue trading, while the Australian insolvent trading provision does not recognize this-it forces directors’ hands by imposing personal liability for all debts arising after insolvent trading.

In *Re Cubelock* [2001] BCC 523 Park J said:

‘The law has to leave room for cases where it was acceptable for the directors to take the view that their company, although insolvent in balance sheet terms for the present, was going to trade its way back into credit so that all creditors would be paid … here has to be room for cases like that even if in the event the directors turn out to have been wrong’

Furthermore, Chadwick J pointed out in *Secretary of State for Trade and Industry v Gash* [1997] 1 BCLC 341:

‘The companies legislation does not impose on directors a statutory duty to ensure that their company does not trade while insolvent; nor does that legislation impose an obligation to ensure that the company does not trade at a loss. Those propositions need only to be stated to be recognised as self-evident. Directors may properly take the view that it is in the interests of the company and of its creditors that, although insolvent, the company should continue to trade out of its difficulties. They may properly take the view that it is in the interests of the company and its creditors that some loss-making trade should be accepted in anticipation of future profitability. They are not to be criticised if they give effect to such view.’

One significant problem with insolvent trading is that establishing solvency is notoriously difficult. The policy that underpins the English wrongful trading law is based on unreasonable conduct and reasonable knowledge of the prospects of avoiding future liquidation. The courts are mindful of the risk of hindsight bias. As was said in *Brooks v Armstrong* at [180]:

‘the court must be careful not to approach the Knowledge Condition with hindsight. Not only are directors not clairvoyant but it must also be remembered that there is a real difference between the court analyzing events in the court room and the directors having to reach decisions on the ground, at the time and under the pressures their office brings’

The courts in England are reluctant to impose hindsight judgments on directors as was demonstrated in *Re Hawkes Hill Publishing Co Ltd (in liq)* [2007] EWHC 3073 (Ch) at [47] per Lewison J:

‘Of course, it is easy with hindsight to conclude that mistakes were made. An insolvent liquidation will almost always result from one or more mistakes. But picking over the bones of a dead company in a courtroom is not always fair to those who struggled to keep going in the reasonable (but ultimately misplaced) hope that things would get better.’

Justice Lewison also said at [41]:

‘The answer to [the question as to whether the director had the requisite knowledge] does not depend on a snapshot of the company’s financial position at any given time; it depends on rational expectations of what the future might hold. But directors are not clairvoyant and the fact that they fail to see what eventually comes to pass does not mean that they are guilty of wrongful trading.’

The flexibility that British wrongful trading gives directors is demonstrated by comments in the recent case of *Brooks v Armstrong* at [180]:

‘the court must bear in mind that directors will often be faced with decisions for which there is no obvious right or wrong answer. The fact that it may subsequently prove that the wrong decision was made, does not necessarily mean they failed to act as reasonable directors in the prevailing circumstances of the time.’

These comments are consistent with sentiments expressed by Palmer J in the leading Australian case of *Hall v Poolman* (2007) 65 ACSR 123; [2007] NSWSC 1330 at [266]:

‘The law recognises that there is sometimes no clear dividing line between solvency and insolvency from the perspective of the directors of a trading company which is in difficulties. There is a difference between temporary illiquidity and “an endemic shortage of working capital whereby liquidity can only restored by a successful outcome of business ventures in which the existing working capital has been deployed... The first is an embarrassment, the second is a disaster. It is easy enough to tell the difference in hindsight, when the company has either weathered the storm or foundered with all hands; sometimes it is not so easy when the company is still contending with the waves.’

However, the Australian provision is still based on relatively strict liability. While relief may be possible, that still involves a contravention of the law. It seems that the English law gives directors greater scope to attempt a restructuring.

*New Zealand*

It is also useful to look at the similar provision in New Zealand company law (reckless trading) under Companies Act 1993 (NZ), which provides:

A director of a company must not—

(a) agree to the business of the company being carried on in a manner likely to create a substantial risk of serious loss to the company’s creditors; or

(b) cause or allow the business of the company to be carried on in a manner likely to create a substantial risk of serious loss to the company’s creditors.

