INSOLVENT TRADING IN AUSTRALIA: A STUDY OF COURT JUDGMENTS FROM 2004 TO 2017

Stacey Steele and Ian Ramsay

The duty imposed on company directors under Australian law to not have the company of which they are a director trade while it is insolvent is controversial. The recent introduction of a safe harbour for directors’ personal liability for breach of the duty to prevent insolvent trading highlights the ongoing controversy surrounding this duty. This article presents the findings from a study of judgments of courts which considered the duty to prevent insolvent trading from 2004 to 2017. Directors were found liable in 72% of the judgments but the success rate differed significantly depending on who was the plaintiff. In cases brought by liquidators, the plaintiff was successful in 84% of the cases. In cases brought by creditors, the plaintiff was successful in only 42% of the cases. Almost 60% of compensation orders made against directors were for less than $500,000, but about one third of judgments involved compensation orders of over $1,000,000. The study also found there was no judgment in which a director successfully argued one of the statutory defences to an insolvent trading claim.

I INTRODUCTION: A STUDY OF INSOLVENT TRADING CASES

This article presents the findings of a study of 39 judgments by Australian courts from the period of 1 January 2004 to 30 November 2017 which have considered allegations of a breach of the director’s duty to prevent insolvent trading under s 588G of the Corporations Act 2001 (Cth). A company director in Australia may be liable for many forms of misconduct, including if a company of which she or he is a director incurs a debt when it is insolvent, or becomes insolvent by incurring that debt, and there are reasonable grounds for suspecting that the company was insolvent, or would become insolvent. In other words, directors in Australia have a positive duty to prevent so-called insolvent trading. This duty has been controversial since its introduction in the early 1990s, and insolvent trading has been analysed from

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1 The research methodology for this study is set out in Part III and a list of the judgments is set out in Appendix A.
2 Corporations Act 2001 (Cth) s 588G.
numerous viewpoints and based on various methodological approaches. Commentators have applied an historical perspective, tracing the development of Australia's approach to a director's liability for insolvent trading, economic perspectives, modern game theory and information economics, doctrinal perspectives, comparative perspectives, and deterrence perspectives. Theoretical and philosophical approaches have also been adopted. The last comprehensive review of the case law, however, was completed in 2004.

This study builds on findings from an earlier study by James, Ramsay and Siva, which reviewed 103 judgments from the 1970s to 19 February 2004. The 2004 study has been cited as part

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\footnote{The 2004 study also considered the historical formulations of the legislative provisions existing prior to the current provisions due to its historical data set.}


This study may provide useful background for the independent review of the recent safe harbour reforms to be carried out as soon as practicable after 18 September 2019.\footnote{Corporations Act 2001 (Cth) s 588HA(1). The review may also consider ‘any other matters the Minister considers relevant’.}

The review will focus on the impact of the safe harbour provisions.\footnote{Corporations Act 2001 (Cth) s 588HA(1). The review may also consider ‘any other matters the Minister considers relevant’.}

After this introduction, the article provides a summary of the background and content of the current legislative provisions, including the new safe harbour framework. A detailed explanation of the provisions is set out in the 2004 study. Part III presents the research methodology used to identify and examine judgments from the period between 2004 and 2017 and discusses the limitations of such studies. Part IV analyses the results based on the 2004 study’s methodology, highlighting that cases are typically bought by liquidators who usually are successful. Defendant directors were found liable in 84 percent of the judgments where the case was brought by a liquidator. However, the chances of liability are much less where a creditor brings an action (41.7%). Moreover, the determination of insolvency continues to be a key driver in case outcomes, with defences playing little, if any, role. Part V analyses additional questions not considered by the 2004 study such as the role of litigation funding, insurers and the Australian Securities and Investments Commission (ASIC). In Part VI, the article argues that the findings from the study have implications for the potential impact of the recent safe harbour reforms which may be relevant when the legislation is mandatorily reviewed two years following the commencement of the reforms.
II   INSOLVENT TRADING: BACKGROUND AND CURRENT LEGISLATION

A  Background to Introduction of the Duty to Prevent Insolvent Trading

Australian law has incorporated some form of liability in relation to insolvency since the 1930s, with the initial liability being focused on fraudulent trading and criminal penalties. An offence of insolvent trading was introduced in the 1960s and this offence still exists in that form in Singapore, which copied the 1960s Australian legislation.\(^\text{17}\) The positive duty on directors to avoid trading whilst insolvent was established in Australia in 1993 after the passing of the *Corporate Law Reform Act 1992* (Cth). The new duty was introduced after a comprehensive review of Australia’s corporate and personal insolvency laws by the Australian Law Reform Commission (ALRC) which commenced in 1983 and resulted in the Harmer Report in 1988.\(^\text{18}\) The ALRC’s study was the first comprehensive review of Australia’s corporate insolvency law. The review was prompted in part by changing economic and social circumstances in Australia, including Australia’s difficult economic circumstances at the beginning of the 1980s, easier access to credit, high unemployment and fluctuating interest rates which were perceived to have led to an increase in insolvency proceedings.

The economic and structural drivers behind the ALRC’s review help to explain the strict nature of the insolvent trading provisions implemented in the 1990s which are now described by some critics as ‘draconian’.\(^\text{19}\) The ALRC made it clear, however, that the new duty was not designed to punish directors for a company’s insolvency.\(^\text{20}\) Chapter 7 of the Harmer Report dealt with director liability and director disqualification. According to the ALRC, ch 7 was based on a policy understanding that directors should be ‘accountable for irresponsible behaviour, particularly where it affects creditors of the company’.\(^\text{21}\) Accordingly, the ALRC wanted to increase the remedies available to unsecured creditors where a director behaved recklessly.

After examining the perceived problems with the pre-reform legislation and all of the submissions to its consultation process, the ALRC concluded that its ‘proposal for a total restructuring of the director liability provisions received broad support’ and ‘none [of the submissions] opposed the general concept’.\(^\text{22}\) At the time of the reforms, however, there were many different opinions about the content, application and consequences of the recommended provisions, including whether liability should be civil or criminally based, and whether creditors should have the right to pursue directors, or even be afforded protection


\(^{20}\) Accordingly, the Commission believed that a breach of the duty to prevent insolvent trading should only give rise to a civil liability and not a criminal liability: Australian Law Reform Commission, above n 18, 126 [283]. As discussed below, the final provisions included criminal liability.

\(^{21}\) Chapter 7 is set out in Australian Law Reform Commission, above n 18, 121–147 [272]–[336].

\(^{22}\) Ibid 126 [282].
in this way at all.\textsuperscript{23} The debates leading up to the recent safe harbour reforms reflect those ongoing controversies.

The new safe harbour provisions became effective at the end of the period for this study in 2017. The safe harbour provides a framework for relief from the duty to prevent insolvent trading where a director can prove that the director was taking a course of action reasonably likely to lead to a better outcome for the company.\textsuperscript{24} According to the Government, the reforms ‘create a “safe harbour” for honest and diligent company directors from personal liability for insolvent trading if they are pursuing a restructure outside formal insolvency’ and encourage ‘entrepreneurship and innovation to drive business growth, local jobs and global success’.\textsuperscript{25} As the expectations reflected in these comments suggest, Australia’s insolvent trading framework is inextricably linked to its political and economic context, and choices between creditor protection and encouraging entrepreneurship amongst directors.\textsuperscript{26}

**B Summary of current legislative provisions**

Based on the ALRC’s recommendations, the duty to prevent insolvent trading was introduced into ch 5 of the *Corporations Act 2001* (Cth).\textsuperscript{27} Chapter 5 deals with the external administration of companies and pt 5.7B of ch 5 deals with the recovery of property or compensation for the benefit of creditors of the insolvent company. Accordingly, the duty to prevent insolvent trading is found in the same section as voidable transactions, because its original legislative purpose was to increase returns to unsecured creditors.

Within pt 5.7B, a director’s duty to prevent insolvent trading is set out in s 588G.\textsuperscript{28} Section 588G applies if a plaintiff can show that:

- a person is a director of a company at the time when the company incurs a debt;\textsuperscript{29} and
- 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
- at that time, there are reasonable grounds for suspecting that the company is insolvent, or would so become insolvent, as the case may be; and

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\textsuperscript{23} On whether creditor protection in the form of the insolvent trading provisions was and is warranted. See, eg, Ian Ramsay, ‘An Overview of the Insolvent Trading Debate’ in Ian Ramsay (ed), *Company Directors’ Liability for Insolvent Trading* (CCH Australia and the Centre for Corporate Law and Securities Regulation, 2000), 9–12.

\textsuperscript{24} *Corporations Act 2001* (Cth) ss 588GA(1), (3).

\textsuperscript{25} Commonwealth, *Parliamentary Debates*, House of Representatives, 1 June 2017, 6011 (Michael Francis McCormack, Minister for Small Business).

\textsuperscript{26} For a history, see Coburn, ‘Insolvent Trading in Australia: The Legal Principles’, above n 4, 73–89.

\textsuperscript{27} The 2004 study sets out a detailed outline of the current insolvent trading provisions which is not repeated in this article. More detailed analysis of the provisions is provided in the publications cited in note 7 above.

\textsuperscript{28} A holding company may also be liable for insolvent trading by its subsidiaries: s 588V. The focus of this research is on insolvent trading by directors. For discussion of s 588V see Sam Marsh and Shane Roberts, ‘The Doubling up of Insolvent Debt: Personal Liability of Directors and the Concurrent Liability of Holding Company’ (2016) Governance Directions, September 2016, 461 (discussing *Carrello as Liquidator of Perrinepod Pty Ltd (in liq) v Perrine Architecture Pty Ltd* [2016] WASC 145); Ian Ramsay, ‘Holding Company Liability for the Debts of an Insolvent Subsidiary: A Law and Economics Perspective’ (1994) 17 *University of New South Wales Law Journal* 520.

\textsuperscript{29} For an early study of the meaning of ‘debt’ and when a debt is incurred, see John Mosley, ‘Insolvent Trading: What is a Debt and When is One Incurred?’ (1996) 4 *Insolvency Law Journal* 155. For more recent analysis of these issues, see the publications cited in note 7 above.
the director fails to prevent the company from incurring the debt and the director is aware at that time that there are such grounds for such a suspicion or a reasonable person in a like position in a company in the company’s circumstances would be so aware.

Section 588E sets out presumptions of insolvency for the purposes of s 588G. One presumption, for example, provides that a company will be presumed to have been insolvent for the purposes of s 588G if the company has failed to keep financial records for a specified period. The company will be presumed insolvent for the period during which it failed to keep those records.

Proceedings may be brought by ASIC, a liquidator or a creditor. Proceedings by a liquidator or creditor must be begun within six years after the beginning of the winding up. An individual creditor’s right to sue a director is subject to the consent of the liquidator or the court. Creditors must wait six months from when a company begins to be wound up before giving a liquidator a written notice of an intention to sue. The liquidator has three months to respond and, if the liquidator does not respond, the creditor may seek leave from the court to sue. The circumstances which prevent a creditor from suing a director are limited and focus on giving preference to liquidators taking action.

