

Independent Advice to Directors in Insolvency

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Agenda

- Directors' Duties
- Safe Harbour Reforms
- Anti-Phoenixing Reforms

Directors' Duties

Safe Harbour Reforms

Anti-Phoenixing Reforms

Directors' Duties in Insolvency

Duty	Corporations Act	
	Civil	Criminal
Duty of care and skill	180(1)	
Duty to act in good faith in the best interests of the company as a whole and for a proper purpose	181(1)	184(1)
Duty to not improperly use position to benefit any person or cause detriment to the company	182(1)	184(2)
Duty not to be present or to vote on a resolution in which the director has a material personal interest		195(1)
Duty to prevent insolvent trading	588G(2)	588G(3)

Changing Role of ASIC

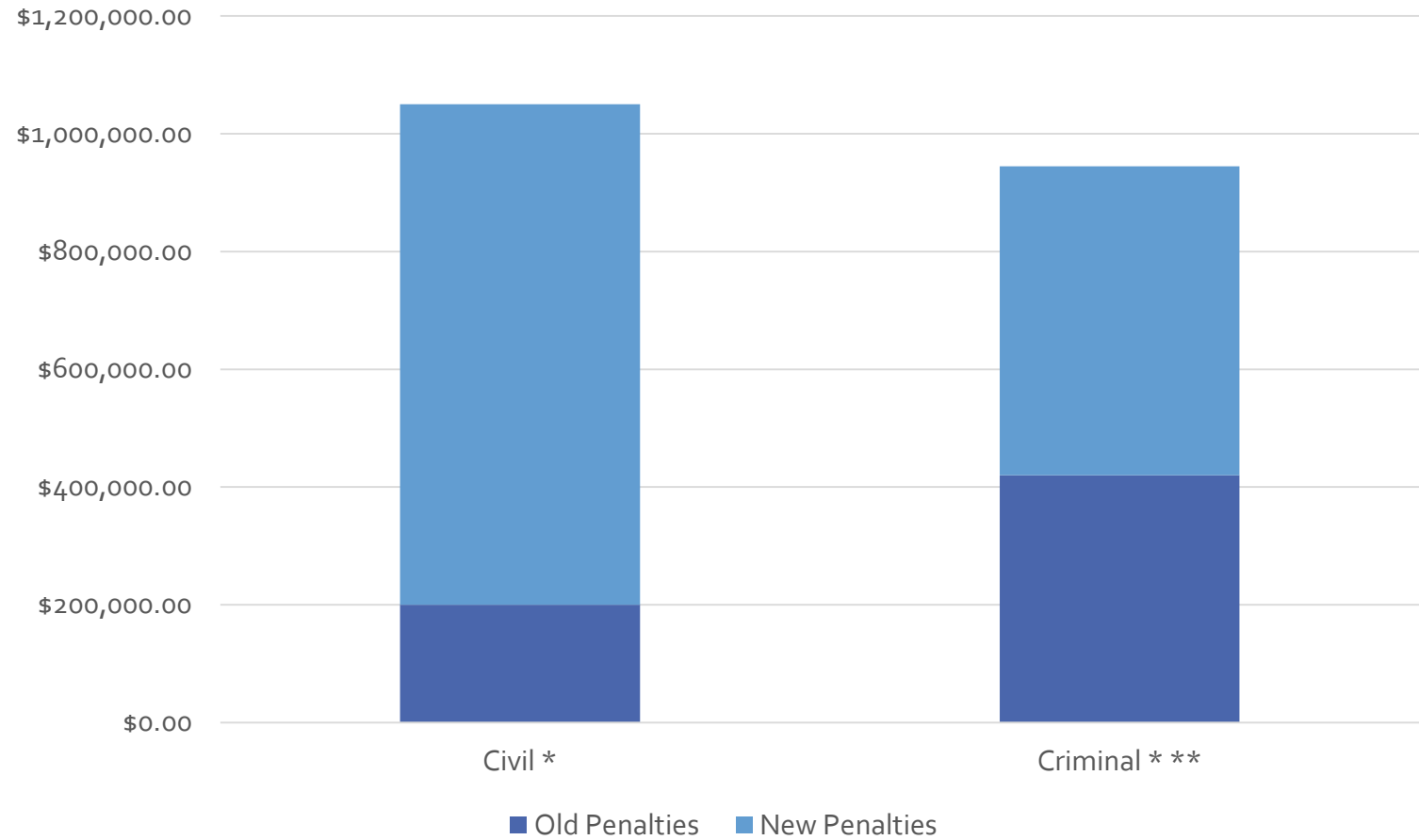
External administrators required to report possible misconduct by directors to ASIC (sections 422, 438A and 533 Corporations Act)