This was explained by the New Zealand Court of Appeal in *Mason v Lewis* [2006] 3 NZLR 225 as follows:

[51] The essential pillars of the present section are as follows:

• the duty which is imposed by s 135 is one owed by directors to the company (rather than to any particular creditors);

• the test is an objective one;

• it focuses not on a director’s belief but rather on the manner in which a company’s business is carried on, and whether that modus operandi creates a substantial risk of serious loss;

• what is required when the company enters troubled financial waters is...a “sober assessment” by the directors...of an ongoing character, as to the company’s likely future income and prospects.[[61]](#footnote-61)

The fact that this is wholly objective assessment marks a difference with the British wrongful trading provision.

The Court of Appeal also explained the concept of substantial risk by quoting from a book for directors:[[62]](#footnote-62)

‘The first phrase, “substantial risk” requires a sober assessment by directors as to the company’s likely future income stream. Given current economic conditions, are there reasonable assumptions underpinning the director’s forecast of future trading revenue? If future liquidity is dependent upon one large construction contract or a large forward order for the supply of goods or services, how reasonable are the director’s assumptions regarding the likelihood of the company winning the contract? Even if the company wins the contract, how reasonable are the prospects of performing the contract at a profit?’

The provision has been described as being aimed at those who take ‘illegitimate business risks’.[[63]](#footnote-63) This distinction is based on whether the company had any prospects of continuing to trade profitably in accordance with ordinary commercial practice. As Young J said in *Re South Pacific Shipping Ltd (in liq)* (2004) 9 NZCLC 263,570 at [125]:

It is not suggested that a company must cease trading immediately upon becoming insolvent. However, it is clear that there are limits to the extent to which directors can trade companies while they are insolvent in the hope that things will improve.

This quote was subsequently discussed in *Mountfort v Tasman Pacific Airlines of NZ Ltd* [2006] 1 NZLR 104 at [25], where Baragwanath J said:

the law must recognise that assessments of the ability of a company to survive are a matter of judgment and a substantial margin of tolerance must be allowed to directors to perform their function of taking legitimate risks.

More recently, in *Grant v Johnson* [2016] NZCA 157 the Court emphasized that (at [37]):

s 135 is not concerned with ordinary business risks but with allowing the business to be carried on in a manner which is likely to create “a substantial risk of serious loss”. The section is prospective in its effect, requiring the directors in a given situation to consider with care whether continuing to trade has realistic prospects of generating sufficient revenue to meet current and future liabilities

*Conclusion*

It seems that in both New Zealand and in England the focus of liability is not on the mere fact of insolvency and a reasonable suspicion of insolvency, but on the failure to have a reasonable plan to avoid insolvent liquidation. This is in stark contrast to the Australian law which can punish directors severely for continuing to trade, even in the hope of achieving a better outcome for creditors. In the author’s view, the focus of insolvent trading should be addressed at some level of culpability in the conduct of the particular director rather than the mere fact of insolvency and reasonable grounds to suspect insolvency, particularly as establishing solvency at a particular point in time can be practically very difficult.

We now consider potential options for reforming insolvent trading.

**Insolvent Trading Reform**

*Options for reform*

This section considers the most recent reform proposals for insolvent trading. It does not revisit the debate concerning the 2010 reform proposals which were ultimately rejected by the Government.[[64]](#footnote-64)

The 2015 Productivity Commission report recommended the following changes to insolvent trading:

RECOMMENDATION 14.2

The Corporations Act 2001 (Cth) should be amended to allow for a safe harbour defence to insolvent trading. The defence would only be available when:

* directors of a company have made, and documented, a conscious decision to appoint a safe harbour adviser with a view to constructing a plan to turnaround the company
* the adviser was presented with proper books and records upon appointment, and can certify that the company was solvent at the time of appointment
* the adviser is registered and has at least 5 years’ experience as an insolvency and turnaround practitioner
* directors are able to demonstrate that they took all reasonable steps to pursue restructuring
* the advice must be proximate to a specific circumstance of financial difficulty, and subject to general anti-avoidance provisions to prevent repeated use of safe harbour within a short period.

The defence would not attach to any particular decision and instead would cover the running of the business and any restructuring actions from the time of appointment until the conclusion of (reasonable) implementation of the advice.

If the adviser forms the opinion that restructure into any form of viable business or businesses is not possible, they are under a duty to terminate the safe harbour period and advise the directors that a formal insolvency process should commence.

The safe harbour adviser may only be appointed in a subsequent insolvency process with leave of the court.