If the elements set out in s 588G are proved, the director may try to prove that one of the four defences set out in s 588H of the Corporations Act apply. The defences may be summarised as: reasonable grounds to expect solvency; reasonable reliance on information of solvency provided by another person; absence from management for good reason; and taking all reasonable steps to prevent incurring the debt. When considering whether reasonable steps were taken by the director, the court will consider actions such as any action the director took to appoint an administrator to the company. The director has the burden of proof in relation to the defences. If a director is found liable for insolvent trading, the director may also be relieved from liability by the court in accordance with ss 1317S or 1318 in certain circumstances.

Section 588G and the defences must now be read in conjunction with s 588GA which sets out the safe harbour framework. To be eligible for the safe harbour protection, a director must show, based on an objective test, that:

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30 Corporations Act 2001 (Cth) s 588E(4).
31 Ibid s 588M(4).
32 Ibid s 588R.
33 Ibid s 588T(3).
34 Ibid s 588S(a).
35 Ibid ss 588S(b) and 588T.
36 Ibid s 588U.
37 Corporations Act 2001 (Cth) s 588H(2).
38 Ibid s 588H(3).
39 Corporations Act 2001 (Cth) s 588H(4).
40 Ibid s 588H(5).
41 Ibid s 588H(6)(a).
42 Ibid ss 1317S, 1318. Section 1317S provides relief from liability for contravention of a civil penalty provision, and s 1318 gives the Court power to grant relief.
first, after the director starts to suspect that a company may become or be insolvent, the director starts developing one or more courses of action that are reasonably likely to lead to a better outcome for that company;\textsuperscript{43} and

secondly, the debt in question was incurred directly or indirectly in connection with such a course of action during a specified period.\textsuperscript{44}

The specified period will depend on what action, if any, the director takes.

A person will not be entitled to rely on the safe harbour if the company of which the person is a director consistently fails to pay employee entitlements (including superannuation) on time, or comply with reporting obligations under the taxation laws.\textsuperscript{45} Directors will also be required to evidence their honesty and diligence in taking a course of action, because directors bear the evidentiary burden that there was a ‘reasonable possibility’ that the matters required to establish a safe harbour exist.\textsuperscript{46} If directors can provide evidence by, for example, showing that they sought ‘appropriate advice from an appropriately qualified entity’, it will then be up to the plaintiff (typically a liquidator bringing a claim against a director for insolvent trading) to rebut the director’s claims. Appropriate advice and advisors are not defined in the legislation and will depend on the circumstances. A small organization would not be expected to take the same steps as a large listed entity, for example.

A director who is found to have breached the duty may be liable to pay compensation to unsecured creditors,\textsuperscript{47} be subject to pecuniary penalties\textsuperscript{48} and even be disqualified from managing corporations for a specified period of time.\textsuperscript{49} A director may also be subject to criminal liability where the failure to prevent the company incurring the debt was dishonest.\textsuperscript{50} If a director is found to be criminally liable, the director may be fined up to 2,000 penalty units ($420,000 at the time of writing), imprisoned for up to five years, or both.\textsuperscript{51}


Although this study reflects the methodology used for the 2004 study, there are differences. Given the various new databases available in 2017 when compared to 2004, the research for this study was conducted on slightly different databases to the 2004 study to find as many Australian insolvent trading judgments as possible.\textsuperscript{52} The databases used for this study were Westlaw AU Cases (for unreported and reported cases), LexisNexis AU Cases (which includes CaseBase), JADE (to confirm parallel citations) and AustLII. The proximity searches carried out for this study focused on the terminology and legislative provisions relevant to insolvent trading since 2004; namely, ‘Corporations Act’ and ‘588G’ (repeated using ‘588H’, ‘588M’, ‘588V’ and ‘588W’). Searches were also conducted using proximity operators in relation to

\textsuperscript{43} Ibid s 588GA(1)(a).
\textsuperscript{44} Ibid s 588GA(1)(b).
\textsuperscript{45} Ibid s 588GA(4).
\textsuperscript{46} Ibid s 588GA(3), (7).
\textsuperscript{47} Ibid s 588M.
\textsuperscript{48} Ibid s 1317G.
\textsuperscript{49} Ibid s 206C.
\textsuperscript{50} Corporations Act 2001 (Cth) s 588G(3).
\textsuperscript{51} Ibid sch 3 item 138.
\textsuperscript{52} The 2004 study used CaseBase, Butterworths Unreported Judgments, Australian Corporations and Securities Reports, Australian Company Law Cases, LawBook Co Unreported Judgments, Australian Digest, Australian Legal Monthly Digest, Australian Company Law Reports, Australian Current Law Reporter and AustLII: James, Ramsay and Siva, above n 12, 219 n 36.
‘insolvent trading’ depending on the syntax required by the relevant database.\(^{53}\) Research was also conducted in relation to the legislation to search for cases citing ss 588G, 588M, 588V and 588W in Jade and LawNow (on Lexis). In addition, cases were found in Westlaw AU by searching relevant case classifications: ‘Corporations > Management and Administration > Duties and liabilities of officers of corporation > Officers of insolvent corporations > Duty to prevent insolvent trading’. Searches were conducted within the judgments for the terms ‘insolvent’ and ‘588’. These searches provided a pool of over 100 cases.\(^ {54}\)

As with the 2004 study, the preliminary pool of cases was reviewed to exclude judgments which clearly did not focus on the allegation of insolvent trading itself. Judgments were excluded, for example, where they related to interlocutory proceedings to determine other legal issues or merely referred to insolvent trading without providing a final decision in relation to s 588G and were decided for other reasons.\(^ {55}\) This study also does not include cases where insolvent trading was alleged but no final decision was included in the judgment in respect of the allegations because, for example, the judge declined to grant a summary judgment as requested by the plaintiff. In _Pioneer Construction Materials Pty Ltd v Schoch_,\(^ {56}\) for example, the creditor alleged insolvent trading in respect of supplies to the insolvent company but the judge dismissed the application for summary judgment. This judgment was not included in the study. The case of _Wily v King_\(^ {57}\) was also excluded because the question of insolvent trading was not finally addressed in the judgment. The liquidators asked the Court for a default judgment because no defence had been filed by the relevant deadline, but the Court found that, ‘[d]espite the apparent inactivity of the defendants, [the liquidators] must prove the elements of their case’ and the case was not of the type to which the default judgment procedure under the _Uniform Civil Procedure Rules_ could appropriately be applied.\(^ {58}\) To the extent that courts have been willing to provide a decision in relation to ss 588G and 588M in the form of a default judgment, however, these cases have been included in this study.\(^ {59}\)

Moreover, liquidators have been able to recover from directors where the defendant directors do not file a defence or attend court.\(^ {60}\) Justice Besanko gave a summary judgment for insolvent trading against a director in _Sheahan v Ren_\(^ {61}\) where the defendant failed to attend a number of hearings.\(^ {62}\) The judgment specifically dealt with the insolvent trading allegations and is included in this study. One or more directors failed to appear or engage in

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\(^{53}\) The 2004 study used additional terms to identify cases decided under previous iterations of the insolvent trading provisions: James, Ramsay and Siva, above n 12, 219.

\(^{54}\) One case is not equivalent to one judgment and may refer to more than one judgment where the same matter involved more than one decision by a court.

\(^{55}\) James, Ramsay and Siva, above n 12, 219–20. For example, the following judgment relating to an interlocutory proceeding in relation to the defendant directors claiming security for costs against applicants who were creditors was excluded from the final pool of cases: _Polstead Pty Ltd (in liq) v Sandip Shah_ [2009] NSWSC 560.

\(^{56}\) [2007] QDC 143.

\(^{57}\) [2010] NSWSC 352.

\(^{58}\) Ibid [32].


\(^{60}\) Cf _Wily v King_ [2010] NSWSC 352.

\(^{61}\) _Sheahan v Ren_ [2017] FCA 1163

\(^{62}\) Ibid [46].
the proceedings on the face of the judgments in another six judgments included in this study.\textsuperscript{63} The directors were found liable in those cases.

The review of the initial pool of cases identified 39 judgments from 2004 to 2017 which were included in this study. The 2004 study identified 19 judgments in relation to s 588G of the \textit{Corporations Act 2001} (Cth) and its predecessor under the \textit{Corporations Law} during the decade after the insolvent trading reforms were introduced in the wake of the Harmer Report.\textsuperscript{64} This relatively small number of judgments in the 2004 study and the 39 judgments identified for this study (2004 to 2017) suggest that there have only ever been a few judgments each year.

There is also evidence from the judgments that there is more activity in relation to insolvent trading not captured by this study. This study does not present data about trends based on private negotiations as between liquidators and directors which may, for example, lead to contributions under deeds of company arrangement.\textsuperscript{65} The judgment of \textit{Smith v Boné} from April 2015 involved one of the directors initially being found liable and ordered to pay $669,582.86.\textsuperscript{66} The parties subsequently came to a settlement, however, whereby the director paid $200,000 and agreed to discontinue an appeal.\textsuperscript{67} The settlement was approved by the Court in July 2015.\textsuperscript{68}

Empirical research methodology based on published judgments is also limited in terms of what any results can tell readers about issues such as whether directors who were found liable were in a financial position to comply with the court’s compensation orders. As the settlement in \textit{Smith v Boné}\textsuperscript{69} suggests, however, litigation may be a precursor to some sort of payment from a director. The judgments also do not typically discuss the impact that any compensation order will have on the net dividend for unsecured creditors. The discussion in \textit{Hall v Poolman}\textsuperscript{70} analysed in Part VA of this article suggests that the payouts to creditors can be quite small after the liquidator’s fees and legal costs are deducted, but it should be noted

\begin{thebibliography}{9}
\bibitem{64} These 19 judgments accounted for 18.4 percent of the 103 cases reviewed for the 2004 study: James, Ramsay and Siva, above n 12, 222.
\bibitem{65} Other references to such settlements may be found in one of the judgments identified by initial searches for this study but not included in the final data set: \textit{Ghose v CX Reinsurance Company Ltd} [2010] NSWSC 110 [14]. Approval for a compromise of an insolvent trading claim may also be obtained by a resolution of a committee of inspection or a resolution by creditors. A liquidator may also seek approval of the Court under s 477(2A) of the \textit{Corporations Act 2001} (Cth) to compromise debts to the company over a certain amount which may include settlements with directors.
\bibitem{66} For the preliminary decision by Gleeson J, see \textit{Smith v Boné} [2015] 104 ACSR 528; \textit{Smith v Boné (No 2)} (2015) 233 FCR 568. In relation to the s 477(2A) hearing, see \textit{Boné v Smith} [2015] FCA 870. This case is also an example of the potential interaction between ss 588M (insolvent trading) and 588FF (voidable transactions) of the \textit{Corporations Act 2001} (Cth). See also the discussion below on this point.
\bibitem{67} \textit{Smith v Boné (No 3)} [2016] FCA 1350 [8].
\bibitem{68} Ibid, citing \textit{Boné v Smith} [2015] FCA 870, referred to in-text as proceeding NSD 1691/2011. The initial 2015 judgment was set aside in the subsequent judgment of \textit{Smith v Boné (No 3)} [2016] FCA 1350 [13]. The amount of $669,582.86 from the initial judgment was used for the purposes of this study.
\bibitem{69} [2016] FCA 1350.
\bibitem{70} [2007] NSWSC 1330. The discussion below also highlights what the judgments in this study say about the amount of fees, if anything.
\end{thebibliography}
that the case also involved a litigation funder whose fees reduced the amount available to creditors further.

