DIRECTORS’ DUTIES – THE INSOLVENT TRADING
ISSUES FROM A LAWYER’S PERSPECTIVE

1. OVERVIEW

The aim of this paper is to:

- provide an overview of the insolvent trading provisions under Australian law;
- look at the liabilities which might be imposed on a director for breach of those provisions;
- examine the defences and in particular:
  - when directors can rely on someone else to tell them about the solvency of their company after Manpac v Ceccatini and Scott v Williams; and
  - the loss of the Southern Cross Interiors defences;
- look at the decisions in the Solomon; Murawai and the Clark v Perkins cases and the potential for de facto or shadow directors to be exposed to an insolvent trading action; and
- finally to look at the potential for directors to set-off any exposure they have to a company for insolvent trading from any liability owed by the company to them such as unpaid salary or outstanding loan repayments.

1.1 So what is insolvent trading?

Section 588G of the Corporations Act (the Act) imposes liability on a director of a company who allows the company to incur a debt at a time when the company is insolvent when at the time that the debt was incurred there existed reasonable grounds for suspecting that the company was, or may become as a result of incurring the debt, insolvent. A director will be liable if at the time the debt was incurred he or she was actually aware of the existence of reasonable grounds to suspect insolvency or a reasonable person in a similar position within a similar company would have been so aware.

One of the main problems directors face is being able to identify when a company is insolvent. The somewhat vague definition of insolvency does not assist. Prior to 23 June 1993 no statutory definition of insolvency existed. The Act now contains section 95A which states that a person (including a company) is insolvent if they are not solvent. They are only solvent if they are able to pay all their debts as and when they become due and payable. The emphasis is on the ability to discharge all of one’s debts, rather than merely particular debts. Insolvency is not usually determined merely by looking at the balance sheet of a company and determining whether there is a surplus of assets over liabilities. Rather, the emphasis is on cash-flow. Of course companies may experience both types of insolvency simultaneously.
The term ‘debt’ has a wide meaning which often varies according to the context in which it is used. The courts have stated that the terms ‘debt’ and ‘incurs’ are not terms of precise definition but are to be applied flexibly in a practical and commonsense manner.

A number of defences are available to directors against whom an insolvent trading action is brought:

- The director had reasonable grounds to expect that the company was solvent and would remain solvent even if it incurred the relevant debt. This requires a director to prove that he or she had an actual expectation of solvency as well as the existence of reasonable grounds for that expectation.

- The director relied upon information regarding the solvency of the company which was provided by another and which led to a belief in the actual solvency of the company based on that information. This is intended to encourage a system of proper financial management. This defence was considered in the Manpac Industries decision, and more recently in the Scott v Williams decision, both dealt with later in this paper.

- The director did not participate in the management of the company at the time the debt was incurred for some ‘good reason’. There must be a connection between the non-participation and the ‘good reason’. This defence was considered in the Southern Cross Interiors case, dealt with later in this paper.

- The director took reasonable steps to prevent the company incurring the debt, such as appointing a voluntary administrator to the company.

The court can also excuse a director from liability if he or she has acted honestly and ought fairly to be excused.

1.2 What liability is imposed for insolvent trading?

The liability which may be imposed on a director for insolvent trading is wide-ranging and stringent. The sanctions which can be imposed fall into two categories: civil penalties and criminal penalties. Where a director allows a company to trade whilst insolvent and this is done knowingly, intentionally or recklessly and was either dishonest with a view to gaining an advantage or was intended to deceive or defraud someone then the director is guilty of a criminal offence. The maximum penalty payable for such criminal offence is a fine of $200,000 and/or imprisonment for 5 years. A director who is guilty of a criminal offence is prohibited from managing any company for 5 years.

Civil penalties are similar to criminal penalties but do not include an automatic disqualification from managing companies. A director can be made to pay a pecuniary penalty, or a fine, to ASIC. This fine can be for an amount of up to $200,000. A director can also be ordered to pay compensation to the company under either of two provisions facilitating the ordering of compensation. Under one (ss588J(1)) the compensation payable is equal to the loss and damage suffered by an unsecured creditor. Under the
other (s1317H) the compensation payable is equal to the 'damage' suffered by the relevant unsecured creditor or creditors. Presumably these two standards are the same, or substantially similar. Finally, a director can be prohibited from managing any company for a specified period if he or she is not a fit and proper person to manage a company.

A major difficulty in proving insolvent trading has traditionally been the problem of proving insolvency on the day that the particular debt was incurred. Often the financial records of the company are inadequate or they enable proof of insolvency on dates other than the one required. To remedy this situation the Act now specifies two rebuttable presumptions of insolvency. The first states that where it is proved that a company was insolvent at a particular time during the 12 months ending on the 'relation back day' (most often the date on which an application to wind up was filed or an administrator was appointed) it is presumed that the company was insolvent from that time until the relation back day. Under the second presumption a company will be presumed insolvent where it is proved that the company failed to keep proper accounting records which correctly explain and record its transactions and financial position and which enable true and fair financial statements to be prepared and audited (s588E(4)). These presumptions can be rebutted.

2. THE DEFENCE OF RELYING ON ANOTHER PERSON

2.1 Manpac Industries Pty Ltd v Ceccattini [2002] NSWSC 330
Supreme Court of New South Wales: Young J

In this case, the directors of a company in liquidation were faced with an allegation that they failed to prevent the company from insolvent trading. This case looks at the circumstances in which directors can defend such allegations on the basis that they relied on someone else to provide them with information in relation to the company’s solvency.

Section 588M of the Act provides that where a person has contravened the duty to prevent insolvent trading (s588G of the Act) and an unsecured creditor suffers loss and the company is being wound up, the company’s liquidator, or a creditor of the company (with the liquidator’s or court’s permission), may recover that amount from the directors of the company.

Section 588H of the Act sets out a number of defences to proceedings for a contravention of a director’s duty to prevent insolvent trading. One of those defences, in s588H(3), is that the directors:

- had reasonable grounds to believe and did believe that a competent and reliable person was responsible for providing them with adequate information about whether the company was solvent and was fulfilling that responsibility; and
- expected, on the basis of the information provided by that person, that the company was solvent at that time and would remain solvent even if the director incurred the relevant debt.
In this case, a creditor of a company in liquidation commenced proceedings against the former directors of the company seeking compensation under s588M of the Act.

The directors raised the defence that the company had engaged a financial adviser and that the directors had relied upon the financial adviser in relation to the question of the company’s solvency and, as such, the defence contained in s588H(3) should apply.