The Productivity Commission’s draft report contained a very similar recommendation (Rec 15.2) and this received general support from a broad range of parties who made final round submissions, including the Governance Institute of Australia, ARITA, the Law Council of Australia, CAANZ and the AICD.[[65]](#footnote-65) Even ASIC gave tentative support for insolvent trading reform, although it stressed the need for accountability by company directors and the adequate protection of creditors.

The Government agreed generally with the Productivity Commission’s recommendations and announced on 7 December 2015 that it would amend insolvent trading laws to provide a safe harbor defence. After a period of informal consultation with industry Treasury released a discussion paper on 29 April 2016, which offered a safe harbor defence (Model A) but also offered an alternative proposal in the form of a carve out from s 588G for good faith restructuring efforts. This had not been flagged in prior reports or inquiries, but garnered broad support from the AICD, The Governance Institute of Australia, the Law Council of Australia, the NSW Law Society Business Law Committee and a range of professional services firms that made submissions to Treasury on the discussion paper.[[66]](#footnote-66) two models for reforming the law of insolvent trading to better support good faith restructuring efforts. The Treasury discussion paper does not provide specific drafting recommendations but the two models may be summarised as follows:

Model A

The Model A defence takes the form of a safe harbour defence that would be applied against an insolvent trading finding. Clearly the goal would be to discourage claims against director that had a potential case to establish the defence. The broad terms of the proposed defence are:

It would be a defence to s588G if, at the time when the debt was incurred, a reasonable director would have an expectation, based on advice provided by an appropriately experienced, qualified and informed restructuring adviser, that the company can be returned to solvency within a reasonable period of time, and the director is taking reasonable steps to ensure it does so.

The defence would apply where the company appoints a restructuring adviser who:

(a) is provided with appropriate books and records within a reasonable period of their appointment to enable them to form a view as to the viability of the business; and

(b) is and remains of the opinion that the company can avoid insolvent liquidation and is likely to be able to be returned to solvency within a reasonable period of time.

The key element of the safe harbour defence is the appointment of a restructuring adviser who would be required to exercise their powers and discharge their duties in good faith in the best interests of the company and to inform ASIC of any misconduct they identify. This is aimed at addressing concerns about facilitating illegal phoenix activity where directors obtain advice that helps them to set up new companies and transferring assets to try and avoid paying the debts of the old company. Such activity can constitute a breach of directors duties such as ss 181 and 182 of the Corporations Act.[[67]](#footnote-67) The restructuring advisor would need to seek leave from the court to take a formal insolvency appointment following the period of restructuring to address any concerns about independence of the insolvency practitioner once appointed.

The Model A proposal raises queries about how the restructuring advisor should be regulated, including whether they need to be registered. ARITA and several insolvency firms have argued in their submissions that the restructuring advisor should be a registered company liquidator. However, in the author’s view this unduly limits who can provide appropriate restructuring advice. While registered liquidators operate under the regulatory framework of both professional membership (with most being members of ARITA and bound by its Code of Conduct and Professional Ethics) as well as regulation by ASIC, it is argued that non-liquidator professionals such as some general accountants, restructuring and turnaround lawyers, some investment bankers and potentially a range of turnaround practitioners with extensive experience and knowledge in turning around distressed businesses could fulfil this role. In the author’s view the restructuring advisor should be registered with ASIC and satisfy minimum experience and qualifications requirements that could be set out in a regulatory guide.

The discussion paper also raises a number of potential circumstances under which the defence would not operate, including

* it would not be applicable to disqualified directors or, potentially to any person determined by ASIC or court to be ineligible (on an ex post basis)
* it would not be available where company failed to make BAS lodgements, or failed to pay employee entitlements
* it would not be available where the director breached their duties and this contributed to losses (including losses to the Fair Entitlements Guarantee scheme administered by the Commonwealth for the benefit of employees of companies in liquidation)
* it would not protect against liability for unpaid employee entitlements during the safe harbour

Furthermore, the defence would only apply to s588G and would not extend to other directors’ duties (such as s 181), nor would it apply to voidable transactions or liability for tax or superannuation.

When these factors are taken together with the requirement that appropriate books and records be provided to the restructuring advisor and that they form the view that the company is likely to be returned to solvency within a reasonable period of time, this proposed defence begins to look like a mirage. In the author’s view, it requires so many qualifications in order to operate that it will be rarely used. It may well become nothing more than a sleepy hollow that offers cold comfort to directors.

