liability of XYZ for insolvent trading.

This question concerns the potential liability of XYZ for insolvent trading. The company appears to have been experiencing financial difficulties for some time and eventually collapsed into liquidation after enforcement action by the ATO.

Was the company insolvent?

Solvency is defined in s 95A as the ability to pay debts as and when they become due and payable.

In this situation it appears that the company has been unable to pay its debts for some time. This is supported by a range of facts from the question: 1 XXX , 2 XXX

***Appointment of liquidator*

Therefore, applying the standard of commercial reality, it appears the company was insolvent prior to the liquidator being appointed because it was unable to pay all of its debts that were due and payable: *Southern Cross Interiors Pty Ltd (in liq) v Deputy Commissioner of Taxation*

Liability for insolvent trading under 588G

Liability for insolvent trading requires proof of a number of elements:

- ***Was A a director of the company?***

  *****Director***

  The facts of the question indicate that XYZ is a director of the company therefore liable for insolvent trading.

  Or

  *****Not a director***

  A was an accountant. Unless it could be proven that A was a shadow or de facto director he will not be liable for insolvent trading.

- ***Was a debt incurred under 588G(1A)?***

  There are no facts in the question that suggest the existence of any deemed debts as described under s 588G(1A).

  it can be assumed that debts were being incurred because XXX

- ***Were there reasonable grounds to suspect the company's insolvency?***

  In *Queensland Bacon Pty Ltd v Rees* it was stated that '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'.

  The facts show a number of indicators of insolvency including XXX debts going unpaid) this would lead a reasonable person to suspect that the company company's insolvency.

In order to be found liable for insolvent trading it must be established that the directors were aware of the reasonable grounds to suspect insolvency or that a reasonable person would have been aware.

This can be established from the facts of the question because XXX. it would be clear that a reasonable director in a company in similar circumstances would have been aware.

Reasonably diligent directors would have put in place systems to enable them to effectively monitor the company's financial performance: *Daniels v Anderson* and would have therefore been aware of the grounds to suspect insolvency.

Potential defences (s 588H)

s 588H(2)) is reasonable expectation that the company was solvent.

As the directors have not taken an active role in monitoring the company's financial performance it is unlikely that they could have had a reasonable expectation that the company was solvent (s 588H(2)).

The directors are also unlikely to be able to prove that they had good reason for not taking part in the management of the company simply because of their lack of financial skill (s 588H(4)): *Deputy Commissioner of Taxation v Clark*

if it is proved that the person took all reasonable steps to prevent the company from incurring the debt: s 588H(5)

The directors did nothing to prevent the company incurring further debts so there will be no defence under s 588H(5).

at the time debt incurred, the person had reasonable grounds to believe that a competent and reliable person was responsible for providing information about if the company was solvent and the other person was fulfilling that responsibility: s 5878H(3)

the directors would also be unable to establish a defence under s 588H(3) as accountant did not advise them that the company was solvent.

Or

they are relying on the accountant information XXX

S 189 defence is reliance on information or advice provided by others

Consequences of insolvent trading

If the directors contravened the insolvent trading provision, there may be a claim compensation in respect of the debts that were incurred after the company became insolvent: s 588M(2). The amount of compensation is measured by losses suffered by the company's creditors as a result of the insolvent trading.

The other directors/liquidator/creditor can claim compensating under 588M

The directors may face insolvent trading actions even if the liquidator does not bring proceedings, as ASIC (s 588J) and creditors of the company may also take action (s 588M(3)). If ASIC brings proceedings against the directors it will seek a declaration of contravention under s 1317E and may then also seek an order disqualifying the directors from managing corporations under s 206C: see, for example, Elliott v Australian Securities and Investments Commission

Failed to act diligent and due care

A did not participate in the meeting

This would be a breach of both the general law obligation and the statutory obligation under 180(1). However, as negligence is an unintentional tort, it must still be proved that the failure to act with due care caused the company harm. Causation of harm is not necessary for a breach of the statutory provision: *Permanent v Wheeler* .

Reasonably diligent directors would have put in place systems to enable them to effectively monitor the company's financial performance: *AWA* and *Daniels v Anderson* This will typically involve attending all board meetings when they are reasonably able to do so: *Vrisakis v ASIC*. The essence of director negligence is failing to properly balance the foreseeable risk of harm against the potential benefits that could reasonably have been expected to accrue to the company: *Vrisakis* endorsed in *Vines v ASIC*

On the present facts, there may be a risk that the XXX will not be beneficial to the company, which must be weighed against any potential benefit flowing from the contract. This is not conduct that a reasonable person would engage in if they were a director of the company in similar circumstances.

It would appear that A has failed to act with due care and diligence and skill by failing to participate in the board discussion…

> ***If A has the knowledge of the harm caused to company***
>
> If A has knowledge about potential harm that may be caused by the transaction he should seek to protect the company's interests: *Permanent Building v Wheeler; ASIC v Adler*
>
> It should, however, be noted that both of these cases concerned the positive obligation imposed on chief executive officers. It is arguable that if a reasonable person had actual knowledge of potential harm to the company on which they were serving as a director they would take steps to disclose that potential harm and argue against the transaction: *ASIC v Macdonald* (where non-executive directors were held to be negligent for failing to oppose the release of a misleading press release).
>
> ***If all the director approved of transaction***
>
> As in *PBS v Wheeler*, if all of the other directors had been determined to approve the transaction it is doubtful that A's negligence could be said to have caused the harm suffered by the company, as the result would have been the same regardless. This need not be proved if the action is brought under the statute.
>
> Furthermore, if ASIC were bringing the action, it may not necessarily be seeking compensation for loss suffered by the company, but rather a banning order against A.