The court found that the company was, in fact, insolvent at all relevant times. While the directors had relied upon their financial adviser in relation to the financial state of the company, the financial adviser’s figures were not always accurate because the information and figures supplied to the financial adviser by the directors were either inaccurate or incomplete.

In the circumstances, Chief Justice Young in Eq found that it was not open for the directors to rely on a person to provide adequate information about solvency in circumstances where the directors allegedly relying on the other person were the source of the information and the information provided was not ‘completely full’.

Accordingly, any expectation of the directors that was founded on analysis by the financial adviser that the company was solvent was unreasonable in the circumstances, because the directors knew, or ought to have known, that the analysis provided by the financial adviser had been provided on the basis of incomplete information.

The court held that the prime thrust of the defence is to cover the situation where there is a large corporation with bulky accounts and where there is a system in place of competent accountants, credit controllers and financial management reporting to the board. The defence does not deal with the situation where a small company with directors who have little idea of accountancy brings in a trouble-shooter, supplies that person with limited information and then relies on incomplete reports.

In order to establish the defence to an allegation of insolvent trading that the director was relying on a reliable and competent person to provide information in relation to the company’s solvency, the director must ensure that the person is not only reliable and competent, but also has been charged with that responsibility and is provided with all of the necessary information available to enable the person to make the determination.

2.2 Scott v Williams & Ors [2002] SASC 424

Supreme Court of South Australia per Lander J

The Supreme Court of South Australia ordered a company director to pay $500,000 for breach of his duty under section 588G of the Act to prevent the company from trading while insolvent. Even though the director lived in another state, and relied on advice from other directors and management within the state about the company’s finances, a defence under s588H(2) of the Act was not established because the director’s belief about the company’s solvency was not based on reasonable grounds.

The plaintiff was the liquidator of South Australian Ships Pty Ltd (SAS), a South Australian-based ship building company that went into liquidation on 21 March 1997. SAS had been in financial difficulty for some time before that, and the liquidator claimed that the company had been insolvent since 1 June 1996.
The liquidator brought an action under s588M against the five directors of SAS for the period when it was alleged to have traded while insolvent. Section 588M(2) allows a liquidator to recover from a director, as a debt owing to the company, the amount of loss suffered by the company in such circumstances. However, before relief can be granted against a director under s588M(2), it must be shown that the director breached their duty under s588G to prevent insolvent trading.

Four of the directors reached settlement with the liquidator, so only the case of Mr Hercus, the fourth defendant, went to trial. Mr Hercus admitted that SAS was insolvent at the relevant time. He relied on a defence under s588H(2), however, claiming that he reasonably believed that a competent and reliable person was responsible for providing him with adequate information about SAS’s solvency and that, based on such information, he expected that SAS was, and would continue to be, solvent. In particular, as Mr Hercus lived outside South Australia, he claimed to have relied on two of SAS’s executive directors and management generally for information on the company’s finances.

Justice Lander held that, from 1 June 1996 onwards, there were reasonable grounds for suspecting that SAS was insolvent, and that the company was clearly insolvent from 25 September 1996. His Honour considered that Mr Hercus was misadvised about the company’s finances from time to time, including about possible further financial support sources. However, Justice Lander decided that (even assuming that further financial support might come from the sources referred to by Mr Hercus) a reasonable director in the same position would have formed the opinion that SAS was insolvent during the whole of the relevant period and, in particular, would not be able to pay its debts as and when they fell due. Therefore, the defence under s588H(2) was not made out because Mr Hercus did not have reasonable grounds to expect that SAS would remain solvent. Accordingly, Mr Hercus was held to have breached his duty under s588G to prevent insolvent trading.

Mr Hercus also relied on a defence under s588H(3) on the basis that a chartered accountant, Mr Sims, gave advice on 24 September 1996 that SAS was still solvent. However, this defence was unsuccessful since, on the evidence, the court found that Mr Sims had not given any such advice.

In assessing the quantum of Mr Hercus’s liability, the court was required to take into account the settlement sums paid by the other directors, as s588N precludes double recovery under s588M.

The court also exercised its discretion under s1317JA(2) to partially relieve Mr Hercus from liability (although the judgment does not specify what amount was subtracted in the application of this discretion). Justice Lander was satisfied that Mr Hercus had acted honestly and that, having regard to the circumstances of the case (including those connected with his appointment as a director), he ought fairly to be partially excused from the contravention of his duty under s588G.

After these matters were taken into consideration, Mr Hercus was ordered to pay $500,000 to the liquidator.

This case should serve as a cautionary tale for company directors who simply accept at face value the word of others that their company remains solvent. Even though the court, in this case, believed that the director had acted honestly and with the company’s best
interests at heart at all times, when he did not pay close enough attention to the company’s financial position, he was found liable to reimburse the company to the tune of $500,000.

3. **SOUTHERN CROSS INTERIORS AND THE “OTHER GOOD” REASON DEFENCE**

A very nasty provision in the Act about which many directors may be blissfully unaware is section 588 FGA. This provides that if the company pays the ATO tax under any of the following provisions of the Tax Act:

- Section 220 AAE, 220 AAM or 220 AAR;
- Section 221F (except subsection 221F(12));
- Section 221G (except subsection 221G(4A)); or
- Section 221P;
- Subsection 221 YHDC (2);
- Subsection 221 YHZD (1) or (1A);
- Subsection 221 YN(1); or
- Section 221 AHA; or
- under a provision of subdivision 16-B in Schedule One to the Taxation Administration Act 1953.

and the company goes into liquidation and the ATO is successfully pursued by the liquidator under the voidable transaction provisions (namely those relating to unfair preferences, uncommercial transactions etc) and is ordered by the Court to repay to the liquidator any amount of money, the directors of the company at the time the payment was made by the company to the ATO are liable to indemnify the ATO in respect of any loss or damage resulting from the order. Effectively if the ATO is successfully pursued for a preference claim the ATO can then recover the amount that it pays to the liquidator from the directors personally.

The defences to such a claim are very similar to the defences which would apply to an insolvent trading claim namely:

(a) that the director had reasonable grounds to expect and did expect that the company was solvent at that time and would remain solvent even if it made the payment (section 588 FGB(3)); or

(b) that the director:

   (i) had reasonable grounds to believe and did believe that a competent and reliable person was responsible for providing him or her with adequate information about the solvency of the company and that person was fulfilling that responsibility and on the basis of that information expected that the company was solvent at that time and would remain solvent even if it made the payment to the ATO (section 588 FGB(4));
(ii) that because of illness or for some other good reason the director did not take part in the management of the company at the payment time (section 588 FGB(5)); or

(iii) the person took all reasonable steps to prevent the company from making the payment or there were no such steps the person could have taken (section 588 FGB(6)). In determining whether a defence under section 588 FGB(6) has been proved the matters to which the Court is to have regard include but are not limited to:

- any action the person took with a view to appointing an administrator of the company; and
- when that action was taken; and
- the results of that action.