Judgments that were the subject of an appeal were considered to complement appellate decisions in this study. For instance, some appellate decisions were read in conjunction with the relevant first instance decisions to obtain the data to answer the study questions. The final numerical analysis does not, however, double count matters which went to appeal and the analysis is based as much as possible on information available from the final decision. Using these judgments, this study attempted to extract similar data to the 2004 study where possible for comparison. It was not possible, however, to answer every research question in relation to every judgment based on the information provided in the judgment itself. This limitation also applied to the findings of the 2004 study.

IV FINDINGS AND ANALYSIS IN RELATION TO 2004 STUDY QUESTIONS

This section highlights the findings from this study based on the questions asked in the 2004 study, which are reflected in the headings used below for the analysis, and offers some comparisons to the 2004 study’s findings. The first question from the 2004 study about which legislative provision the initial case was brought under is not relevant to this study. A key difference between this study and the 2004 study is that the 2004 study covered a key period during which Australia’s corporate law was reformed substantively and procedurally. The 2004 study also covered the decade after which the insolvent trading reforms were introduced in the wake of the Harmer Report. The judgments reviewed for this study related to the current formulation of the duty set out in s 588G except one judgment.

A Is It a Civil or Criminal Action?

None of the judgments revealed by the searches for this study were based on criminal proceedings, although media reports suggest that criminal liability has been imposed for breach of the duty to prevent insolvent trading in at least some cases, as discussed further

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71 The 2004 study noted that it may have included some duplication because first instance and appeal decisions in relation to the same case may have been included in the study: James, Ramsay and Siva, above n 12, 220.

72 James, Ramsay and Siva discuss the historical development of insolvent trading and the relevant provisions since the 1960s, which were as follows in chronological order: s 303(3) and related sections of the uniform Companies Act 1961 (Cth); s 374C and related sections of the Companies Act 1961 (Cth); s 556 and related sections of the Companies Code (Cth); s 592 and related sections of the Corporations Law; S 588G and related sections of the Corporations Code (Cth); and, the current formulation, s 588G and related sections of the Corporations Act 2001 (Cth): James, Ramsay and Siva, above n 12, 221-2.

73 See Tru Floor Service Pty Ltd v Jenkins (No 2) [2006] FCA 632. The Corporations Act Endnotes state that s 588G was last amended in Treasury Legislation Amendment (Application of Criminal Code) Act (No 3) 2001 (Cth). The Act was assented to on 18 September 2001, after the statement of claim on 6 September 2001. The amending act only changed s 588G(3)(a) and inserted ss 588(3A), (3B).
below in Part IVL.74 The lack of criminal actions amongst the cases reviewed for this study, however, is consistent with other empirical research on ASIC’s enforcement approach to directors’ duties generally which finds ASIC typically relies on other sanctions such as disqualification from acting as a director.75 The lack of dishonesty is also consistent with the reports made to ASIC by external administrators.76 The 2004 study also ‘did not reveal any criminal proceedings’ under the contemporary s 588G.77 The 2004 study suggested that cases were more likely to be brought as civil proceedings because they provide more options for relief and criminal prosecutions require a higher burden of proof.78

B Is the Judgment by a State Court or Federal Court?

The 2004 study asked this question about geographical jurisdiction based on State Supreme Courts, but the data available for this study also included two judgments from the Queensland District Court and one judgment from the New South Wales District Court. These judgments are included in the summary below as State courts.79 A majority of cases are heard in State courts (69.2%).

74 The Kleenmaid case is discussed further below in Part IVL. Australian Securities and Investments Commission, ‘Former Kleenmaid Director Sentenced to Nine Years Imprisonment for Fraud and Insolvent Trading’ (Media Release, 16-257MR, 15 August 2016) <http://asic.gov.au/about-asic/media-centre/find-a-media-release/2016-releases/16-257mr-former-kleenmaid-director-sentenced-to-nine-years-imprisonment-for-fraud-and-insolvent-trading/>. It is not clear why the Kleenmaid decision was not reported. The orders are available in the case file at the Queensland District Court and were accessed for the purpose of this study in December 2017 for the authors. For a related decision, see R v Armstrong & Ors QDC [2015] 80. It has been said that convictions for insolvent trading are not common: Australian Restructuring Insolvency and Turnaround Association, “Former director convicted of insolvent trading”, 30 November 2011. However, there have been some criminal convictions. For example, in August 2011, the former director of International Consulting Group Pty Ltd, Anula Kumari Kauye, pleaded guilty to insolvent trading, theft, and providing false information following an investigation by ASIC and sentenced to a total of three years and two months imprisonment: Australian Securities and Investments Commission, ASIC enforcement outcomes:July to December 2011, Report 281, March 2011, paragraph 45.

75 See Hedges et al, above n 11.

76 Of the 7765 reports lodged with ASIC by external administrators from 1 July 2016 to 30 June 2017, 117 reports (1.5%) alleged a breach of s 588G(3) (criminal breach), and 4878 reports (62.8%) alleged a breach of ss 588G(1)–(2) (civil breach). Dishonesty was alleged in only 32 reports alleging criminal breach: Australian Securities and Investments Commission, Insolvency Statistics: External Administrators’ Reports (July 2016 to June 2017) (Report No 558, December 2017) 28 [60], 34 [75].

77 James, Ramsay and Siva, above n 12, 223. The 2004 study found that most cases (85.4 %) involved civil proceedings even over the longer historical period taking into account the 1960s onwards.

78 Ibid 223.

79 Hambleton v Finn [2017] QDC 61; Pioneer Construction Materials Pty Ltd v Schoch [2007] QDC 143. Herzberg notes that initially cases were heard by either the Federal Court or the Supreme Courts and this jurisdictional restriction increased the cost of any litigation. Herzberg argues that this matter was resolved in October 1995 when the Corporations Law was amended to make it clear inferior courts have jurisdiction with respect to civil claims under the Corporations Law: see Corporations Legislation Amendment Act 1994 (Cth).
Table 1: Judgments categorised by State court and federal court

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<td>Total</td>
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</table>

C If it is a judgment of One of the State Courts, Which State Court?

Tables 2 and 3 present the judgments categorised by State and Territory based on the location of the State court and registry of the relevant Federal Court of Australia according to the judgment. As these two tables show, New South Wales is the most common jurisdiction for bringing an insolvent trading case. Two thirds of all State court judgments were from New South Wales and even when Federal Court judgments are included, New South Wales still accounts for a majority of judgments. This finding is not surprising given that New South Wales is the busiest insolvency jurisdiction in Australia with reference to the number of insolvencies, and there is a large and experienced insolvency and legal profession. There were no judgments from the State courts of the Australian Capital Territory or Northern Territory identified for this study. However, one Federal Court case appears to have been heard in Canberra, and another heard in Brisbane via video conference with Darwin. The majority of judgments in New South Wales and Queensland were from the State courts (see Tables 2 and 3). The division of judgments from Victoria between the State courts (2 judgments) and Federal Court of Australia in Victoria (4 judgments), however, suggests that there may have been a slight preference for running cases in the Federal Court in Victoria during the period of this study.

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80 One Federal Court case was noted as being heard in Brisbane with video conference to Darwin: see Playspace Playground Pty Ltd v Osborn [2009] FCA 1486. The order states that it was made at ‘Brisbane (via Videolink to Darwin)’ in the headnote to the judgment.


82 Engineered Thermal Systems Pty Limited v Salmon (in liq) [2012] FCA 1159. The place of hearing is cited as ‘Canberra’ in the headnote to the judgment.

Table 2: Distribution of judgments between the State courts (excluding Federal Court of Australia and Family Court judgments)

<table>
<thead>
<tr>
<th>State</th>
<th>Number of judgments</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>New South Wales</td>
<td>18</td>
<td>66.7</td>
</tr>
<tr>
<td>Queensland</td>
<td>6</td>
<td>22.2</td>
</tr>
<tr>
<td>Victoria</td>
<td>2</td>
<td>7.4</td>
</tr>
<tr>
<td>Western Australia</td>
<td>1</td>
<td>3.7</td>
</tr>
<tr>
<td>South Australia</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Tasmania</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>27</td>
<td>100</td>
</tr>
</tbody>
</table>

Table 3: Distribution of judgments between the States and Territories (including Federal Court and Family Court based on registry)

<table>
<thead>
<tr>
<th>State / Territory</th>
<th>Number of judgments</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>New South Wales</td>
<td>20</td>
<td>51.3</td>
</tr>
<tr>
<td>Queensland</td>
<td>7</td>
<td>17.9</td>
</tr>
<tr>
<td>Victoria</td>
<td>6</td>
<td>15.4</td>
</tr>
<tr>
<td>Western Australia</td>
<td>3</td>
<td>7.7</td>
</tr>
<tr>
<td>Australian Capital Territory</td>
<td>1</td>
<td>2.6</td>
</tr>
<tr>
<td>South Australia</td>
<td>2</td>
<td>5.1</td>
</tr>
<tr>
<td>Tasmania</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Northern Territory</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>39</td>
<td>100</td>
</tr>
</tbody>
</table>

D Is It a Judgment of a Court at First Instance or a Judgment of an Appeal Court?

The results from this study suggest that appeals are reasonably common with about one third of the judgments coming from appeals.

Table 4: Distribution of judgments between first instance and appeal

<table>
<thead>
<tr>
<th>Nature of judgment</th>
<th>Number of judgments</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>First instance</td>
<td>28</td>
<td>71.8</td>
</tr>
<tr>
<td>Appeal</td>
<td>11</td>
<td>28.2</td>
</tr>
<tr>
<td>Total</td>
<td>39</td>
<td>100</td>
</tr>
</tbody>
</table>
E Was the Defendant Director Found Liable for Insolvent Trading?

Directors were found liable in 71.8 percent of judgments in this study. The 2004 study found that directors were found liable in about the same percentage of judgments in that study (74.8%). Accordingly, this study does not support a finding that the likelihood of a director being found liable has changed significantly over time. Furthermore, no significant difference was revealed between the percentage of directors found liable when the outcomes of the judgments from the Federal Court of Australia were compared to the outcomes of judgments from the State courts in this study. Directors were found liable in 72.7 percent of judgments from the Federal Court of Australia and in 74.1 percentage of judgments from State courts (see Tables 6 and 7).

Table 5: Distribution of judgment according to finding

<table>
<thead>
<tr>
<th>Finding of court</th>
<th>Number of judgments</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liable</td>
<td>28</td>
<td>71.8</td>
</tr>
<tr>
<td>Not liable</td>
<td>11</td>
<td>28.2</td>
</tr>
<tr>
<td>Total</td>
<td>39</td>
<td>100</td>
</tr>
</tbody>
</table>

Table 6: Distribution of judgment according to finding for Federal Court of Australia judgments

<table>
<thead>
<tr>
<th>Finding of court</th>
<th>Number of judgments</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liable</td>
<td>8</td>
<td>72.7</td>
</tr>
<tr>
<td>Not liable</td>
<td>3</td>
<td>27.3</td>
</tr>
<tr>
<td>Total</td>
<td>11</td>
<td>100</td>
</tr>
</tbody>
</table>

Table 7: Distribution of judgment according to finding for State court judgments

<table>
<thead>
<tr>
<th>Finding of court</th>
<th>Number of judgments</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liable</td>
<td>20</td>
<td>74.1</td>
</tr>
<tr>
<td>Not liable</td>
<td>7</td>
<td>25.9</td>
</tr>
<tr>
<td>Total</td>
<td>27</td>
<td>100</td>
</tr>
</tbody>
</table>

---

84 James, Ramsay and Siva, above n 12, 225. The study noted that where there was more than one defendant director, the percentage does not reflect the findings made against each individual director and ‘to the extent that there were different findings made against individual directors, if one defendant director was found liable, then that case appears in the “liable” part of the results’. This study also adopted this approach.
If the Defendant Director Was Found Liable for Insolvent Trading, What Was the Amount of Compensation Ordered by the Court?