ASIC increasingly proactive:

- "why not litigate" enforcement;
- Corporate Governance Taskforce;
- additional \$400 million funding to ASIC

Increase in Penalties

2019 Increase in Maximum Penalties for Individuals
Insolvent trading/breach of duties



* Or three times the total of all benefits derived and detriment avoided (if this figure is higher).

** And/or up to 15 years' imprisonment.

New Definition of 'Dishonesty'

Section 9: Dictionary

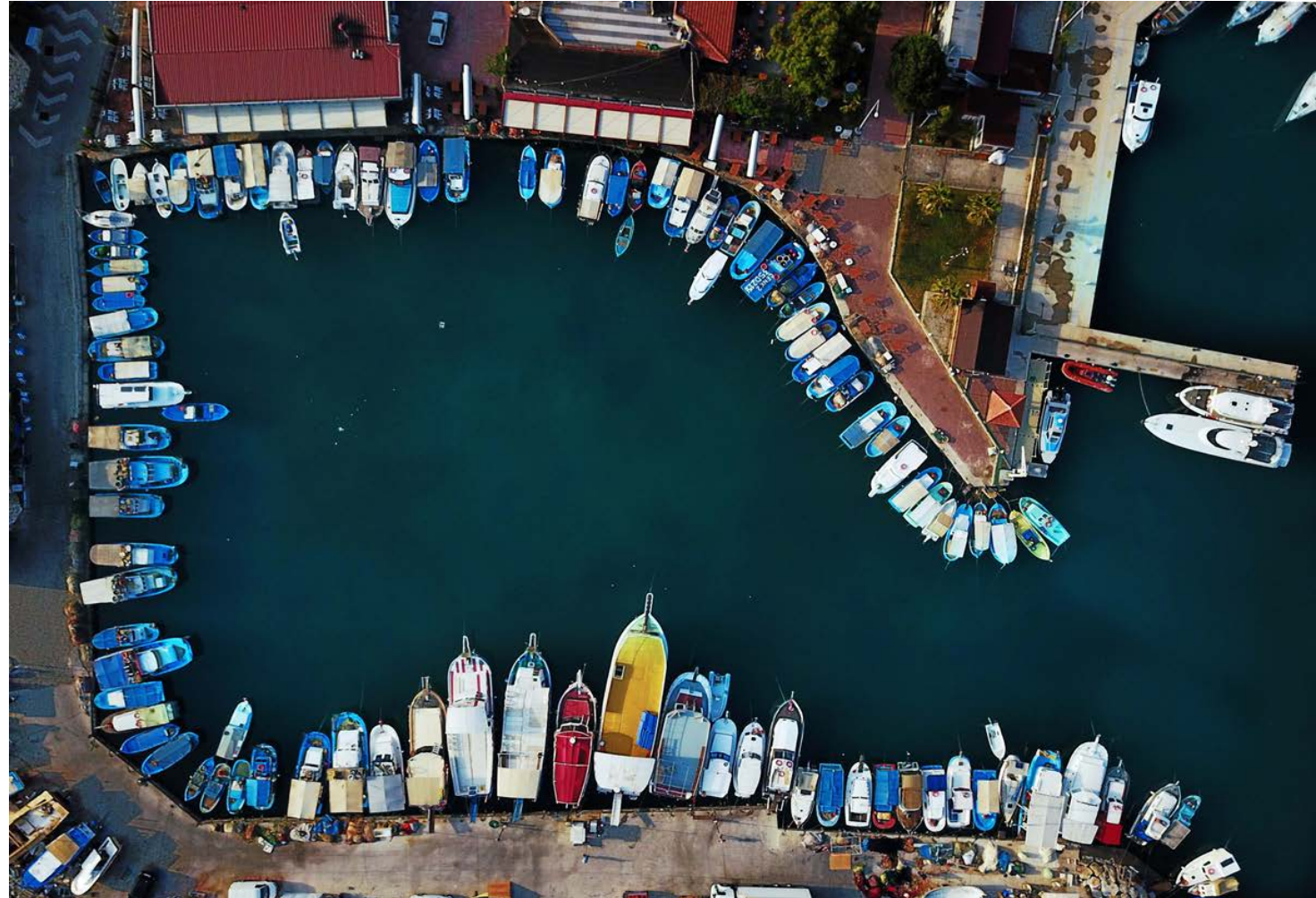
"dishonest" means dishonest according to the standards of ordinary people.