*Southern Cross Interiors*, delivered by Justice Palmer of the Supreme Court of New South Wales on 31 August 2001, was a case under these provisions. Justice Palmer's decision in so far as it concerned Mrs Clark was reversed by the New South Wales Court of Appeal on 1 May 2003 in *Deputy Commissioner of Taxation v Clark* [2003] NSWCA.

This case concerned Southern Cross Interiors Pty Limited (*SCI*). SCI made and installed partitioning. Mr Clark was the founder of SCI and in 1996 became a director. In August 1995 directors of SCI resigned and Mr Clark asked his wife to become a director. Mrs Clark agreed however the evidence was that the couple never discussed SCI’s affairs and although Mrs Clark was aware that the company made and installed partitioning and had an accountant she never saw any documents of the company and left the management of the company to Mr Clark.

In mid 1997 SCI fell on hard times and a voluntary administrator was appointed in September 1997 with SCI ultimately being wound up in October 1997.

The liquidator sought to recover monies paid by SCI to the ATO between 22 May 1997 and 19 August 1997. The ATO’s only defence was that the liquidator had failed to prove that SCI was insolvent at the time of the payments. In the same proceedings the ATO brought an application against Mr & Mrs Clark. In that application the ATO claimed that the Clark’s were liable to indemnify the ATO in respect of any payments which the ATO might have to repay to the liquidator.

The Clarks claimed that they had entered into a Deed of Release with the liquidator and that the effect of that release was that the liquidator was prevented from bringing any preference claim against the ATO. They argued that in return for $75,000 the liquidator had undertaken to them not to do anything which would result in a claim being made against them. They therefore argued that the liquidator was barred from successfully pursuing his claim against the ATO if that would result in the ATO making a claim against the Clarks for an indemnity under section 588FGA. Mrs Clark also sought to argue that she should succeed on the basis that she had a “good reason” for not participating in the management of SCI namely that she was never given information that she was required to take an interest in the company’s affairs.
The Court found for the liquidator against the ATO and ordered that Mr Harris indemnify the ATO for the amount which it would otherwise have to pay to the liquidator but at first instance found that Mrs Clark was not so liable because she did have a "good reason".

The ATO sought to recover the amounts which it was liable to pay to the liquidator against SCI's directors, Mr & Mrs Clark. Unfortunately for the Clarks, the Deed of Release which they had entered into with the liquidator only released them from claims made by the liquidator himself against them; It did not provide any indemnity or release to the Clarks for any claim which the ATO might make against them, so the argument relying on the Deed of Release failed.

3.2 The decision at first instance

The most interesting aspect of the case at first instance was the finding that the "good reason" defence succeeded for Mrs Clark. Although the case concerned section 588 FGB(5), Palmer J approached it by looking at the identical language in section 588H(4) in relation to insolvent trading. The case is therefore clearly relevant to both sections.

Palmer J was satisfied at first instance that in accepting her appointment as a director of SCI Mrs Clark acted at Mr Clark's request and relied entirely on his implied assurance that her appointment was a formality because the company needed 2 directors at first instance. Palmer J found:

She thought that that was what she had to do as Mr Clark's wife and she was happy to comply with the request.

I am satisfied that Mrs Clark left the management of SCI entirely to Mr Clark and that she did so, again, because she believed that as Mr Clark's wife that was what she should do. She did not know what was involved in becoming a director of the company but believed that her husband did know. I infer that Mrs Clark trusted Mr Clark to the extent that she believed that, in asking her to become a director in name only, he would not deliberately place her at risk in any way without telling her.

I am satisfied that Mr Clark did not ask his wife to become a director for any reason other than that he thought it was a necessary formality that SCI have 2 directors. He did not withhold information as to the affairs of the company from his wife for any sinister purpose but, rather, out of consideration for her and because he thought that it was his role to accept the responsibility of providing for his family without burdening his wife with his business worries. In short, I am entirely satisfied that in acting as they did, both Mr & Mrs Clark honestly believed that there was nothing improper or untoward in Mrs Clark taking no part at all in the management of SCI.

Palmer J considered the decision of Austin J in Bott where Austin J found that:

Mr Bott clearly did not show a proper degree of commitment to involvement in the financial management of the company, for he was never involved in financial management at all. He ought to have realised that by not having any such involvement, he was not properly discharging his responsibilities as a director. He ought to have taken steps from the outset, and at least by mid 1993, to ensure that he had a proper degree of involvement as a director in the management of the company. He ought, in short, to have confronted Mr Moore and insisted upon proper involvement in the company's affairs. He cannot now treat Mr Moore's deceptive conduct as a good reason for not taking part in management when he did not assert his rights as a director from the outset and with vigour.
At first instance Palmer J distinguished that decision on the basis that Mr Bott had previously been a managing director and must therefore have been aware of at least some of his responsibilities of a company director. Mrs Clark on the other hand was not in that position. Despite the fact that the courts have more and more been expecting and requiring directors to take a proper role in the management of companies (in very many cases but including the Eise case relating to the National Safety Council and the activities of Mr Friedrich). He felt that the words “good reason” were deliberately as wide as they could be in order that the court could determine each individual case on its own particular facts. He found that:

In my opinion, in evaluating a defence under subsection (4) it is proper to start with the assumption that a person who accepts appointment as a company director has a sufficient understanding of the responsibilities which that office carries with it to know what is required of him or her in order to discharge those responsibilities as the law requires. That assumption is justified in a society which is generally literate, educated to secondary school standard, exposed to commercial transactions at varying levels ranging from the purchase of a car or home to running a small business, and in which the professional assistance of accountants and solicitors is readily available. But that assumption is by no means an irrebuttable presumption. Many examples can be readily be given in which the assumption would not be valid: recent immigrants from non English speaking countries who are themselves not English speaking; those with limited education and little, if any, exposure to a commercial environment, such as indigenous people in remote areas; those with intellectual disabilities, to name but a few.