The amount of compensation awarded where the director or directors were found to be liable was able to be established from 21 judgments (seven Federal Court, 14 State court). In most cases where a compensation order was made at the time of the decision, costs, interest or goods or services tax were also ordered to be payable, but the final figures regarding those amounts were typically yet to be calculated at the time of judgment. The figures used in this study include those amounts where the final figure including interest and other amounts was given. The average compensation award across the 21 judgments was $846,739.41, but the median was much less at $410,592.69. The highest compensation award was $3,422,900.27 (including interest) in 2008. Most of the awards, were for less than $500,000, but one third were for more than $1,000,000. The lowest awards were $53,504 in 2010 and $74,159.37 in 2016.

Table 8: Distribution of judgments according to amount of compensation ordered

<table>
<thead>
<tr>
<th>Range of compensation</th>
<th>Number of cases</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1 – $20,000</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>$20,001 – $50,000</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>$50,001 – $100,000</td>
<td>2</td>
<td>9.5</td>
</tr>
<tr>
<td>$100,001 – $200,000</td>
<td>5</td>
<td>23.8</td>
</tr>
<tr>
<td>$200,001 – $500,000</td>
<td>5</td>
<td>23.8</td>
</tr>
<tr>
<td>$500,001 – $1,000,000</td>
<td>3</td>
<td>14.3</td>
</tr>
<tr>
<td>$1,000,001 – $2,000,000</td>
<td>3⁹⁹</td>
<td>14.3</td>
</tr>
<tr>
<td>$2,000,001 and above</td>
<td>3⁹⁰</td>
<td>14.3</td>
</tr>
<tr>
<td>Total</td>
<td>21</td>
<td>100</td>
</tr>
</tbody>
</table>

Of the 27 judgments where liability for insolvent trading was found, a number of decisions did not complete the calculation of the compensation award, including because parties were asked to submit calculations for interest and other amounts. Similar limitations were found during the research for the 2004 study: James, Ramsay and Siva, above n 12, 225–6. In one Federal Court case, the director was ordered to pay $328,006.53 to the plaintiff under s 588FF of the Corporations Act 2001 (Cth): see Muscat v Mustafa [2015] FCA 358. That judgment also suggests, however, that the director was liable for insolvent trading. This judgment was excluded from the judgments established as having awarded compensation where a director was found liable for insolvent trading.

Similarly to the 2004 study, this study collated results ‘with respect to the amount of compensation ordered by the court in the proceeding, rather than against each individual defendant director’.

⁹⁵ Williams v Scholz [2008] QCA 94.
⁹⁷ Ball v Sinclair [2015] NSWSC 2103 ($1.398m); Roufeil v Linder [2007] NSWSC 489 ($1.418 million); Perrine v Carrello [2017] WASCA 151 ($1.355 million).
No trends over time were discerned from the data in relation to compensation. It is worth noting, however, that to the extent the amount claimed by a plaintiff and the amount of compensation awarded was ascertained from the judgments, this study suggests that plaintiffs do not always get the full amount of compensation which they claim. This finding suggests that plaintiffs need to ensure that the debts alleged to have been incurred are clearly articulated and documented. In some cases, certain debts were excluded from the award on the basis that the date of insolvency occurred after those debts were incurred despite the director being found liable for insolvent trading overall.

The average compensation amount was much lower for the seven judgments from the Federal Court of Australia where the amount was able to be established ($343,428.90) than the average for other courts across the other applicable 14 judgments ($1,098,394.67). Whilst these figures may have been expected to reflect the large number of cases heard in the New South Wales State courts, only two of the judgments where the award was identifiable and more than $1 000 000 were from New South Wales (Supreme Court). The amount of the compensation award was only able to be established from seven judgments from New South Wales, however. The finding that a majority of compensation awards are less than $500 000 and one third are less than $200 000 is notable. A low level of alleged debts may not support a liquidator bringing a claim to court, but this finding suggests that even these amounts may support an action. The study also found, however, a large percentage of judgments where an award of more than $500 000 was made (42.9% of judgments). This level of award suggests that the judgments involve a high level of alleged debts, which may also reflect the expense involved in bringing proceedings. Plaintiffs may be more likely to bring an action where the possible returns make it economically worthwhile.

G Were There Any Other Orders Made by the Court?

Three other types of orders were made or to be made by the courts in the judgments reviewed for this study. Although cases are rarely brought by ASIC, ASIC may seek additional orders against a director for breach of the duty if certain further factors are found to have been present. First, ASIC may seek an order for a director to pay a pecuniary penalty. Secondly, ASIC may seek an order that the director be disqualified from managing companies for a period to be determined by the court. Thirdly, in this study, other allegations and findings of misconduct such as preferences or undervalue transactions were also identified and included in this section where findings were made by the court.

There were three disqualification orders from the two judgments where ASIC was the plaintiff. First, a non-executive director was disqualified from acting as a director for ten years.

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91 In the case representing the highest compensation awarded of the 19 judgments, for example, the liquidator claimed $5 327 686.96. Williams v Scholz [2008] QCA 94.
92 For ASIC’s information on the estimated amount of debts allegedly incurred by companies after the date of insolvency, see Australian Securities and Investments Commission, above n 766, 29.
93 The two main other types of orders highlighted by the 2004 study were disqualification orders and pecuniary penalties or fines. It is not clear if the authors looked for orders such as those made under voidable transaction provisions: Ramsay and Siva, above n 12, 226. In one case in this study, the Court made a finding in respect of an unfair transaction and requested that the parties propose orders: Smith v Boné [2015] 104 ACSR 528 [448].
94 Corporations Act 2001 (Cth) s 1317G.
95 Ibid s 206C.
Another director involved in the insolvent trading conduct had already agreed to a disqualification of five years; this outcome was not ordered by the appellate court and thus not counted for this study. The director who received the disqualification order for ten years argued on his appeal that the duration was unfair in light of the five years received by the other director. Macfarlan JA found that the defendant was more senior, ‘had considerably more relevant experience’ than the other director, and that other director ‘deferred in the conduct of the business to him’. Accordingly, his Honour concluded that it was ‘open to the judge to take the view that he did’ and apply a disqualification period of ten years. The other two disqualifications arose from the judgment in Elliott v ASIC where directors were disqualified for four and seven years each. Pecuniary penalties of $15 000 and $25 000 were also ordered in that judgment.

Table 9: Distribution of judgments according to the making of other orders by the courts (some judgments included more than one type of order)

<table>
<thead>
<tr>
<th>Were other orders made (or to be) by the court?</th>
<th>Number of judgments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Section 588FF voidable transactions</td>
<td>3</td>
</tr>
<tr>
<td>Disqualification orders</td>
<td>2</td>
</tr>
<tr>
<td>Pecuniary penalties</td>
<td>1</td>
</tr>
<tr>
<td>Total</td>
<td>6</td>
</tr>
</tbody>
</table>

Of the judgments reviewed for this study, three Federal Court of Australia judgments made (or proposed to make) orders in relation to s 588FF of the Corporations Act 2001 (Cth). Two judgments involved payments by directors to themselves which were found to be voidable transactions. In one judgment, the judge was satisfied that payments the director made to himself ‘were either “unreasonable director-related transactions” within the terms of s 588FDA of the Act, and/or “uncommercial transactions” within the terms of s 588FB of the Act and/or that the defendant contravened s 588G in relation to the incurring of a debt by the company’. In a second judgment, the director drew three cheques from a company account and cashed them for himself for which the court granted relief and ordered that he pay $33,000 plus interest pursuant to s 588FF, as well as compensation for insolvent trading of $163 228.17 plus interest. In Smith v Boné, the Court also found that there had been an...
unfair preference and called for the parties to propose orders accordingly.103 In the case of *Sheahan v Ren*, Besanko J noted transfers of real estate to the director’s wife ‘so that he would be entirely divested of that asset which appears to be his only asset in Australia’, but the judgment itself was only in relation to the allegations of insolvent trading.104

These judgments suggest how the failure to prevent insolvent trading may be intertwined with other corporate governance failings. Other decisions may not have led to orders, but some decisions did demonstrate other corporate governance failures such as failure to keep or present books. Suspicion of phoenix activity on the part of at least some of the parties was also expressed in another judgment in this study.105 The judge in that judgment also expressed concern about the ‘involvement of well-known firms of accountants and solicitors in the transaction’ and was considering whether to report them to the relevant authorities.106 In one other case, the director was found not liable for insolvent trading because the Court found it ‘difficult to conclude’ that a debt had been incurred, but the director was ordered to pay the plaintiff-creditor $3 636 368 plus interest and costs based on claims relating to misleading and deceptive conduct and breach of trust.107 These judgments and the judgments making orders under s 588FF suggest the possible linkages between inappropriate corporate governance and trading whilst a company is insolvent. The judgments in this study did not suggest any overall trend, however, of insolvent trading cases also evidencing other ‘misfeasance or breach of duty’.108

**H What Year Was the Judgment Decided?**

The year that the judgment was handed down was also noted. Previous studies suggest a rate of about two insolvent trading judgments during the period from 1993 to 2010.109 Over the last three years of this study, there appears to have been a slight increase in the number of judgments at first glance. Of the judgments in this study from 2015 and 2017, however, two judgments each year were appeals from earlier judgments. These appeal judgments suggest that there has not really been an increase in cases being brought in the last three years and the rate of insolvent trading judgments for the period of the study is two to three annually on average.

**Table 10: Number of judgments in this study by year of the judgment**

<table>
<thead>
<tr>
<th>Year</th>
<th>'04</th>
<th>'05</th>
<th>'06</th>
<th>'07</th>
<th>'08</th>
<th>'09</th>
<th>'10</th>
<th>'11</th>
<th>'12</th>
<th>'13</th>
<th>'14</th>
<th>'15</th>
<th>'16</th>
<th>'17</th>
</tr>
</thead>
<tbody>
<tr>
<td>All judgments</td>
<td>1</td>
<td>0</td>
<td>3</td>
<td>2</td>
<td>4</td>
<td>5</td>
<td>4</td>
<td>0</td>
<td>1</td>
<td>1</td>
<td>3</td>
<td>6</td>
<td>5</td>
<td>4</td>
</tr>
<tr>
<td>Appeal judgments</td>
<td>1</td>
<td>-</td>
<td>1</td>
<td>-</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>-</td>
<td>-</td>
<td>1</td>
<td>-</td>
<td>2</td>
<td>-</td>
<td>2</td>
</tr>
</tbody>
</table>

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103 *Smith v Boné* [2015] 104 ACSR 528 [448].
104 *Sheahan v Ren* [2017] FCA 1163 [38].
105 *Roufeil v Linder* [2007] NSWSC 489 [18].
106 Ibid [19].
107 *Deloitte Services Pty Ltd v HBO EMTB Interiors (NSW) Pty Ltd (in liq)* [2016] NSWSC 1597.
108 Cf the United Kingdom: Williams, above n 10.
109 See also MacFarlane, above n 11, 145.
What Type of Company Does the Allegation of Insolvent Trading Apply to?