Businesses that become distressed have often missed payments, or have incomplete books and records and yet may still have perfectly viable businesses if effective financial restructuring can be undertaken. The problem that distress poses is that time is needed to determine whether this is possible. Some directors may be reluctant to undertake good faith restructuring because they don’t know how bad the problem could be until they investigate, but the longer they delay appointing an administrator the greater their potential liability for insolvent trading.

Imposing a long list of elements necessary to establish the defence together with a range of carve outs will only serve to chill its effectiveness in giving comfort to directors at a time when there is great uncertainty about the prospects of the company and when we need directors focussed the management of the restructuring not thinking about putting their personal assets at risk when they do so.

Model B

In contrast to the apparently prescriptive nature of proposed Model A, Model B offers much greater latitude to directors when undertaking restructuring.

Section 588G does not apply:

(a) if the debt was incurred as part of reasonable steps to maintain or return the company to solvency within a reasonable period of time; and

(b) the person held the honest and reasonable belief that incurring the debt was in the best interests of the company and its creditors as a whole; and

(c) incurring the debt does not materially increase the risk of serious loss to creditors.

The most striking thing about this provision is that it would create a presumption against liability that a liquidator (or creditor) would need to overcome when bringing an insolvent trading claim, which would undoubtedly make it more difficult to sue directors for insolvent trading. However, it has been argued above that the focus of insolvent trading should be aimed at directors whose culpability has contributed to the shortfall, to those who unreasonably trade on the business into oblivion to the detriment of creditors. This model provides a more balanced approach.

Perhaps Model B provides too much flexibility for directors because it leaves all of the decisions up to them? It is submitted that concerns regarding illegal phoenix activity and the need to engender creditor confidence in the restructuring process (which will be crucial to landing a successful whole of business restructuring) calls for some degree of external monitoring. It is recommended that a suitable solution could be introduce the registered restructuring advisor concept into Model B so that the director’s ‘reasonable steps’ and ‘reasonable belief’ could be satisfied (in part) by seeking and relying on expert advice from an independent and registered professional with expertise in restructuring. The role of the restructuring advisor could similarly be to advise and report on the viability of the restructuring plan, as well as to assist the company to negotiate and formalize a restructuring plan with the creditors.

The wording of (b) and (c) could also be improved by making it clear that directors do not need to forensically examine each and every debt to measure it against the restructuring plan. A preferable model would be to allow for consideration of the debts as a whole during the restructuring period. Furthermore, the wording of (c) could be amended to make it clear that merely increasing losses to creditors would not be sufficient to preclude the provision. An alternative wording could be to focus on unreasonably increasing risk to significant loss, which allows for good faith restructuring efforts to be undertaken.

Model B has elements of debtor in possession about it, reminiscent of the US Chapter 11 Bankruptcy procedure where independent advisors help companies restructure, but does not come with the court-driven process and supervision through the specialist US Bankruptcy Courts. Some might criticize this propose on the basis that court protection is needed for debtor in possession regimes, but it should be noted that a true debtor in possession regime like Chapter 11 involves suspending and in many cases varying the rights of creditors, even secured creditors.[[68]](#footnote-68) This proposal does not go that far, but simply gives directors a way to avoid liability by creating a presumption against liability that must be overcome in order to pursue directors for insolvent trading. It is submitted that this would give directors comfort that their good faith restructuring efforts will not attract insolvent trading liability provided they engage in good faith restructuring efforts. If it were considered that this unduly infringes on the rights of creditors who deal with the company during this time it must be noted that the company maintains unlimited liability and creditors are able to protect themselves by requesting satisfactory information regarding the company’s financial position and in certain cases to retain title over goods they supply or otherwise request security. A requirement to appoint a registered restructuring advisor will also provide a measure of creditor protection.