It may be said that people in these categories are inherently unlikely to find themselves appointed as company directors. As a general observation, that is undoubtedly so. But it is the difficult and unusual cases, as well as the common place, with which the law, as embodied in the subsection, must deal. Assume, for example, that a non English speaking immigrant with no commercial experience is persuaded by a rogue to sign a consent to be a company director on the assurance that the document is something quite different or that appointment as a company director is merely a formal bureaucratic requirement which does not entail responsibility for the company’s management. Assume, for example, that a criminal threatens a highly experienced and competent company director with death or injury unless the director remains on the board of a company but turns a blind eye to the company’s activities. Can it be said that the policy of the Corporations Act or the expectations of the community require that persons such as these be held accountable for insolvent trading and be denied a defence under section 588H(4)? So to hold would make the office of a director one of strict liability.

The civil law knows how to relieve people from the legal consequences of their acts or omissions according to well defined principles. Duress, non est factum, undue influence, deceit, misleading or deceptive conduct, and unconscionable conduct are but some of the basis upon which a court acts to protect a person from the legal consequences and liabilities of his or her acts, whether voluntary or involuntary.

In my opinion, any reason which the law holds sufficient, according to accepted legal principles, to excuse a person from the legal consequences of his or her acts or omissions is a “good reason” for the purposes of a defence under CA sections 588H(4) and sections 588FGB(5).

Within the category of circumstances constituting “good reason” for non participation in a company’s management I would include those circumstances which underlay the reasons of

Garcia is that well known case where a married women voluntarily and without undue influence guaranteed her husband’s businesses bank loans. Even though the bank did not coerce her nor have any actual knowledge of the means by which her husband had procured the execution of the guarantee the court held that the guarantee could not be enforced against the woman as enforcement would be unconscionable.

On that basis at first instance Palmer J found that Mrs Clark was not liable:

- If a woman, inexperienced in business and completely unaware of the responsibilities of company directorship, is told by her husband, whom she trusts and believes to be honest and to be knowledgeable in such matters, that some formality requires her to be appointed as a director to a family company and that management of the company may be left entirely to him, then, in my view, she has a “good reason” for not participating in management for such time as she genuinely remains in ignorance of her duties.

If the decision at first instance correctly stated the law, it potentially opens the door to directors to argue that a good reason includes:

- duress;
- non est factum;
- undue influence;
- deceit;
- misleading and deceptive conduct; and
- unconscionable conduct.

The decision at first instance, whilst it might well have been a fair one for Mrs Clark, seemed to me at the time it was delivered to leave open a door which other courts seem to have been closing – there seems to have been a growing expectation in the community and in the courts for directors who are appointed to companies to properly perform their duties and to ensure that they are aware of the activities of the company over which they have been appointed. In my view the decision did not sit well with the general trend of cases and ignores the fact that the general body of creditors probably expect that all directors of a company are properly taking part in the management of the company in accordance with their statutory obligations so to do. Having said that it was an attractive decision for directors and for insurers of directors notwithstanding Palmer J’s comment that:

it will be a comparatively rare case in which a wife is able to establish such a defence on the facts. I venture to think that if the unsuccessful defendants in each of the insolvent trading cases which I have reviewed had raised a defence of non participation in management for good reason under section 588H(4) CA none would have fared any better and all would have failed on the facts, either because there was no relationship of trust and confidence which induced the acceptance of the directorship, because the defendant was sufficiently experienced in commercial matters to have appreciated the duties of a director or because the defendant was sufficiently involved in the company’s affairs not to be able to claim non participation in management: see eg; Lewis at first instance: above that 131. The present case is, however, one of those rare cases in which the defence should succeed.
3.3 The Appeal

The New South Wales Court of Appeal overturned Palmer J's findings in relation to Mrs Clark last year. The key findings of the Court of Appeal were quite different to the findings of the Court at first instance. On appeal the Court found that:

(a) A total failure to participate, for whatever reason, should not be regarded as a "good reason" pursuant to s588FGB(5). This is supported by:
   - an analysis of the legislative change and judicial decisions which indicate that the expectation that directors will participate in management has intensified over time; and
   - that a director's duty of care and diligence is a core, irreducible requirement of participation in the management of the company and this requirement is one of the factors underlying the scheme for insolvent trading of which s588FGB is a part.

(b) It is a common assumption that where general words follow particular words in legislation, then the general words will be construed as being limited to the same "kind" as the particular words. This is known as the ejusdem generis rule. The Court held that before this rule can be applied, it must be shown that there are at least two specific words which constitute a common category. If this is not the case, the rule can not apply because it is not then possible to determine a relevant category for the purpose of reading down general words which follow.

Spigelman CJ summarised the evidence at first instance in this way (at para 10):

Mrs Clark has never been a director of any other company. Nor did she have any business experience. Her time was taken up as a housewife and mother. She said that when requested to become a director, she thought she had to accept as a wife. She agreed, from time to time, she signed company documents, but that they were not explained to her and signature occurred in situations which 'I would often have a frying pan in one hand and be signing with the other'.

3.4 The decision of the Supreme Court of New South Wales, Court of Appeal per Spigelman CJ, Handley and Hodgson JJA

The issue before the Court of Appeal was whether Mrs Clark "did not take part in the management" of SCI "for some other good reason" at the times of the payments. The court analysed the following:

- the approach to statutory interpretation;
- the statutory interpretation of s588FGB(5); and
- the risk of reinforcing gender stereotypes.

3.5 The approach to statutory interpretation

When phrases are used of generality in statutory provisions, those phrases "must take its colour from its surrounding". The contemporary approach to statutory interpretation is literal but not literalistic and requires words to be construed in their total context. However, with specific reference to the ejusdem generis rule, which gives the immediate verbal
context determinative weight in the process of construing general words, the court held that the application of this rule is rarely justified. Rather, whether or not general words ought to be read down is to be determined by the whole of the relevant context, including other provisions of the statute and the scope and purpose of the statute.

Additionally, where Parliament has chosen a formulation which is of indeterminable scope and of a high level of generality, a court should interpret the provision on the basis that the intention of the original enactment was that the particular application of the provision may vary over time. This is particular evident in constitutional interpretation, however, in the corporations context, it will be changes in the principles establishing duties of directors that determine whether there has been any relevant change in the context which justifies a differing interpretation to be given to a provision.

3.6 Section 588FGB(5)

The Court of Appeal analysed the case law, amendments to the Act and the policy underpinning s588FGB(5) and held that the focus of attention in interpreting a "good reason" for a director not to participate in management for the purposes of the corporations law requires consideration of:

- the duties of a director, particularly in, but not limited to insolvent trading; and a recognition that;
- it is a basal structural feature of corporations legislation in Australia that directors are expected to participate in the management of the corporation.