The companies were all listed as ‘Pty Ltd’, indicating that they were proprietary companies.¹¹⁰

Is It Possible to Identify the Number of Shareholders in the Company?

Similar to the 2004 study, it was difficult to identify the number of shareholders in the debtor company. It was possible to identify the number of shareholders from a few judgments. The number of shareholders in each was typically only one or two.

What Sort of Business Is the Company Involved in?

Similar to the 2004 study, this study uses the Australian and New Zealand Standard Industrial Classification (ANZSIC) to classify the industries in which the insolvent companies in the judgments were operating.¹¹¹ ANZSIC is used by the Australian Bureau of Statistics and contains 19 divisions.¹¹²

Not all of the ANZSIC industry divisions are represented in the judgments in this study. It was possible to ascertain the business in which the director’s company was involved in 24 out of the 39 judgments. Whilst these findings relate to a small data set, it is not surprising to see that almost one third of the judgments relate to businesses involved in matters listed under the Construction Division of ANZSIC.¹¹³ There have been numerous investigations into insolvency in the construction industry which has been found to account for 22 to 24 percent of all insolvencies in Australia.¹¹⁴

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¹¹⁰ One judgment from the initial searches for this study stated that the company was an unlisted public company, but the judgment was not included in the final pool of 39 judgments reviewed for this study: see Pioneer Construction Materials Pty Ltd v Schoch [2007] QDC 143.

¹¹¹ Ibid, 228. See Australian Bureau of Statistics, 1292.0 — Australian and New Zealand Standard Industrial Classification (ANZSIC), 2006 (Revision 2.0) (26 June 2013) <http://www.abs.gov.au/AUSSTATS/abs@.nsf/Latestproducts/1292.0Contents12006%20(Revision%202.0)?opendocument&tabname=Summary&prodno=1292.0&issue=2006%20(Revision%202.0)&num=&view>. The Classification was updated in 2006 after publication of the 2004 study. The current classification includes a new division: Information Media and Telecommunications Division, and the old ‘Property and Business Services Division’ has been rearranged into three new divisions: Rental, Hiring and Real Estate Services; Professional, Scientific and Technical Services; and Administrative and Support Services.

¹¹² A Agriculture, Forestry and Fishing; B Mining; C Manufacturing; D Electricity, Gas, Water and Waste Services; E Construction; F Wholesale Trade; G Retail Trade; H Accommodation and Food Services; I Transport, Postal and Warehousing; J Information Media and Telecommunications; K Financial and Insurance Services; L Rental, Hiring and Real Estate Services; M Professional, Scientific and Technical Services; N Administrative and Support Services; O Public Administration and Safety; P Education and Training; Q Health Care and Social Assistance; R Arts and Recreation Services; and S Other Services.

¹¹³ Manufacturing was also allocated to some judgments which also had elements of agriculture or construction.

Table 11: Distribution of judgments according to ANZSIC division (relevant divisions only in alphabetical order)

<table>
<thead>
<tr>
<th>Industry division</th>
<th>Number of judgments</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture, Forestry and Fishing</td>
<td>1</td>
<td>4.2</td>
</tr>
<tr>
<td>Mining</td>
<td>2</td>
<td>8.3</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>5</td>
<td>20.8</td>
</tr>
<tr>
<td>Construction</td>
<td>7</td>
<td>29.2</td>
</tr>
<tr>
<td>Wholesale Trade</td>
<td>1</td>
<td>4.2</td>
</tr>
<tr>
<td>Retail Trade</td>
<td>1</td>
<td>4.2</td>
</tr>
<tr>
<td>Transport, Postal and Warehousing</td>
<td>1</td>
<td>4.2</td>
</tr>
<tr>
<td>Rental, Hiring and Real Estate Services</td>
<td>1</td>
<td>4.2</td>
</tr>
<tr>
<td>Professional, Scientific and Technical Services</td>
<td>3</td>
<td>12.5</td>
</tr>
<tr>
<td>Administrative and Support Services</td>
<td>2</td>
<td>8.3</td>
</tr>
<tr>
<td>TOTAL</td>
<td>24</td>
<td>100</td>
</tr>
</tbody>
</table>

**Who Is the Plaintiff?**

A majority of cases were brought by liquidators (64.1%), but one third of the cases leading to judgments were brought by creditors (30.8%). Where a creditor brings a case, this study suggests that the likelihood of a director being found liable in the relevant judgment is about half that when compared to judgments where the liquidator was the plaintiff (84% versus 41.7%). Possible reasons for the disparity in outcomes include a liquidator potentially having more information than creditors, because liquidators conduct investigations into a company’s downfall. Liquidators may also be more experienced than creditors and better placed to determine the potential success of an action, as well as possibly having more resources to the extent that a liquidator decides to pursue an action. It is also likely that the most viable litigation is brought by liquidators, because in practice it is only after a liquidator decides not to bring an action that a creditor seeks liquidator or court consent to do so.

The 2004 study concluded that about 60 percent of judgments were instigated by creditors, about 17 percent by corporate regulators and 16 percent by liquidators.115 Accordingly, the number of creditor-led claims appears to have reduced, with a corresponding increase in

115 James, Ramsay and Siva, above n 12, 237.
liquidator-led claims. This difference may be explained, however, by the period which the 2004 study covers, when liquidators did not have the power to bring cases. Liquidators received the power to bring insolvent trading claims as part of the reforms which commenced in 1993. 116 When the insolvent trading prohibition was conceived in the 1990s, the ALRC recommended that a director ‘only be liable for a breach of the duty where the company has gone into insolvent winding up’. 117 Although some commentators argued that an individual creditor should have the right to bring a proceeding and thus benefit from any compensation paid by a director, the ALRC rejected this approach. The ALRC found that any proceedings should reflect the principle of equal sharing in insolvency and therefore recommended that the benefit of any liability found against a director should flow to all creditors, not just a creditor with the resources to take an action. 118 The final legislative provisions, however, allow creditors to bring proceedings against a director.

ASIC may also seek compensation for all creditors and other orders (for example, Corporations Act 2001 (Cth) ss 1317G and 1317H). Only two of the judgments identified by the searches for this study arose from litigation brought by ASIC (5.1%). Other information sources suggest that ASIC has at least commenced action in perhaps three or four other matters. 119 It appears that not all of the cases resulted in judgments, however, with actions being abandoned or settled. Furthermore, ASIC was the plaintiff in the Kleenmaid litigation bringing criminal actions against three directors and the searches for this study did not locate a judgment in relation to the known verdicts against two of the directors. 120 In 2016, a former director of a company called Kleenmaid was sentenced to nine years imprisonment. The company distributed whitegoods and collapsed in 2009. The sentence related to one count of fraud for dishonestly obtaining $13 000 000 worth of loan facilities and 17 counts of insolvent trading involving $3 500 000 worth of debts. 121 Another director of Kleenmaid received a jail sentence of two years and eight months for two counts of insolvent trading. 122 The case against the third director was ongoing at the time of writing. 123 Because there was no judgment in the Kleenmaid case revealed by the searches for this study, it was not included in this study for the purposes of the findings presented in the tables.

116 James, Ramsay and Siva, above n 12, 235.
117 Australian Law Reform Commission, above n 18, 129–30 [288].
118 Australian Law Reform Commission, above n 18, 124–5 [279], 141 [320]. The Commission recommended, however, that any benefit should not flow to secured creditors: at 141 [320]. A secured creditor may benefit to the extent that a part of its claim is unsecured.
119 Based on information from ASIC, the Productivity Commission reported that ASIC ‘commenced action for insolvent trading for circumstances involving five companies between 2005 and 2011’ including three criminal actions: see Productivity Commission, above n 13, 378. Empirical research on civil, criminal and administrative directors’ duties matters brought by ASIC and the Commonwealth Director of Public Prosecutions which were finalised between 1 January 2005 and 31 December 2014 found that contraventions were proved in three matters (one civil and two criminal).
120 See Australian Securities and Investments Commission, above n 76.
121 Ibid.
123 See Australian Securities and Investments Commission, above n 76.
### Table 12: Distribution of judgments according to plaintiff

<table>
<thead>
<tr>
<th>Plaintiff</th>
<th>Number of cases</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liquidator/company</td>
<td>25</td>
<td>64.1</td>
</tr>
<tr>
<td>Creditors</td>
<td>12</td>
<td>30.8</td>
</tr>
<tr>
<td>ASIC</td>
<td>2</td>
<td>5.1</td>
</tr>
<tr>
<td>Total</td>
<td>39</td>
<td>100</td>
</tr>
</tbody>
</table>

### Table 13: Distribution of judgment according to finding where plaintiff was liquidator

<table>
<thead>
<tr>
<th>Finding of court</th>
<th>Number of judgments</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liable</td>
<td>21</td>
<td>84</td>
</tr>
<tr>
<td>Not liable</td>
<td>4</td>
<td>16</td>
</tr>
<tr>
<td>Total</td>
<td>25</td>
<td>100</td>
</tr>
</tbody>
</table>

### Table 14: Distribution of judgment according to finding where plaintiff was creditor

<table>
<thead>
<tr>
<th>Finding of court</th>
<th>Number of judgments</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liable</td>
<td>5</td>
<td>41.7</td>
</tr>
<tr>
<td>Not liable</td>
<td>7</td>
<td>58.3</td>
</tr>
<tr>
<td>Total</td>
<td>12</td>
<td>100</td>
</tr>
</tbody>
</table>

### M What Are the Key Characteristics of the Defendant Director (ie, Type of Director)?

The liability for insolvent trading is imposed on directors, including executive directors, non-executive directors, and de facto and shadow directors. This study adopted the 2004 study’s definitions of these types of directors. The duty is not imposed on other officers of the company or senior management. The ALRC argued that the overall management of the company was the duty of the directors and refrained from recommending that the duty apply to senior management.

The judgments reviewed for this study did not always explicitly state what type of director was being sued for insolvent trading unless the director was identified as, or alleged to be, a non-executive director, shadow director, de facto director, or chairman of the board (see Table 15). There were also judgments involving more than one director and defendants with more than one title; for example, Chair and Non-Executive Director (‘NED’) or Deputy Chair and Executive Director. In many judgments the facts suggested that the director(s) may have been executive director(s), but the judgment did not clearly specify this role and thus it was difficult to categorise the judgments. Executive directors are ‘directors engaged by a

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124 James, Ramsay and Siva, above n 12, 230.

125 Australian Law Reform Commission, above n 18, 143 [325].

company under a contract of employment to perform functions additional to those involved in being a member of the board of directors'.

The judgment may also have focused on, for example, whether the defendant was in fact a director at the relevant time, and whether the director was alleged to have been a de facto or shadow director. Shadow directorships were the basis for the claim by the liquidator in *Buzzle Operations Pty Ltd (in liq) v Apple Computer Australia Pty Ltd*. The liquidator alleged that Apple Computer Australia Pty Ltd ('ACA') and its finance director were shadow directors because of the influence they had over Buzzle. The Court found that the defendants were not shadow directors of Buzzle Operations just because ACA was able to impose its contractual terms on Buzzle Operations. Moreover, there was ‘no instruction or wish [which] was given or expressed on which the directors [of Buzzle Operations] collectively acted’, and the directors were not ‘accustomed to acting’ on ACA or the finance director’s ‘instructions or wishes’. It appears that the liquidator pursued ACA and its finance director because all of Buzzle Operations’ actual directors except one were already bankrupt.