Defence

A could not use the business judgment rule defence in s 180(2) as he either failed to make a business judgment or because he was not properly informed: Gold Ribbon v Sheers.

S 189 defence is reliance on information or advice provided by others

A did not exercise an independent judgment about information provided by others and therefore could not rely on the defence in s 189 either.

***Conflicting of interest**

As a director, A is bound by a fiduciary duty to avoid conflicts of interest between his personal interests and those of the company: *Aberdeen v Blaikie Bros* . This can cover situations where there is no clear conflict, but where there is a `real sensible possibility of conflict': *Phipps v Boardman.*

In A's case, the facts go much further than a possibility of conflict, for in his case he is serving only the interests of X Pty Ltd(his other company) instead of Y Pty Ltd (the plaintiff)

This would clearly establish that *he* has not acted in good faith in the best interests of the company: *ASIC v Adler*.

When a director acts knowingly under a conflict of interest, then he or she also does not act in the interests of the company as a whole, and, he is certainly not acting in good faith.

***Interest in other company**

The fiduciary duty is breached when a director has interests in another company other than the company upon which he or she is a director: *Transvaal v New Belgium*.

A director of a company who is also a director of another company may owe conflicting fiduciary duties. Being a fiduciary, the director of the first company must not exercise his or her powers for the benefit of the second company without clearly disclosing the second company's interest to the first company and obtaining the first company's consent: *R v Byrnes*

At the very least, A should have disclosed his interest in (Y Pty Ltd – his other company) to the directors of X Pty Ltd, and probably should not have taken part in any deliberation or voting: Jenkins *v Enterprise Gold*.

***Transactions that has not benefit to the company**

This is also a requirement of ss 191, 195. It has also been held that directors owe a positive duty to protect the company's interests by taking action to prevent the transaction from going ahead when the transaction is clearly of no benefit to the company, but rather will cause harm to the company: *Permanent Building v McGee* . Failing to protect the company's interests in such a situation may also give rise to a breach of the duty of care and diligence: see *ASIC v Sydney Investment*

***Restriction on Voting when there is conflict of interest**

If we assume that A attended and voted at the board meeting, he would also have contravened s 195(if it is private company s 194), as XYZ Pty Ltd is a public company, unless he obtained approval from the other directors under s 195(2), although this requires full disclosure.

It is also possible that the transaction confers a financial benefit on a related party (B) which would require shareholder approval under Ch 2E (related party transactions), although the consulting contract might fall within a carve-out such as an arms- length transaction (s 210) and not need approval.

***Conflict of interest - Disclosure**

A fiduciary who acts under a conflict of interest may have a defence if they have given full and frank disclosure to the company (preferably the shareholders): *Regal (Hastings) Ltd v Gulliver*.

***Sufficient disclosure*

This raises the question as to whether A has given sufficient disclosure to enable the transaction to stand because of the relief granted by the constitution provision: *Imperial v Coleman*, where the disclosure by a director that `had an interest' in the transaction was insufficient to confer protection, and the details of the conflict and any profit had to be disclosed.

It would seem therefore that B has not given sufficient disclosure to gain the protection of the constitutional provision, and the transaction would be voidable at the option of the company.

Lastly, B may also have contravened s 191 by failing to give proper notice of his `material personal interest' in the transaction.

It does not appear that A has done this and therefore he is unlikely to have any defence available.

Consequences of breaching the no conflict rule

*****Contract***

Relevantly, the directors would seek to rescind the contract with (Y Pty Ltd- the other company)

For the court to make an order for rescission, X Pty Ltd would need to show that Y Pty Ltd (the other company) knew of the breach of duty: *Transvaal Lands Co v New Belgium*

X Pty Ltd must also show that restitution is possible

*****Against Director***

Where a breach of fiduciary duty causes loss, then the court has power to award monetary compensation called equitable compensation: *Tavistock v Saulsman*

X Pty Ltd would be seeking an order to recover their losses.

*****Statutory duties***

The statutory duties of directors mirror the fiduciary duties quite closely. Section 182 is a civil penalty provision: s 1317E, with the possibility that A would also be liable for the criminal offence set out in s 184(2). ASIC is the relevant body to pursue a breach of statutory duty or a criminal offence: ss 1317J and 1315.

The directors of X Pty Ltd do not have standing to pursue a breach of statutory duty. However, they can report this matter to ASIC for investigation and possible prosecution.

Or

if ASIC would prosecute for a criminal offence, as they would be able to prove that X pty acted dishonestly and with intention to gain an advantage for X pty s 184(2.Whether ASIC pursues either a civil penalty a criminal prosecution, there are proceedings incidentally available for the company to recover loss occasioned as a result of the activity: ss 1317H and 1317J(2).