The Court concluded that ss588H(4) and s588FGB(5) operate on the assumption that every director will be involved in the management of the company. This is supported by the fact that the sections are constructed in such a way to infer that the explanation for a failure to participate is focused on a particular point in time and in considering the duties expressly imposed upon directors at the time the monies were paid in 1997, as well as the history of the case law, statutory reform and textual context, the words "good reason" must be read down so that they do not conflict with the obligation of directors generally to participate in the management of the company. In this way, reasons which cause a director never to participate in the management of a corporation are not capable of constituting a "good reason" for not participating at a particular point in time.

3.7 The risk of reinforcing gender stereotypes

The court analysed the alternate arguments in relation to gender stereotypes and the interpretation of s588FGB(5), namely:

1. that gender neutral rules ignore the actual experience of many women who assume subordinate roles in both the public and private spheres; and in the alternate
2. the adverse consequences on the ability of women to participate equally in commercial life if the legal system permits women to rely upon stereotypes embodied in special rules.

The Court concluded that the recognition of complete abdication of responsibilities as a director as a "good reason" for purposes of the statutory defence, carries with it the risk of
reinforcing gender stereotypes and undermining the confidence with which potential creditors will deal with small companies in which women participate with their husbands.

3.8 The result

The Court held that Mrs Clark's total reliance on her husband in the management of SCI is not a "good reason" within the meaning of s588FGB(5), for her non-participation in the management of the company at the times when payment were made to the DCT. Mrs Clark was therefore unable to resist her liability under s588FGA as a director of SGI.

The Court of Appeal's decision effectively limits the ambit of possible arguments to justify non participation by a director in the management of a company. While the Court of Appeal did not specifically exclude the availability of arguments based upon duress, non est factum, undue influence, deceit, misleading and deceptive conduct or unconscionable conduct, it limited the ambit of s588FGB(5) by deciding that the words "good reason" must be read down so that they do not conflict with the obligation of director's generally to participate in the management of a company and that an argument attempting to justify why a director has never participated will not succeed and will never constitute a "good reason". This conclusion, therefore, indicates the strict stance that the Court of Appeal has taken with regard to the responsibilities of directors and reinforces the importance and absolute nature of director's duties.

4. DE FACTO DIRECTORS

4.1 Definition of "director" in the Act (and the Act's predecessors)

The definition of "director" is encapsulated in s9, being the Definition section, of the Act. Section 9 reads as follows:

"Director" of a company or other body means:

(a) a person who:
   (i) is appointed to the position of a director; or
   (ii) is appointed to the position of an alternate director that is acting in that capacity,

regardless of the name that is given to their position; and

(b) unless the contrary intention appears, a person who is not validly appointed is a director if:
   (i) they act in the position of a director; or
   (ii) the directors of the company or body are accustomed to act in accordance with the persons instructions or wishes.

Subparagraph (b)(ii) does not apply merely because the directors act on advice given by the person in the proper performance and functions attaching to the person's professional capacity, or the person's business relationship with the directors or the company or body.

Note:

Paragraph (b) --- contrary intention --- Examples of provisions for which a person referred to in paragraph (b) would not be included in the term "director" are:
As many of the relevant cases in this area predate the enactment of the Act, it is important to also note the preceding provisions of s9:

- the Corporations Law immediately preceding the Act was identical;
- Prior to this s60 encapsulated similar provisions to s9 being:

Section 60 Directors

60(1) [Director] Subject to Subsection (2), a reference to a director, in relation to a body, includes a reference to:

(a) a person occupying or acting in the position of director of the body, by whatever named called and whether or not validly appointed to occupy, or duly authorised to act in, the position;

(b) a person in accordance with whose directions or instructions the directors of the
body are accustomed to act;

(c) in the case of a body incorporated or formed outside Australia:

(i) a member of the body's board;

(ii) a person occupying or acting in a position of member of the body's board
by whatever named called and whether or not validly appointed to occupy,
or duly authorise to act in, the position; and

(iii) a person in accordance with whose directions or instructions the members
of the body's board are accustomed to act.

60(2) [Professional capacity or business relationship]

A person shall not be regarded as a person in accordance with whose directions or instructions:

(a) body's directors; or

(b) the members of the board of a body incorporated or formed outside Australia,

are accustomed to act merely because the directors or members act on advice given by the
person in the proper performance of the functions attaching the person's professional
capacity or to the person's business relationship with the directors or the members of the
board, or with the body.

60(3) [No directors]

For the purposes of subsection (1), if there are no positions of director (by whatever name called) in relation to a body, the reference in paragraph (1)(a) to a person or director of the
body is a reference to a position the holder of which has control, or shares control, over the
general conduct of the affairs of the body.

The difference with the effect of s60 is that at that time, pursuant to the then s556(1) of the
Companies (New South Wales) Code, a director (whether validly appointed at law or otherwise) had a defence if it could be shown that the debt in question was incurred without the express or implied authority or consent of the relevant director. For this reason, some of the cases which applied s60 did not hold the defacto director liable, however, these
cases have continued to be applied in interpreting the current provisions and remain relevant in assessing when a lender or consultant may be deemed a shadow or de facto director.

4.2 Difference between a shadow and de-facto director

- **Defacto director (s9(b)(i)):** although not validly appointed as a director any person who acts in the position of director will (unless the contrary intention appears) be a "director" of the company or body.
- **Shadow director (s9(b)(ii)):** although not validly appointed as a director, any person with whose instructions or wishes the directors of the company or body are accustomed to act, will (unless the contrary intention appears) be a "director" of the company or body.

The insolvent trading provisions of the Act apply to a ‘director’.

4.3 *Natcomp Technology Australia Pty Ltd v Graiche* [2001] NSWCA 120 ("Natcomp Case")

**NSW Court of Appeal: Spigelman CJ, Stein and Heydon JJ**

Natcomp had supplied computer equipment to Amtech which was a small company and was operated by only 2 people. Amtech subsequently entered into liquidation in late 1996 and Natcomp sought to recover the price of the computer equipment that it had delivered to Amtech from the directors of Amtech.