**Table 15: Alleged type of director involved in judgments (other than executive directors and where specified)**

<table>
<thead>
<tr>
<th>Alleged type of director</th>
<th>Judgment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chairperson + NED</td>
<td><em>Hall v Poolman</em></td>
</tr>
<tr>
<td>Deputy Chair + Exec director</td>
<td><em>Hall v Poolman</em></td>
</tr>
<tr>
<td>NED</td>
<td><em>Box Valley v Kidd; Edwards v ASIC; Elliott v ASIC</em></td>
</tr>
<tr>
<td>De facto director</td>
<td><em>Akron, Swan Services; Williams v Bearing; Featherstone v Hambleton; International Cat</em></td>
</tr>
<tr>
<td>Shadow director</td>
<td><em>Akron; Buzzle; Condon v Commissioner of Taxation</em></td>
</tr>
</tbody>
</table>

Some cases were commenced against more than one director, but the judgment relates to only some of those directors because the others settled or were not pursued in the final case. In *Deloitte Services Pty Ltd v HBO EMTB Interiors (NSW) Pty Ltd (in liq)*, for example, Deloitte settled with three of the four directors. The fourth director was found liable to Deloitte on grounds other than insolvent trading. For these cases, to the extent the plaintiff was not pursuing a particular director at the time of the final judgment, those directors were not included in the review for director type or attributes.

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127 James, Ramsay and Siva, above n 12, 230.
129 Ibid [243].
130 Ibid [325].
131 Ibid [22].
133 See, eg, the decision in *Green v CGU Insurance Ltd* (2008) 67 ACSR 398. The proceedings were originally brought against the directors and officers as well as CGU Insurance.
Wagstaff, the liquidator reached a compromise with one director (Mr Kajewski) such that the judgment only relates to the liability for insolvent trading of Ms Bates-Wagstaff.\textsuperscript{134}

\textbf{N Other Characteristics of Defendants?}

The 2004 study considered whether defendant directors were male or female, and husband and wife.\textsuperscript{135} To the extent that gender was clear from the judgment, less than 20 percent of directors in this study were female. Moreover, only two judgments involved exclusively female directors.\textsuperscript{136} In five judgments, the directors were husband and wife, including one ex-wife. In some judgments, it appears that the director’s wife was a director of the company or a related company at some point but was not ultimately pursued for a breach of duty and thus not counted for this study. In \textit{Hall v Poolman},\textsuperscript{137} for example, Mrs Poolman was the director of another group entity which was wound up; she was not ultimately pursued for insolvent trading.

<table>
<thead>
<tr>
<th>Other characteristic</th>
<th>Number of directors</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Male</td>
<td>40</td>
<td>75.5</td>
</tr>
<tr>
<td>Female</td>
<td>10</td>
<td>18.9</td>
</tr>
<tr>
<td>Company</td>
<td>3</td>
<td>5.7</td>
</tr>
<tr>
<td>Total</td>
<td>53</td>
<td>100.1 (due to rounding)</td>
</tr>
</tbody>
</table>

\textbf{O What Specific Action Is Alleged to Be the ‘Incurring of the Debt’?}

Table 17 sets out the types of debts identified based on similar categories from the 2004 study and shows that the majority of debts in the judgments relate to the purchase of goods or services by the company.\textsuperscript{138} There was more than one debt in some judgments. The number of judgments involving debts owed to the tax authorities was also very high (40%), ranking second after general debts relating to the purchase of goods or services. There were also two cases where debts to directors were alleged to have been incurred, and damages relating to passed building works for defects were also alleged in another two cases.

\textsuperscript{134} \textit{Hambleton and Imray v Bates-Wagstaff} [2014] QDC 162. The judgment relates to the liquidation of Total Barge Services Pty Ltd.

\textsuperscript{135} See Fehlberg’s research on sexually transmitted debt: Belinda Fehlberg, \textit{Sexually Transmitted Debt: Surety Experience and English Law} (Clarendon Press, 1997). The facts and names of some directors suggested that the cases involved a number of directors based outside of Australia and non-English-speaking-background defendants, but there was not enough information to draw any findings from this initial observation.


\textsuperscript{137} [2007] NSWSC 1330 [6].

\textsuperscript{138} For discussion of the meaning of incurring of a debt, see above n 29.
Table 17: Distribution of judgments according to the type of debt incurred or alleged

<table>
<thead>
<tr>
<th>Type of debt</th>
<th>Number of judgments (may be more than one type of debt in a judgment)</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debts relating to the purchase of goods and/or services by the company</td>
<td>21</td>
<td>44.7</td>
</tr>
<tr>
<td>Debts to a bank or financier</td>
<td>2</td>
<td>4.3</td>
</tr>
<tr>
<td>Property-related debts</td>
<td>4</td>
<td>8.5</td>
</tr>
<tr>
<td>Debts to ATO (eg, unpaid superannuation, GST, income tax)</td>
<td>19</td>
<td>40.4</td>
</tr>
<tr>
<td>Workers’ compensation insurance(^{139})</td>
<td>1</td>
<td>2.1</td>
</tr>
<tr>
<td>Total</td>
<td>47</td>
<td>100</td>
</tr>
</tbody>
</table>

P Did the Defendant Director Argue Any Defences?

Directors argued a defence in about one third of the judgments in this study.\(^{140}\) According to most judgments, however, the key issue before the court was the timing of the state of insolvency, particularly in relation to the timing that the alleged debts were incurred.

Table 18: Distribution of judgments according to whether a defence was argued

<table>
<thead>
<tr>
<th>Defence argued?</th>
<th>Number of judgments</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>13</td>
<td>33.3</td>
</tr>
<tr>
<td>No</td>
<td>26</td>
<td>66.7</td>
</tr>
<tr>
<td>Total</td>
<td>39</td>
<td>100</td>
</tr>
</tbody>
</table>

Q If Any of the Defences Were Argued by the Defendant Director, Was the Defence Successful?

Of the 13 judgments where s 588H defences were argued by the defendant director, there was no judgment in which the director succeeded in the argument. In the 2004 study, directors were held not liable because of a successful defence in 11 percent of the judgments in that study. Defences were argued more frequently (63% of judgments) in the 2004 study when compared to this study (33.3%). Directors successfully relied on ss 1317S or 1318 in two

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\(^{139}\) See Re LA Technologies Pty Ltd (in liq) [2009] FCA 805.

\(^{140}\) For discussion of the defences to insolvent trading, see Tristan 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.
judgments in this study. These provisions and the issue of defences are discussed below in relation to the prospects for the safe harbour reforms.\textsuperscript{141}

V FURTHER ANALYSIS OF FINDINGS FROM THIS STUDY

This section considers a number of other questions arising from contemporary debates about insolvent trading in light of the findings from this study which were not the focus of the 2004 study.

A Is Litigation Funding facilitating Insolvent Trading Cases?

The rise of litigation funding to support insolvency-related proceedings is evident in the market for insolvency professional services. There are numerous advertisements by funders in the December 2017 edition of the Australian Restructuring Insolvency & Turnaround Association’s journal, for example.\textsuperscript{142} ASIC suggests that a lack of assets to fund litigation is the key reason that cases are not pursued.\textsuperscript{143} Litigation funding could provide a source of funds for insolvent trading cases. Running cases in superior courts is expensive, although it is difficult to evidence specific costs. In a judgment from 2004, Mandie J cites a practitioner and costs expert who found that costs up to and including the trial in the Victorian Supreme Court would be $114,727.\textsuperscript{144} The judgment in the well-known and complex case of Hall v Poolman\textsuperscript{145} suggests that the liquidator’s costs of the proceedings was ‘in the order of $2,000,000’.\textsuperscript{146} Moreover, Hall v Poolman demonstrates that litigation funders can and do fund insolvent trading cases against directors which may improve a liquidator’s financial capacity to bring actions. The Hall v Poolman judgment was, however, the only judgment in this study from which it was clear that a litigation funder was involved.\textsuperscript{147} Accordingly, this study does not support a finding that litigation funding is facilitating insolvent trading cases. Moreover, the judgments did not reveal any actions funded by the ATO or the Department of Employment (as it then was).\textsuperscript{148}

\textsuperscript{141} Hall v Poolman [2007] NSWSC 1330 (ss 1317S and 1318 by Mr Irving in relation to some but not all debts alleged by the liquidator at [407]); and McLellan v Carroll [2009] FCA 1415 (s 1317S argued successfully where the liquidator was the plaintiff).

\textsuperscript{142} See, eg, the advertisements by funders in the Australian Restructuring, Insolvency & Turnaround Association’s journal: (2017) 29(4) ARITA inside cover (by IMF Bentham), 3 (by Litigation Lending), 13 (by Augusta).

\textsuperscript{143} Australian Securities and Investments Commission, Insolvency statistics: External administrators’ reports (July 2015 to June 2016) (Report No. 507, December 2016), 15. Judgments also refer to this difficulty. See, Re Origin Internet Solutions Pty Ltd (in liq); Taylor v Williams (No 2) (2004) 51 ACSR 163. See especially at [4], noting that the liquidator unsuccessfully sought support from creditors to fund a claim. This judgment was identified by the initial searches for this study but not included in the final data set because it did not involve findings in relation to insolvent trading.

\textsuperscript{144} The judgment dealt with an application by the defendant directors for security for costs in relation to a claim bought by a creditor under s 588G: see Thirteenth Corp Pty Ltd v State 50 ACSR 425 (2004) [39]. This judgment was identified by the initial searches for this study, but was not included in the final data set because it did not make findings in relation to insolvent trading itself.

\textsuperscript{145} [2007] NSWSC 1330.

\textsuperscript{146} Ibid [381]. The judge noted that the proceedings had taken 17 days of court time with 25 volumes of exhibits being submitted.

\textsuperscript{147} Ibid.

\textsuperscript{148} The Department was dissolved on 20 December 2017 and its functions assumed by the newly formed Department of Jobs and Small Business. In practice, the authors understand that the ATO does sometimes fund liquidators to recover debts on its behalf. Anderson also suggests that the Department may be a new source of funding and litigation. Employees are priority creditors and the Department is subrogated to their rights in
A majority of judgments in this study resulted in less than $500 000 in compensation being awarded to plaintiffs and less than $200 000 was awarded in over one third of judgments. These compensation amounts suggest that it may not be worth the time and cost involved in litigation for litigation funders to play a greater role in this area.\textsuperscript{149} According to its website, for example, IMF Bentham will consider funding litigation for insolvency-related cases where the claims are over $1 000 000.\textsuperscript{150} The amounts sought and awarded typically in the judgments in this study do not meet this criterion. Moreover, one third of judgments involved plaintiffs who were creditors, not liquidators. Funders may also be disincentivised by the complexity of the cases and the number of appeals. Almost one third of the judgments in this study are appeals.