One further issue of creditor protection is whether there needs to be disclosure of the commencement of a period of protection under either Model A or B. It is submitted that the discussion paper’s proposal to not require mandatory disclosure but rather to leave it up to companies to decide should be the preferable approach. Disclosing entities (such as publicly listed companies) will need to assess whether a restructuring effort triggers continuous disclosure obligations under the ASX Listing Rule 3.1 and under Corporations Act 674, but it is arguable that a confidential and incomplete restructuring negotiation would not be required to be disclosed due to the operation of the carve outs under ASX LR 3.1A (assuming a reasonable person would not expect disclosure). It is highly beneficial if a consultant advisor (such as a management consultant or corporate financial advisor) could encompass one or more persons as restructuring advisors to that companies could (as they do now) announce to the market that they have engaged the advisory firm to assist with advice without flagging to the market that financial distress may be a potential occurrence. If and when the company does become official financially distressed or insolvent then this would arguable require continuous disclosure. Requiring mandatory public disclosure of a restructuring safe harbor would simply strip away confidence in the company at a time when it is needed most.

**Conclusion**

Insolvent trading creates perverse incentives that drive directors away from companies when they are most needed. This article has argued that insolvent trading is too strict and this creates sub-optimal outcomes for companies in need of restructuring and this has a detrimental effect on the economy and on the government revenue base as more viable companies fail than should be the case if restructuring and turnarounds were better supported by the legal framework.

In the author’s view, the suggested business judgment rule defence offered by the Productivity Commission and suggested in the Treasury Discussion Paper (Model A) seems too detailed to provide any certainty for directors. It should be remembered that the onus of proving the defence will fall on directors. The more elements involved in the defence the harder it will be to satisfy. The difficulty of establishing the current defences in s 588H is one of the existing criticisms of the regime. It would be advisable to reduce, rather than increase the complexity of the provisions.

In the author’s view, the preferred model should be to reform the underlying prohibition against insolvent trading so that it is focused (like the New Zealand and English models) more on the culpability of the director in failing to shut down a company that has past the tipping point of avoiding insolvent liquidation. Model B can achieve this by carving out appropriate and reasonable conduct, although it is suggested that the appointment of a registered restructuring advisor would help in building confidence in the new regime. We need to implement a set of incentives that encourages directors to act early and to seek advice to determine if a restructuring is possible and if so whether it should be implemented.

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 National Innovation and Science Agenda ([www.innovation.gov.au)](http://www.innovation.gov.au)). [↑](#footnote-ref-1)
2. Senate Economics References Committee, *The regulation, registration and remuneration of insolvency practitioners in Australia: the case for a new framework* (2010). [↑](#footnote-ref-2)
3. Senate Economics References Committee, *The performance of the Australian Securities and Investments Commission* (Rec 61) (2014). [↑](#footnote-ref-3)
4. Treasury, *Insolvent Trading: A Safe Harbour for Reorganisation Attempts Outside of External Administration* (2010). [↑](#footnote-ref-4)
5. AICD, *The honest and reasonable director defence* (2014). [↑](#footnote-ref-5)
6. ARITA, *A platform for recovery* (2014), although the IPA (the former name for ARITA) advocated insolvent trading reform back in 2007 (submission, Review of Sanctions in Corporate Law, Treasury, 2007). [↑](#footnote-ref-6)
7. See Hon W Martin CJ, Official Opening Address, 2009 IPA Conference, 28 May 2009, at <http://www.supremecourt.wa.gov.au> (accessed 22 September 2016). [↑](#footnote-ref-7)
8. See the analysis by Professor Paul Redmond in relation to the statutory business judgment rule in Corporations Act 2001 (Cth) s 180(2): ‘Safe Harbours or Sleepy Hollows: Does Australia Need a Statutory Business Judgment Rule?’ in I Ramsay (ed), *Corporate Governance and the Duties of Company Directors*, Melbourne University Centre for Corporate Law and Securities Regulation, 1997. [↑](#footnote-ref-8)
9. Companies Act 1961 (NSW) s 303(3). [↑](#footnote-ref-9)
10. The maximum penalty was a period of imprisonment for three months or a fine of than £100. [↑](#footnote-ref-10)
11. For a discussion of the history of insolvent trading see N Coburn, *Coburn's insolvent trading*, Thomson Legal, 3rd ed, 2003; A Keay and M Murray, ‘Making Company Directors Liable: A Comparative Analysis of Wrongful Trading in the United Kingdom and Insolvent