Dr Graiche was a medical practitioner and had an association with Amtech as follows:

- Graiche accompanied the directors of Amtech and the Managing Director of Natcomp to a trade fair in Taiwan in June 1996, during which Graiche made frequent use of the term "we at Amtech".
- During the fair, Graiche had distributed a business card carrying the logo of Amtech, which described him as the "CEO" of the Company, which in the view of the Court was intended to mean the Chief Executive Officer. Graiche subsequently claimed that the reason he used these cards was in order to deal with the exhibitors at the trade fair for his own purposes, and obtain technical information.
- Evidence was produced by a number of third parties that they had had conversations with Graiche in which he had said that "he was the person who made the decisions at Amtech".
- On at least one instance Graiche had paid for computer equipment ordered by Amtech and paid for it in cash. At the time Graiche had said that he had a financial interest in Amtech.
- At a meeting between the directors of Amtech, Graiche and an advertising agency, Graiche was introduced as the Company's business advisor, he had contributed financially to the company. At a later meeting, Graiche was introduced as "the brains behind Amtech".
- Graiche had lent $18,000 to Amtech for a short period.
The trial judge held that Graiche was not a director for the purposes of the *Corporations Act 2001*. Natcomp appealed.

The leading judgment in the case was delivered by Stein J. The Court decided that:

- indications that a person may be a "director" despite the absence of formal appointment require a consideration of the duties performed by that person in the context of the operations and circumstances of the particular company concerned (*Natcomp Case* at 13; *Austin* at 569);

- in a large and diversified company, great discretion to deal with important matters must be reposed in employees. So, for example, a manager of a large supermarket would not be considered a director of the company where the supermarket is but one of many operated by the company (at 13);

- a relevant issue may be the reasonable perception of the person who is claimed to have acted as a director by outsiders who dealt with the company (at 13). To that extent, the fact that the person holds himself or herself out as a director is relevant to a finding as to the person’s status as director or otherwise (at 13)

It was found that Graiche’s involvement with Amtech was apparently limited to an interest in the development and marketing of possible new products and this was insufficient to bring Graiche within the definition of "director". Accordingly the appeal was dismissed.

The result is surprising as the facts indicate that Graiche wielded real authority in Amtech and had permitted third parties to perceive him in that capacity. Unfortunately, in confirming the decision of the trial judge, the Court did not explain why Graiche did not come within the definition of defacto director. However this case does indicate that the threshold to be considered a de facto or shadow director is reasonably high.

### 4.4 Deputy Cmr of Taxation v Muriwai; Deputy Cmr of Taxation v Solomon [2003] NSWCA 62 (Unreported, 24 April 2003)

**NSW Court of Appeal, Handley, Sheller JJA, Gzell J ("Muriwai")**

The *Natcomp* Case, has been considered and applied in the most recent Australian case dealing with this topic, *Muriwai*.

In this case, two related companies failed to remit to the Commissioner of Taxation PAYE deductions. Pursuant to s222AOB(3) (which relates to such payments):

> If this section is not complied with on or before the due date, the persons who are directors of the company from time to time after the due date continue to be under the obligation imposed [to make such payments]

Dr Solomon was a re-appointed director of both of the relevant companies but subsequently resigned. However, Dr Solomon continued to act in the interests of the companies. The evidence was that he:

- had daily contact with directors;
- had the right of approval of the sale of the Singapore operations;
- attempted to generate revenue from stock sales;
- had an active involvement in the preparation of projected cash flows;
had an active involvement in an arrangement with the ATO to receive a reduction of the group's taxation liabilities; and

had an active involvement with the employees of the companies.

Mr Muriwai was a director who subsequently resigned but he remained on with the companies as an employee "to try to manage a way out of the [companies' financial difficulties] but not as a director" (at para 22). Mr Muriwai also:

- had conversations with Dr Solomon about the running of the companies;
- had involvement in the preparation of projected cash flows;
- entered into negotiations with various directors and third parties for the obtainment of funds to be injected into the companies to avoid liquidation;
- was attempting to convince the directors of the companies to place them into liquidation or administration;
- had involvement with the employees of the companies and instructions to the employees which the employees treated as superior to the instructions given by the directors of the company;
- was seeking financial advice and legal advice on behalf of the companies.

Various issues were raised in Muriwai but the relevant issue for present purposes was whether Dr Solomon and/or Mr Muriwai were defacto or shadow directors at the relevant time and thereby liable for the debt to the Commissioner of Taxation?

The Court considered the Natcomp Case and held that Dr Solomon and Mr Muriwai were directors of the companies pursuant to s9 of the Corporations Act 2001 (ata para 47):

In Deputy Commissioner of Austin (1998) 28 ACSR 565 Madgwick J identified performance of top level management functions, acting as the company in matters of great importance and the reasonable perception by outsiders that a person was a director of the company as factors in determining whether the extended definition in s60 of the Corporations Law applied. Those observations were endorsed by this court in Natcomp Technology Australia Pty Ltd v Graiche (2001) 19 ACLC 117.

With regard to Dr Solomon, it was argued that the facts indicated a similar situation to Dr Graiche in the Natcomp Case. However this submission was not successful as the Court distinguished the facts in this case on the basis that Dr Graiche was not involved in the company's main activity of retail sale of computer packages, his involvement being limited to the development and marketing of new products. By contrast, the Court found, Dr Solomon was involved in the main activity of the companies.

The significance of this case is two-fold:

- firstly it reaffirms the authority of Austin and the Natcomp Case; however
- by distinguishing the Natcomp Case on the basis that the defendants unlike Mr Graiche were involved in the "main activity" of the company.

4.5 Clark v Perkins [2002] SASC 382

South Australian Court of Appeal per Perry, Williams, and Gray JJ
At first instance a Master of the South Australian Supreme Court ordered the chairman of the board of directors to pay the liquidator compensation for transactions undertaken while the company was insolvent. This decision was challenged on the basis that the chairman was not a director and that the insolvent trading claim was not formally made out. A challenge was also brought about the date from which interest was payable. A cross-claim was brought by the liquidator about the reduction of compensation payable.

**Insolvent trading**

The court noted that three elements needed to be present to show a breach of the duty to prevent insolvent trading.

- the company must have incurred a debt;
- the company must have been insolvent at the time of incurring each debt (or have become insolvent by incurring that debt); and
- there must have been reasonable grounds at the time to suspect that the company was insolvent or would become insolvent as a result of the transaction.

The liquidator alleged that LVS traded while insolvent between 23 June 1993 and 13 May 1994. There was no dispute that LVS incurred the debts. The Master considered evidence that indicated that there were times between June 1993 and June 1995 when it must have been clear that LVS was either 'insolvent … or in danger of becoming insolvent'. However, he also accepted that, in the same period, there were times when the 'position looked more positive'.

The court held that this evidence was insufficient to link the times when the debts were incurred to the times when LVS was insolvent or would become insolvent. Two errors by the Master meant that the liquidator's claim was not made out. These were:

- the consideration of the position of the company in a general way over a two-year period, rather than the relevant period of 23 June 1993 to 13 May 1994; and
- the failure to specifically consider the position of the company at the time of incurring each individual debt.