Justice Palmer’s comments in \textit{Hall v Poolman}\textsuperscript{151} may also have deterred litigation funders from focusing on this area of law. The litigation funder in that case was IMF (Aust) Ltd, as it then was. \textit{Hall v Poolman} was a decision of the Supreme Court of New South Wales involving many proceedings, claims and cross-claims about a group of companies which owned vineyards and a winery and became insolvent in 2003. The company owed secured and unsecured creditors approximately $130 000 000.\textsuperscript{152} Liquidators sought to recover approximately $9 600 000 in the proceeding.\textsuperscript{153} Justice Palmer expressed concern about the ‘huge costs’ which were ‘incurred in prosecuting claims by liquidators when virtually every cent of the proceeds of the claims, even if wholly successful, would go to a litigation funder and to the costs and disbursements of the professionals engaged in conducting the litigation’.\textsuperscript{154} He noted that, ‘the true beneficiaries of this huge piece of litigation are a litigation funder, the liquidators and their lawyers, not the creditors’.\textsuperscript{155} On one estimate put forward by his Honour, creditors would receive $0.0040 in the dollar after deducting IMF’s success fee of 50 percent and other costs and expenses.\textsuperscript{156} Ultimately, the decision went in favour of the liquidators, however, suggesting that litigation funders may be successful in this area.\textsuperscript{157}

\textsuperscript{149} Williams also argues that unsecured creditors may be worse off as a result of a liquidator’s assignment of a claim at a discount: Williams, above n 1010, 69.
\textsuperscript{152} [2007] NSWSC 1330.
\textsuperscript{153} Ibid [15].
\textsuperscript{154} Ibid [16].
\textsuperscript{155} Ibid. Palmer J also accused the liquidators of spending an unnecessary amount of time and money on the proceedings: at [384]–[385].
\textsuperscript{156} \textit{Hall v Poolman} [2007] NSWSC 1330 [363].
\textsuperscript{157} Palmer J ordered an inquiry into the conduct of the liquidators as part of the first instance decision. These orders were overturned on appeal. See \textit{Hall v Poolman} [2009] NSWCA 64.
B Deep Pockets: The Role of Insurance and Insurers

The extent of involvement by insurers in meeting insolvent trading claims is not clear from this study, but insurance was disclosed in two judgments. Plaintiffs may face difficulty in obtaining any financial recoveries even if they win a case because the directors may also be in financial difficulties personally.\textsuperscript{158} Moreover, the director and officers’ insurance policies may also exclude breaches of the duty to prevent insolvent trading.\textsuperscript{159} The cases demonstrate that even where polices do include insolvent trading, their application may be challenged by the insurance company. These realities are another practical reason why cases are not pursued by liquidators and are unattractive to funders.

In \textit{Green v CGU Insurance Ltd},\textsuperscript{160} the issue was whether the insurer would have issued the relevant policy without imposing an insolvency exclusion had it known of the financial difficulties of the insured which the insurer argued should have been disclosed to CGU’s underwriting department.\textsuperscript{161} The proceedings were originally brought against the directors and officers, and the administrator of the estate of one of the directors as well as CGU Insurance in relation to one of the directors. A settlement was reached with the directors, but CGU did not participate and successfully argued that it was not liable under the policy.

In \textit{Re Akron Roads Pty Ltd (in liq) (No 3)},\textsuperscript{162} Crewe Sharp Pty Ltd (‘Crew Sharp’) was alleged to have been a director of Akron within the extended meaning of s 9 of the \textit{Corporations Act 2001} (Cth). Crewe Sharp operated a management consultancy and provided services to Akron, together with Mr Crewe who was found to have been a director of Akron.\textsuperscript{163} In the event that Crewe Sharp was found to have been a director and liable, it claimed an indemnity from CGU under its professional indemnity policy. Robson J found that the CGU policy would respond to Mr Crewe’s liability under the judgment and settlement deed and would have responded if Crewe Sharp had been found to have been a shadow director.\textsuperscript{164} Robson J found, however, that Crewe Sharp was not a de facto or shadow director, and thus not liable for insolvent trading. His Honour went on to find, however, that CGU could avoid liability to both Crewe Sharp and Mr Crewe in any event because of non-disclosure or misrepresentation.\textsuperscript{165}

\textsuperscript{158} A study of wrongful trading in the United Kingdom compared the names of the defendant directors from judgments with data on personal bankruptcies and suggests that more than half of directors with judgments against them filed for bankruptcy. Williams identified the directors from the small data set available and checked those names against lists of bankrupts: Williams, above n 1010, 82.

\textsuperscript{159} KWM notes that D&O policies may respond to breaches of other directors’ duties. King & Wood Mallesons, above n 13, 7, 14.

\textsuperscript{160} [2008] NSWSC 825.

\textsuperscript{161} Ibid [295].

\textsuperscript{162} [2016] VSC 657.

\textsuperscript{163} Ibid [1].

\textsuperscript{164} \textit{Re Akron Roads Pty Ltd (in liq) (No 3)} [2016] VSC 657 [32]–[33].

\textsuperscript{165} Ibid [36].
C  ASIC Enforcement and the Duty to Prevent Insolvent Trading

The study found few judgments where ASIC was the plaintiff,\(^{166}\) although ASIC did undertake a national insolvent trading program during the period of this study.\(^{167}\) However, 64 percent of reports provided to ASIC by external administrators in 2016-17 included allegations of insolvent trading and there was evidence to support the allegations in 72.6 percent of reports alleging a criminal breach of the duty and 80.1 percent of reports alleging a civil breach.\(^{168}\) Cost and merit concerns which apply to liquidators and prevent them from bringing actions also apply to ASIC.\(^{169}\) There could also be various other reasons for ASIC’s approach.\(^{170}\) First, there are few allegations of dishonesty which might prompt ASIC, as regulator, to pursue a director in court.\(^{171}\) Secondly, ASIC may also avoid litigation by using other powers, including obtaining enforceable undertakings and disqualifying directors. Given the lack of judgments identified for this study where ASIC was the plaintiff, the study considered these other enforcement mechanisms.

The research for this study found that three of the 236 undertakings accepted by ASIC between 20 February 2004 and 24 November 2017 dealt with insolvent trading.\(^{172}\) The undertakings were accessed through ASIC’s enforceable undertakings’ register on its website which lists all undertakings accepted by ASIC and provides detailed information on each undertaking.\(^{173}\) Each undertaking was searched for the terms: ‘S88G’ and ‘insolvent trading’.

\(^{166}\) ASIC succeeded in the two cases where it was the plaintiff identified in this study: Australian Securities and Investments Commission v Plyman, Elliott and Harrison (2003) 175 FLR 124; Edwards v Australian Securities and Investments Commission [2009] NSWCA 424.

\(^{167}\) See Australian Securities and Investments Commission, National insolvent trading program report, (Report No 213, October 2010). Under this program, ASIC (1) visited over 1530 companies displaying solvency concerns during the period from 2005–06 to 2009–10; (2) provided an awareness of director duties and ASIC’s expectations of professional advisers when companies are experiencing financial difficulties; (3) encouraged directors to seek advice from an insolvency professional about the appointment of an external administrator where significant insolvency indicators were identified; and (4) observed that 15% of companies reviewed by us were subsequently placed into external administration—mostly by the directors: ibid paragraph 3.

\(^{168}\) ASIC received 7765 reports from liquidators, receivers and administrators in 2016–17: Australian Securities and Investments Commission, above n 766, 28 [60]–[61].

\(^{169}\) In comments made prior to the introduction of the safe harbour reforms, the Productivity Commission noted that ‘[t]he relative scarcity of insolvent trading actions is in part due to the difficulty in proving an individual’s intention, state of mind and personal knowledge, particularly in relation to complex financial matters. Further, pursuing such cases can be expensive for regulators as the presence of reasonableness tests (ss 588G(1)(c) and (2)(b)) means there is considerable scope to mount a defence based on the circumstances’: Productivity Commission, above n 13, 379.

\(^{170}\) On ASIC’s enforcement approaches generally, see Hedges et al, above n 11.

\(^{171}\) ASIC found only 32 reports alleging criminal breach where there was evidence showing that the breach was due to dishonesty: Australian Securities and Investments Commission, above n 766, 34 [75].

\(^{172}\) Variations and withdrawals of undertakings were not considered. Where there were many parties to an enforceable undertaking and they all signed the one undertaking, this was considered to be one undertaking. Where parties signed separate copies of the identical undertaking, this was also considered to be one undertaking. However, where the terms of the undertaking varied for different parties, these were considered to be separate undertakings.

In an undertaking from 2014, ASIC alleged that the director failed in his duties in a number of respects including by ensuring that the company was solvent when it incurred debts. The director agreed not to take part in the management of a corporation or act in any compliance role for a corporation which carries on a financial services business for five years. The director also agreed not to take part in a financial services business for two years, unless he notifies ASIC of his employment details and engages a compliance officer to audit his work with respect to retail clients, a copy of which must be provided to ASIC.

The two other enforceable undertakings were from two long-standing registered liquidators who did not bring insolvent trading cases, despite reporting to ASIC and creditors that there was evidence of insolvent trading. The undertakings are very similar in form and substance. The first undertaking resulted from ASIC’s review of the liquidator’s conduct in an external administration in South Australia. ASIC found that, amongst other things, the liquidator failed to identify a claim for insolvent trading. As a result of ASIC’s review, the liquidator decided to undertake public examinations of the company’s director and others, employed additional staff and reviewed procedures. The liquidator also agreed not to act as a registered liquidator for two months, undertake professional education, and appoint a quality reviewer and report back to ASIC.

The second undertaking involved a registered liquidator in Sydney. As part of its surveillance activities, ASIC reviewed the liquidator’s conduct in an external administration and found that he ‘failed to carry out or perform the duties and functions of a liquidator to the standard of a reasonably competent liquidator’, including because he did not ‘make a claim against the Company’s director for possible insolvent trading despite identifying the existence of the possibility of such a claim which was notified to ASIC and the creditors’.

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175 Ibid [7.2]–[7.3].
176 Ibid [7.4], [7.6.1]–[7.6.2], [7.6.4].
178 Ibid [2.4.1].
179 Ibid [2.5.2].
180 Ibid [3.5], [3.7], [3.15].
181 Clifford John Sanderson, ‘Enforceable Undertaking’ (Document No 029738906, 20 October 2016); Australian Securities and Investments Commission, ‘ASIC accepts EU from NSW liquidator’ (Media Release, 16-361MR, 25 October 2016) <http://asic.gov.au/about-asic/media-centre/find-a-media-release/2016-releases/16-361mr-asic-accepts-eu-from-nsw-liquidator/>. The case was brought under ASIC’s power to regulate registered liquidators (Corporations Act 2001 (Cth) pt 9.2); Sanderson at [2.2]. The EU also mentions ASIC’s power to bring proceedings in CALDB 1292(2)(d) which is no longer relevant after recent reforms. at [2.3].
182 Sanderson, above n 181 [2.9]. See especially [2.9(f)]. The liquidator registered as liquidator in 1995 and official liquidator in 1997: at [2.5].
Moreover, he failed to adequately document why he did not take such action.\textsuperscript{183} The liquidator was required to undertake professional education, appoint a quality reviewer, and communicate the results to ASIC.\textsuperscript{184}

Apart from instigating litigation under s 588G or using enforceable undertakings, ASIC may also seek to disqualify a person from acting as a director for other misconduct which may involve circumstances which suggest but may not necessarily prove insolvent trading. The Administrative Appeals Tribunal’s decision in 2010 to affirm a decision to disqualify a director refers to the prospect of insolvent trading by the director and the ‘substantial sums of money involved and that the unsecured creditors will recover nothing’. This judgment did not make a finding in relation to insolvent trading and was excluded from the final pool of judgments reviewed for this study, but it evidences the possible interaction between director disqualification and insolvent trading.\textsuperscript{185} Recent empirical research on ASIC’s enforcement of directors’ duties suggests that disqualification orders are the most likely sanction imposed for a contravention of directors’ duties in Australia.\textsuperscript{186} Proposals to introduce identification numbers for directors may also make it easier for ASIC to track director misconduct.\textsuperscript{187}

VI WHAT DOES THE STUDY SUGGEST ABOUT THE SAFE HARBOUR REFORMS?