Trading in Australia’ (2005) 14 *International Insolvency Review* 27. [↑](#footnote-ref-11)
12. Companies Code 1981 (NSW) s 556; as cited in P James, I Ramsay and P Siva, ‘Insolvent trading: an empirical study’ (2004) 12 *Insolvency Law Journal* 210 [↑](#footnote-ref-12)
13. Corporations Act 2001 (Cth) s 588G(2) and (3) respectively. [↑](#footnote-ref-13)
14. A debt does not include a claim for unliquidated damages: *Box Valley Pty Ltd v Kidd* [2006] NSWCA 26. [↑](#footnote-ref-14)
15. Insolvency is established either under Corporations Act 2001 (Cth) s 95A or by operation of the deemed insolvency provision in s 588E. [↑](#footnote-ref-15)
16. Reasonable grounds to suspect insolvency may be drawn from the ‘usual indicia of insolvency’ that have been recognized by the courts as well as by ASIC: *Lewis v Doran* [2004] NSWSC 608 at [75] (Palmer J); *ASIC v Plymin* [2003] VSC 123 at [386] (Mandie J); ASIC INFO 42, *Insolvency: a guide for directors* (2015). [↑](#footnote-ref-16)
17. Corporations Act 2001 (Cth) s 588G(2). [↑](#footnote-ref-17)
18. *Ho v Akai Pty Ltd (in liq)* [2006] FCAFC 159. [↑](#footnote-ref-18)
19. *Queensland Bacon Pty Ltd v Rees* (1966) 115 CLR 266. [↑](#footnote-ref-19)
20. *Elliott v ASIC* (2004) 10 VR 369; [2004] VSCA 54. See further Anderson C and Morrison D, ‘Should Directors be Pursued for Insolvent Trading Where a Company has Entered into a Deed of Company Arrangement’ (2005) 13 *Insolvency Law Journal* 163. [↑](#footnote-ref-20)
21. See T Howes, ‘Must the captain go down with the ship? The avenues available to directors to protect themselves from liability for insolvent trading’ (2012) 30 *Company and Securities Law Journal* 7; P Lewis, ‘Insolvent trading defences after Hall v Poolman’ (2010) 28 *Company and Securities Law Journal* 396. [↑](#footnote-ref-21)
22. See further A Keay, ‘Wrongful trading and the liability of company directors: A theoretical perspective’ (2005) 25 *Legal Studies* 431; D Morrison, 'The Australian Insolvent Trading Prohibition - Why Does It Exist?' (2002) 11 *International Insolvency Review* 153; D Morrison, 'The Economic Necessity for the Australian Insolvent Trading Prohibition' (2003) 12 *International Insolvency Review* 171; Harris, ‘Director liability for insolvent trading: Is the cure worse than the disease?’ (2009) 23 *Australian Journal of Corporate Law* 266; T Howes, ‘Must the captain go down with the ship? The avenues available to directors to protect themselves from liability for insolvent trading’ (2012) 30 *Company and Securities Law Journal* 7. [↑](#footnote-ref-22)
23. See generally, J Duns, ‘‘Insolvency: Problems of Concept, Definition and Proof’’ (2000) 28 *Australian Business Law Review* 20. [↑](#footnote-ref-23)
24. See further S Parbery, ‘Assessing voluntary administration in Australia: including suitability for workouts, turnaround and pre-packs’ in R Austin and F Aoun (eds), *Restructuring Companies in Troubled Times: Director and Creditor Perspectives*, Ross Parsons Centre, 2012. [↑](#footnote-ref-24)
25. See generally, C Howard and B Hedger, *Restructuring Law and Practice*, 2nd ed, Butterworths, 2013; S Slatter and D Lovett, *Corporate Turnaround*, revised ed, 1999, Penguin. [↑](#footnote-ref-25)
26. See A Shutter and D McLaughlin, ‘Waivers, amendments and standstills’ in C Mallon and S Waisman (eds) *The Law and Practice of Restructuring in the UK and US*, Oxford University Press, 2011. [↑](#footnote-ref-26)
27. It should be noted that some parts of the Centro restructure used a scheme of arrangement to implement the restructuring plan. [↑](#footnote-ref-27)
28. See further C Howard and B Hedger, *Restructuring Law and Practice*, 2nd ed, Butterworths, 2013 [↑](#footnote-ref-28)
29. Corporations Act 2001 (Cth) s 588H. [↑](#footnote-ref-29)