As a result, the court was not required to consider the other issues raised on appeal. However, the court offered comments on these issues.

**Was Mr Clark a director?**

Mr Clark was chairman of the board of directors and his role was to bring procedural expertise to directors' meetings. Notice was given to ASIC of Mr Clark's appointment as a director in February 1987; however, this notice appears to have occurred without his consent or knowledge.

The articles of association of LVS included two relevant articles. Article 108 stated that the 'director may elect one of their number Chairman' and that if no person is elected or the chairman is not present they 'shall choose some one of their number'. Article 90 notes that the chairman 'shall not be entitled to any second or casting vote'.
Section 60(2) CA (now s9 'director') notes that a person will not be a director (s60(1)(b) CA) where the directors are accustomed to acting merely because of advice given in that person's professional capacity. Consequently, it was also relevant that Mr Clark acted as an adviser to the board.

Justice Gray read the articles of association as permitting, but not requiring, the chairman to be a director. He also drew on the exception within the definition of director regarding those advising a board in a professional capacity, in concluding that the question of whether Mr Clark was a director would have had to be reconsidered on the evidence, had the appeal not been allowed on other grounds.

Justice Gray also referred to the Duomatic principle, which allows an informal meeting of minds of the members of a company to determine matters that would normally require a formal meeting of shareholders. He noted that there was nothing in the articles to prevent the shareholders from appointing a non-director as chairman.

Justice Perry, however, took the view that the articles of association required a director to hold the position of chairman. In the situation where Mr Clark was not properly appointed as a director, this would mean that LVS had a further irregularity in its affairs. This would allow a finding that Mr Clark was acting as a director (even if not properly appointed).

This case emphasises the importance of identifying each of the alleged debts that are incurred within a period of insolvency. It also indicates that a person who participates in board meetings may not necessarily be held to have acted as a 'shadow director', as defined in s9 of the CA if they participated in a professional capacity.

5. AVAILABILITY SET-OFF TO PREFERENCE CLAIM RECOVERIES

5.1 Insolvent Companies – Mutual Credit and Setoff

Section 553C operates to require an unsecured creditor who seeks to prove in a winding up to set off mutual credits and mutual debts between itself and the insolvent company in liquidation and prove for the net amount owing to it in the liquidation. The provision provides:

(1) Subject to subsection (2), where there have been mutual credits, mutual debts or other mutual dealings between an insolvent company that is being wound up and a person who wants to have a debt or claim admitted against the company:

(a) an account is to be taken of what is due from the one party to the other in respect of those mutual debts; and

(b) the sum due from the one party is to be set off against the sum due from the other party; and

(c) only the balance of the account is to be admissible to proof against the company, or is payable to the company, as the case may be.

(2) A person is not entitled under this section to claim the benefit of a set-off if, at the time of giving credit to the company, or at the time of receiving credit from the company, the person had notice of the fact that the company was insolvent.
The leading High Court decision on the question of set-off in an insolvency context is *Gye v McIntyre* (1991) 171 CLR 609. That case related to setoff in the bankruptcy context under s 86 of the Bankruptcy Act. The High Court held (at pages 618-619):

"Where there are genuine mutual debts, credits or other dealings, it would be unjust if the trustee in bankruptcy could insist upon having 100 cents in the dollar upon the whole of the debt owed to the bankrupt but at the same time insist that the bankrupt’s debtor must be satisfied with the dividend of some few cents in the dollar on the whole of the debt owed by the bankrupt to him...On the other hand, “substantial justice” requires that the operation of set-off in bankruptcy be confined within limits which protect the creditors of the bankrupt from being disadvantaged by set-off being allowed in circumstances where debts, credits or other dealings have not been genuinely mutual as a matter of substance, such as where beneficial ownership is not the same or where, after bankruptcy or notice of an act of bankruptcy, a debtor of the bankrupt has brought up liabilities of the bankrupt at a discount for the purpose of setting them off against his own indebtedness."

The fundamental policy behind the operation of set-off in the insolvency context is to “do substantial justice between the parties, where a debt is really due from the bankrupt (or insolvent company) to the debtor to his estate. The prime purpose is to protect those persons who engage in mutual dealings with the bankrupt, and as a protective provision of a statute, it is to be interpreted in the widest scope”: *Forster v Wilson* (1843) 12 M&W 191 at 204.

As a result, pursuant to section 553C, where a party wishes to lodge a proof of debt in the liquidation of a company, any debts owed by the company to that person must be set-off against any amount owed by that person to the company by way of debt, claim or other dealing.

The key element here is mutuality. The High Court in *Gye v McIntyre* held that mutuality in the insolvency context has three key aspects:

(a) the claims must arise between the same persons;
(b) the relevant interest is the equitable interest of the parties;
(c) the claims must be of a kind which ultimately sound in money.

In summary therefore, where a party seeks to prove in a winding up, provided the debts satisfy the requirements of mutuality, that party must set-off its debt against monies owing by the insolvent company prior to proving in the winding up in accordance with s553C.

5.2 *Re ACN 007 537 000 Pty Limited; Ex parte Parker* (1997) ACSR 360

**Federal Court of Australia per Mansfield J**

This case involved an application by the liquidator of a company for a declaration that he be able to set off the amount of a proof of debt of Amber Ceramics (the holding company of the company in liquidation) in circumstances where the liquidator believed that the holding company was liable for insolvent trading in respect of the insolvent company. The debt owed by the company to Amber Ceramics arose out of loans made by Amber Ceramics to its insolvent subsidiary.
The facts in the case were as follows:

- On 30 May 1995 Barossa Ceramics Pty Limited (Barossa) appointed Messrs Parker and Freer as joint and several administrators. Amber Ceramics (SA) Pty Limited (Amber Ceramics) was the holding company of Barossa.
- On 27 June 1995, the creditors of Barossa resolved that the company be wound up and Messrs Parker and Freer be appointed liquidators.
- On 2 June 1995 Westpac appointed receivers to Amber Ceramics.
- On 15 June 1995, Messrs Parker and Freer resigned as administrators of Amber Ceramics.
- Amber Ceramics lodged a formal proof of debt in the liquidation of Barossa Ceramics on 23 May 1996 for $516,453.74 made up of a loan account of $456,870.41 and sundry debts of $59,583.33.
- On 9 October 1996 the liquidators of Amber Ceramics admitted that claim for $460,977.53, but indicated at that time that they may have a claim against Amber Ceramics as the holding company to the extent of $314,796.73 by reason of a claim against it pursuant to section 588V of the Corporations Law.
- The liquidators applied to the court for directions as to whether he was entitled to set-off pursuant to section 553C, or otherwise, the sum due to Amber Ceramics as its claim against Barossa Ceramics in the winding up of Barossa Ceramics, the sum he would otherwise be entitled to recover from Amber Ceramics pursuant to section 588W of the Law.