The findings in this study suggest a number of possibilities for the safe harbour reforms.\textsuperscript{188} First, the reforms may have a number of consequences in practice which require further research for the mandatory review of the reforms. Further, the findings point to the pivotal role that the ATO is likely to continue to play in shaping the jurisprudence around insolvent trading in future. This section considers these possibilities in light of the study’s findings.

A Will There be Fewer Judgments in Relation to Insolvent Trading?

The study does not suggest that there will be fewer judgments in relation to s 588G in future, but the safe harbour reforms ought to make it harder for liquidators to credibly threaten insolvent trading. Where directors argue that they are protected under the safe harbour set out in s 588GA, liquidators will need to look closely at the conduct of directors. The mandatory review may look to reports made to ASIC about the possibility of insolvent trading. Will liquidators continue to report suspicions of insolvent trading to ASIC in external administration reports at high rates?\textsuperscript{189} What level of scrutiny and pursuit of such claims will be expected of liquidators to ensure that liquidators comply with their own obligations?

Moreover, the final version of the safe harbour regime was deliberately not drafted as a defence, the elements of which a director needs to prove after a finding of liability against that director. This approach also makes sense in the context of this study to the extent that

\begin{itemize}
\item \textsuperscript{183} Ibid [2.10].
\item \textsuperscript{184} In accepting Sanderson’s undertaking, ASIC acknowledged that he had already started a review of his systems and procedures and was arranging for a peer review, as well as having enrolled and paid for courses run by ARITA: Ibid [2.12].
\item \textsuperscript{185} See Scott v Australian Securities and Investments Commission [2010] AATA 54.
\item \textsuperscript{188} For discussion of the safe harbour reforms, see the publications cited in note 15 above.
\item \textsuperscript{189} See above n 766 for the discussion of reports to ASIC.
\end{itemize}
the reform’s policy focus was allowing directors more flexibility to address a company’s financial problems within legal guidelines with a view to avoiding formal insolvency. This study suggests that directors were unlikely to be successful in invoking the existing defences, for example. In the judgments where directors did overcome a finding of liability, the provisions in ss 1317S and 1318 were relevant. Accordingly, even prior to the safe harbour reforms, a court’s discretion under ss 1317S and 1318 provided protection to directors, but it was invoked after a finding of liability had been made. In McLellan v Carroll, the court rejected Mr Carroll’s attempt to rely on s 588H(3) and he was found liable for failing to prevent the company from incurring debts whilst insolvent, but he was relieved from liability under s 1317S. The judgment details the steps taken by Mr Carroll in circumstances where the company was in financial distress, including obtaining advice from a business restructure specialist with experience in the relevant industry and taking active steps to expand sales and fix problems. It was an ultimatum from the Australian Taxation Office which appears to have led Mr Carroll to contact Mr McLellan who was appointed liquidator soon after. The judgment reflects genuine efforts made by the director to resolve the company’s financial problems. The court’s reasoning may also make for useful reading in the context of the new safe harbour approach and provide some guidance for liquidators, directors and their advisers in relation to issues such as the steps which should be taken as part of any action designed to bring a course of action within the safe harbour.

Discouraging creditor actions may also be one other possible outcome of the safe harbour reforms. This study found that creditors were much less successful than liquidators in terms of liability outcomes. Liquidators brought a majority of cases leading to the judgments (64.1%) and won in the vast majority of those judgments (84%). Creditors brought 30.8 percent of the actions leading to the judgments, but directors were found liable in only 41.7 percent of those judgments. This finding suggests that creditors instigate less meritorious cases. There could be various explanations for the lower success rate of creditors when compared to liquidators, including because creditors may be motivated by issues other than the legal merits of the case and face financial constraints. In some cases, the interests of one creditor may even conflict with the course of the liquidation and the interests of other creditors.

The new safe harbour provides directors with further protection in cases brought by creditors. Some judgments revealed by the initial searches for this study showed directors seeking payments of costs into court by creditor-plaintiffs, which is another tool directors may use when faced with insolvent trading allegations. These judgments were not included in the final

190 See above n 141 for the judgments.
192 Ibid 111.
193 Ibid. Section 588GA(2) sets out certain steps for working out whether a course of action is reasonably likely to lead to a better outcome.
194 For an example of a court rejecting a creditor’s request for leave to bring an insolvent trading claim, see Edenden v Bignell [2007] NSWSC 1122; Edenden v Bignall [2008] NSWSC 666. These judgments were identified as part of the initial searches for this study, but were not included in the final data set because there was no final finding on insolvent trading. The creditor initially based the claim on a voidable transaction allegation and the court did not give consent under s 588T(2).
195 See also the discussion above at Part IV, Section L.
196 See, eg, David Lambourne Yacht Rigging & Consultancy Pty Ltd v Perry Catamarans Pty Ltd (recs and mgs apptd) (2006) 58 ACSR 155. This judgment was identified as part of the initial searches for this study, but was not included in the final pool of judgments because there were no findings in relation to insolvent trading itself.
pool of judgments because they involved interlocutory proceedings. Some consideration could be given to further reforms in this area. The threshold requirements for a liquidator or court giving consent to a claim by a creditor, for example, could be set out in more legislative detail and include whether a director is likely to succeed in invoking the safe harbour.

B The Role of the ATO and Eligibility of Directors

To be eligible to rely on the safe harbour, directors must satisfy certain requirements. Directors must be careful to pay employee entitlements (including superannuation) on time, and comply with reporting obligations under the taxation laws, to be eligible for the safe harbour. Tax is one of the first debts that small-medium enterprises stop paying when they face financial difficulties in Australia. To the extent that debts relate to a consistent failure to pay employee entitlements, including superannuation, a director would be unable to rely on the safe harbour. Further, even if the director has complied with reporting obligations under the taxation laws and is eligible for the safe harbour, a director will be personally liable for pay-as-you-go instalments and superannuation guarantee charge liabilities if that director fails to satisfy a demand for payment from the ATO in the form of a director penalty notice (DPN), file for winding up or appoint a voluntary administrator 21 days after the Commissioner gives a person written notice of the DPN.

Accordingly, even if the safe harbour reforms give a director protection from personal liability for insolvent trading, they do not relieve a director from personal liability for unremitted withholding taxes and superannuation under the tax laws. Anderson argues that the inconsistency between the safe harbour provisions and DPN framework may encourage directors to pay the ATO to avoid personal liability, potentially in preference to other creditors. Given that this study suggests that the ATO is often owed money in an insolvent trading case, this outcome seems plausible. Judgments where the types of alleged debts could be identified revealed cases often involve more than one debt, and of all the types of debts identified, debts were owed to the ATO in 40.4 percent of the judgments. In one judgment, the ATO was also the recipient of a preferential payment which was recovered by the liquidator, causing the ATO to become a creditor in the case and thus increasing the amounts owed by the directors. The interplay between the safe harbour and tax laws in Australia will be an important driver in the practical application of the safe harbour in future and should be a focus for the mandatory review of the reforms.

VII CONCLUSION

The findings from this study based on a data set of 39 judgments reflect ongoing debates about insolvent trading reform in Australia. The success of liquidators and ASIC as plaintiffs suggest that actions are typically only brought by them where they are confident of winning.

197 Corporations Act 2001 (Cth) s 588GA(4).
198 Anderson, above n 15.
199 On the issues relating to non-payment of employee entitlements, see Department of Jobs and Small Business, Australian Government, Consultation Paper – Reforms to address corporate misuse of the Fair Entitlements Guarantee scheme, 17 May 2017.
200 Taxation Administration Act 1953 (Cth) sch 1 ss 269-15–269-25.
201 Anderson, above n 15.
203 See, eg, Condon v Commissioner of Taxation; Condon v Holliday-Smith [2006] NSWSC 745.
This finding does not, however, confirm what might be happening in private negotiations where insolvent trading may be used as leverage against directors. The judgments in this study involved orders for compensation of over $200,000 in 14 out of 21 judgments, suggesting that directors of companies with debts of less than $200,000 are less likely to be pursued in the courts. Moreover, two recent undertakings against liquidators demonstrate that ASIC expects liquidators to carefully consider and explain decisions not to pursue directors in accordance with a liquidator’s overall obligations. These undertakings are significant in the context of an insolvency professional’s decision not to bring insolvent trading proceedings. The likelihood of creditors bringing successful claims for compensation may also be reduced by the safe harbour reforms. This study also highlights the role of debts owed to the ATO in insolvent trading judgments and the role that the ATO is likely to play in the practical implementation of the safe harbour reforms. The mandatory review of the reforms should closely consider the impact of the reforms on the tax laws and the position of the ATO, as well as the role of creditors in insolvent trading litigation.
Appendix A

Judgments reviewed for this study

Federal Court

1. *Ball v Hogg* [2016] FCA 1112
2. *Engineered Thermal Systems Pty Ltd v Salmon* [2012] FCA 1159
5. *Muscat v Mustafa* [2015] FCA 358
9. *Tru Floor Service Pty Ltd v Jenkins (No 2)* [2006] FCA 632
10. *Sheahan v Ren* [2017] FCA 1163
11. *Smith v Boné* [2015] 104 ACSR 528

NSW Court of Appeal

12. *Box Valley Pty Ltd v Kidd* [2006] NSWCA 26
14. *Treloar Constructions Pty Ltd v McMillan* [2017] NSWCA 72

NSW Supreme Court

15. *Ball v Sinclair* [2015] NSWSC 2103
17. *Condon v Commissioner of Taxation; Condon v Holliday-Smith* [2006] NSWSC 745
18. *Deloitte Services Pty Ltd v HBO EMTB Interiors (NSW) Pty Ltd (in liq)* [2016] NSWSC 1597
20. *Hall v Poolman* [2007] NSWSC 1330
25. Re Salfa Pty Limited (in liq) [2014] NSWSC 1493
26. Williams v Bearing Traders Pty Ltd [2008] NSWSC 1358
27. Zappia v Grant Baines Transport Pty Ltd [2010] NSWSC 98

NSW District Court

QLD Court of Appeal
30. Chan v First Strategic Development Corporation Ltd (in liq) [2015] QCA 28
31. Featherstone v Hambleton [2015] QCA 43
33. Williams v Scholz [2008] QCA 94

Qld District Court
35. Hambleton v Finn [2017] QDC 61

VIC Court of Appeal

VIC Supreme Court
37. Re Akron Roads Pty Ltd (in liq) (No 3) [2016] VSC 657

WA Court of Appeal
38. Perrine v Carrello [2017] WASCA 151

Family Court of Australia
39. Karbines v Karbines (No 2) [2008] FamCA 1115