30. Corporations Act 2001 (Cth) s 1317S. See further *Hall v Poolman* (2007) 65 ACSR 123; [2007] NSWSC 1330; *Re McLellan; Stake Man Pty Ltd v Carroll* (2009) 76 ACSR 67; [2009] FCA 1415; Harris J, 'Relief from insolvent trading liability' (2010) 22 Australian Insolvency Journal 14; Harris J, 'Relief from liability for company directors' (2008) 12 University of Western Sydney Law Review 152. [↑](#footnote-ref-30)
31. Admittedly, this is a relatively remote risk with no case finding a major creditor acted as a shadow director for insolvent trading: see the discussion in *Buzzle Operations Pty Ltd (in liq) v Apple Computer Australia Pty Ltd* (2011) 81 NSWLR 47; [2011] NSWCA 109; *Emanuel Management Pty Ltd v Foster's Brewing Group Ltd* (2003) 178 FLR 1; [2003] QSC 205 at [264]. Advisors who act purely in a professional capacity will have the benefit of the carve-out in the s 9 definition of a director. [↑](#footnote-ref-31)
32. Corporations Act 2001 (Cth) ss 674, 675. [↑](#footnote-ref-32)
33. Corporations Act 2001 (Cth) s 674(2A). This is subject to a due diligence defence in s 674(2B). [↑](#footnote-ref-33)
34. The ASX may also require disclosure if a false market develops, which may occur where rumours are circulating regarding the company’s future. [↑](#footnote-ref-34)
35. See further S Villios, ‘Director penalty notices – promoting a culture of good corporate governance and of successful corporate rescue post insolvency’ (2015) 25 *Revenue Law Journal* (article 2). [↑](#footnote-ref-35)
36. *Westpac Banking Corp v Bell Group Ltd (in liq)* (2012) 44 WAR 1; [2012] WASCA 157. See further, R Teele Langford, *Directors’ Duties Principles and Application*, The Federation Press, 2014; D Heydon and M Leeming, *Meagher, Gummow and Lehane’s Equity Doctrines and Remedies*, 5th ed, LexisNexis, 2015, [5-405]-[5-440]. [↑](#footnote-ref-36)
37. *Spies v R* (2000) 201 CLR 603. See further A Hargovan, ‘Directors' Duties to Creditors in Australia after Spies v R: Is the Development of an Independent Fiduciary Duty Dead or Alive?’ (2003) 21 *Company and Securities Law Journal* 390. [↑](#footnote-ref-37)
38. R Maslen-Stannage, ‘Directors' duties to creditors: Walker v Wimborne revisited’ (2013) 31 *Company and Securities Law Journal* 76; A Hargovan and J Harris, ‘For whom the bell tolls: directors' duties to creditors after Bell’ (2013) 35 *Sydney Law Review* 433. [↑](#footnote-ref-38)
39. See T Bathurst and S Merope, ‘It tolls for three: accessorial liability after Bell v Westpac’ (2013) 87 *Australian Law Journal* 831. [↑](#footnote-ref-39)
40. The duty of care is a not a fiduciary duty and hence Barnes v Addy liability does not arise. The statutory duty in s 180 does not provide for statutory accessorial liability. See further Bathurst T and Merope S, ‘It tolls for thee: Accessorial liability after Bell v Westpac’ (2013) 87 *Australian Law Journal* 831. [↑](#footnote-ref-40)
41. For a summary of the principles applied in determining what compensation should be payable see *Brooks v Armstrong* [2015] EWHC 2289 (Ch) at [287] (‘The increase in the net deficiency from the hypothetical insolvent liquidation on the date of wrongful trading to the date of the usual compulsory order or resolution to wind-up will normally reflect the loss to the Company as a result of the liquidation having been delayed’). [↑](#footnote-ref-41)
42. Insolvency Act 1986 (UK) s 214(8). [↑](#footnote-ref-42)
43. Directors’ Disqualification Act 1986 (UK) s 6. [↑](#footnote-ref-43)
44. *Re Bath Glass Ltd* [1988] BCLC 329 at 333 per Gibson J (choosing to pay only selective creditors). [↑](#footnote-ref-44)
45. Insolvency Act 1986 (UK) s 213(1). [↑](#footnote-ref-45)