The Court held that the liquidator was entitled to set-off the liability under section 588W on the bases that:

- although the claim against Amber Ceramics did not result from dealings between the two companies, there were debts due from one company to the other and the expression ‘mutual dealings’ as employed in section 553C was not meant to confine the broad purpose of statutory set-off;
- it did not matter that the claim could only be brought by the liquidator. As a matter of substance the claim under section 588W was the claim of Barossa Ceramics; and
- it did not matter that the claim could only be perfected as a consequence of the liquidation. The conduct constituting the contravention occurred before the commencement of the administration (being the relevant date).

The Court held the relevant question was whether the two claims are “mutual credits, mutual debts or other mutual dealings” between the company and Amber Ceramics under s 553C of the Corporations Law (as it then was).

The Court held that the debts as between Amber Ceramics and the company in liquidation were mutual and applied the principles in Gye v McIntyre in respect of mutuality of debts, finding that: “the debts are between the same companies, the burden of them would lie in the same interests. They are commensurable, in that they both sound in money.”
The key issue was whether the debt owed by Amber Ceramics for insolvent trading was a debt due to the company or a debt due to the liquidator. Mansfield J held that “under s588V of the Act, the debt is recoverable as a debt due to the company. The fact that the claim may be enforced by the liquidator is but a procedural device for enforcing what is clearly a claim of the company.”

Accordingly the Court held that the liquidator was entitled to set off the amount of his claim under s 588W of the Act against Amber Ceramics against the amount for which Amber Ceramics was otherwise entitled to prove for as an unsecured creditor in the winding up of it's subsidiary.

5.3 **Tolcher v National Australia Bank Ltd** [2003] NSWSC 207

**Supreme Court of New South Wales per Palmer J**

The question for determination in this case was whether property recovered by a liquidator upon the settlement of an unfair preference and an insolvent trading claim would become subject to a prior charge or whether it would become available for distribution to unsecured creditors. *Ex parte Parker* is not cited in the judgment and may therefore not have been brought to Palmer J’s attention.

The plaintiff was the liquidator of Lloyd Scott Enterprises Pty Ltd (LSE). LSE had entered into a debenture with the National Australia Bank (NAB). The debenture was a fixed and floating charge over all LSE assets. The liquidator made two claims against Key Equipment Finance Australia Pty Ltd (Key) as a shadow director of LSE. The first was to recover an unfair preference under s588FA and s588FF(1)(a), and the second was a claim under s588M(2) to recover compensation for loss resulting from insolvent trading.

The claims were the subject of a mediation, which resulted in the execution of a deed. The question for determination was whether the proceeds of the settlement was property of LSE caught by the NAB’s charge, or property that was available for distribution to LSE’s unsecured creditors in the winding up.

Justice Palmer did not follow Justice Jones in *Jonsson v Ferrier*. His Honour instead affirmed the correctness of previous authorities: Justice Santow in *SJP Framework (Aust) Pty Ltd (in liquidation) v Deputy Commissioner of Taxation* (2000) 34 ACSR 604, which in turn affirmed *N A Kratzmann Pty Ltd v Tucker (No 2)* (1968) 123 CLR 295. If property is the subject of a fixed charge, it will not be available for distribution to a company's unsecured creditors during a winding-up. This is not the case for property that is the subject of a floating charge. *Kratzmann* establishes that a charge that is not a specific charge cannot prevail over the trustee in bankruptcy or liquidator when monies are recovered by way of preference. The money is paid to the liquidator on the company's behalf. Such an order is made under s588FF for the purposes of s588GFA CL.

Justice Palmer stated that the *Kratzmann* principles were equally applicable to insolvent trading recoveries for claims under s588M. If a liquidator institutes proceedings under s588M(2) and recovers money under a judgment, the proceeds are not available in priority to a secured creditor until the unsecured debts have been paid in full, as provided by s588Y(1).
Unlike *Ex Parte Parker* Justice Palmer reasoned that a reference to payment ‘to the company’ in s588M(2) does not indicate a legislative intention that property recovered by a liquidator under s588M(2) is to be regarded as property of the company, so as to be available to a secured creditor contrary to the principle established in *Kratzmann*.

Justice Palmer emphasised that *Kratzmann* is still good law. If property is the subject of a fixed charge, it will not be available for distribution to a company's unsecured creditors during a winding-up. This is not the case for a floating charge. A floating charge will not prevail over a trustee in bankruptcy or a liquidator when monies are recovered by way of preference. The monies will vest in the liquidator on behalf of the company. In Justice Palmer's view the same principles that apply under s588FF for the purposes of s588FGA CA also apply under s588M(2) in relation to insolvent trading recoveries. The words 'to the company' do not indicate that monies recovered under this section are available to a secured creditor contrary to the principles established in *Kratzmann*.

At this stage there is therefore a conflict between the authorities as to whether or not it is possible to set-off an insolvent trading claim: Mansfield J in the Federal Court said yes in *Ex Parte Parker* in 1997 and Palmer J in the New South Wales Supreme Court in 2003 said no in *Tolcher* but appears to have done so without considering *Ex Parte Parker*

### 6. CONCLUSIONS

Overall, the news is not good for directors:

- the Courts are restricting the availability of the "other good reason" and the "reliance on information provided by another" defences.
- the Courts have shown some willingness to identify non-directors at least if they are involved in the main activity of the company as directors.

There are, however, some good news for directors and de facto directors:

- if you are not formally appointed you may need to be involved in the "main activity of the company to be found to be a director".
- there remains at least a potential for arguing that directors can set off amounts owed to them by the company from any insolvent trading claim the company may have against them although that potential has not been improved by the decision in *Tolcher*.
NOTE: This document is intended only to provide a general review on matters of concern or interest to readers. The text of this document should not be relied upon as legal advice. Matters differ according to their facts. The law changes. You should seek legal advice on specific fact situations as they arise. The case notes incorporated in this paper are largely extracted from the Allens Arthur Robinson Annual Review of Insolvency and Restructuring Law 2002 (http://www.aar.com.au/pubs/arir/) and the soon to be published Allens Arthur Robinson Annual Review of Insolvency Restructuring Law 2003.

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