46. Insolvency Act 1986 (UK) s 213(2). There is also a similar criminal provision: Companies Act 2006 (UK) s 993. This provision does not require that the company end up in liquidation however. [↑](#footnote-ref-46)
47. This includes shadow directors: s 214(7). [↑](#footnote-ref-47)
48. Insolvency Act 1986 (UK) s 214(1). Insolvency in this context is determined by an application of an assets over liabilities test: s 214(6). [↑](#footnote-ref-48)
49. Insolvency Act 1986 (UK) s 214(2)(c). [↑](#footnote-ref-49)
50. *Brooks v Armstrong* [2015] EWHC 2289 (Ch) at [276]. [↑](#footnote-ref-50)
51. See for example *Re Produce Marketing Consortium (In Liq) Ltd (No.2)* (1989) 5 BCC 569 where directors who were experienced property developers should have understood when a project would be unlikely to be completed and hence should have known when the company would be unlikely to avoid insolvent liquidation. [↑](#footnote-ref-51)
52. This will include financial information contained in management accounts: *Brooks v Armstrong* [2015] EWHC 2289 (Ch) at [182]. Directors should know if the accounts are in a poor state and this will be relevant for assessing their reasonable knowledge of the likelihood of avoiding insolvent liquidation: *Re Kudos Business Solutions Ltd (In Liq)* [2011] EWHC 1436 (Ch) [↑](#footnote-ref-52)
53. Insolvency Act 1986 (UK) s 214(4),(5). [↑](#footnote-ref-53)
54. *Re Produce Marketing Consortium (In Liq) Ltd (No2)* (1989) 5 BCC 569 at 594-595 per Knox J. [↑](#footnote-ref-54)
55. *Re Produce Marketing Consortium (In Liq) Ltd (No2)* (1989) 5 BCC 569 at 594-595 per Knox J. [↑](#footnote-ref-55)
56. *Re Produce Marketing Consortium (In Liq) Ltd (No2)* (1989) 5 BCC 569 at 595 per Knox J. [↑](#footnote-ref-56)
57. *Roberts v Frohlich* [2012] BCC 407 at 439. [↑](#footnote-ref-57)
58. *Brooks v Armstrong* [2015] EWHC 2289 (Ch) at [5] per Registrar Jones (applying *Re Idessa (UK) Ltd (In liq)* [2011] EWHC 804 (Ch) at [113] per Lesley Anderson QC). [↑](#footnote-ref-58)
59. See for example, *Rubin v Gunner* [2004] B.C.C. 684 (advisor’s advice based on statement by directors that they believed in good faith that company would receive further funds when they knew this was unlikely). [↑](#footnote-ref-59)
60. *Re Hawkes Hill Publishing Co Ltd (in liq)* [2007] EWHC 3073 (Ch) at [28] per Lewison J (‘The question is not whether the directors knew or ought to have known that the company was insolvent. The question is whether they knew or ought to have concluded that there was no reasonable prospect of avoiding insolvent liquidation.’) [↑](#footnote-ref-60)
61. This will not be satisfied if the directors have failed to maintain proper financial records: *Grant v Johnston* [2015] NZHC 611 [↑](#footnote-ref-61)
62. Quoting from M Ross, *Corporate Reconstructions: Strategies for Directors,* CCH New Zealand 1999 at p 40. [↑](#footnote-ref-62)
63. *Lower v Traveller* [2005] 3 NZLR 479; [2005] NZCA 187; *Mason v Lewis* [2006] 3 NZLR 225 at [49]. [↑](#footnote-ref-63)
64. See further T Howes, ‘Must the captain go down with the ship? The avenues available to directors to protect themselves from liability for insolvent trading’ (2012) 30 *Company and Securities Law Journal* 7; A MacFarlane, ‘Safe harbour reforms – should insolvent trading provisions be reformed?’ (2010) 18 *Insolvency Law Journal* 138. [↑](#footnote-ref-64)
65. For copies of the submissions see [www.pc.gov.au](http://www.pc.gov.au) [↑](#footnote-ref-65)
66. At the time of writing all of the submissions were not publicly available from Treasury. These submissions have been found on the websites of the relevant bodies, identified through a combination of Boolean searches on Google. [↑](#footnote-ref-66)
67. See for example, *ASIC v Somerville* [2009] NSWSC 934. [↑](#footnote-ref-67)
68. 11 US Code §§362-364. [↑](#footnote-ref-68)