Safe Harbour Reforms

Game Changing?

s588GA
*Corporations Act
2001 (Cth)*

September 2017



Credit: Rebecca Georgia
@rebeccageorgia

Safe Harbour Exception s 588GA

The director's duty to prevent insolvent trading will not apply to a **person** and a **debt** if:

- the person starts to suspect the company may become or is insolvent;
- the person starts developing a course of action that is reasonably likely to lead to a better outcome for the company; and
- the debt is incurred in connection with that course of action.

<https://www.turnaround.org.au/tma-australia.php>

Better Outcome Test s 588GA

- Better Outcome = better than immediate liquidation/ administration.
- Is the Director:
 - **properly informing** self of company's financial position? or
 - taking **appropriate steps to prevent any misconduct** by officers or employees that could affect the company's ability to pay all of its debts? or
 - taking **appropriate steps to ensure that the company is keeping appropriate financial records?** or
 - **obtaining advice** from an appropriately qualified entity? or
 - **developing or implementing a plan** for restructuring the company to improve its financial position?
- **STOP** if plan no longer viable.

Safe Harbour To Do List

A company must:

- Pay employee entitlements; and
- Lodge tax returns and notices.

The director must:

- Keep records both of decision and ensure financial records kept;
- Comply with obligations to assist an administrator, liquidator or company controller;
- Comply with directors' duties;
- Comply with any continuous disclosure obligations

Safe Harbour Review

Independent review as soon as practicable after 19 September 2019 on impact of safe harbour:

- Conduct of directors;
- Interests of creditors and employees; and
- Any other matters.

Is failing to consider safe harbour a breach of directors' duties?

Anti- phoenixing Reforms



Credit: Anna Popovic
@and_her_eyes_were_wild

Treasury Laws Amendment (Combatting Illegal Phoenixing) Bill 2019

Schedules:

1. Creditor-defeating dispositions.
2. Accountability of directors.
3. Liability of directors for company GST liability.
4. Allows Tax Commissioner to retain tax refunds.

Creditor Defeating Disposition s588FDB

- Disposal of company property
- for less than:
 - market value; or
 - the best price reasonably obtainable for the property, (whichever is the lesser);
- that has the effect of preventing, hindering or delaying the property becoming available to satisfy the company's liability to creditors in the winding up.

Voidable Creditor Defeating Disposition

A creditor defeating disposition made:

- while the company is insolvent and less than 12 months before the relation-back day, or
- causing the company to become insolvent and less than 12 months before the relation-back day, or
- where the company enters external administration within the following 12 months as a direct or indirect result of the CDD.

Note: There is a presumption of insolvency where the company failed to keep or maintain financial records.

Defences/ Exception to Recovery Action

A creditor defeating disposition will not be voidable where:

- it is made by a liquidator, pursuant to a DOCA, or otherwise authorised by law.
- the party to the CDD transaction was a bona fide purchaser for value without reasonable grounds to suspect insolvency.
- the property was subsequently acquired by a third party in good faith and without reasonable grounds to suspect insolvency.
- it is made as part of a genuine attempt to turn around the affairs of the company – ie safe harbour.

ASIC Power to Make Orders

- ASIC may make orders with respect to voidable CDDs on the application of a liquidator or on its own initiative.
- ASIC must consider the same factors as would a court, including the defences in 588FG if applicable.
- It is an offence not to comply with an order made by ASIC.
- A person affected by an order has 60 days to seek judicial review.

Offence of Causing a Creditor Defeating Disposition

- An officer;
- engages in conduct which causes a company to make a CDD;
- in any of the following circumstances:
 - when the company is insolvent;
 - which causes the company to become insolvent; or
 - less than 12 months before the relation-back day or the company ceases to carry on business as a direct or indirect result of the disposition; and
- the officer knows or a reasonable person in the officer's position would know that the disposition was a CDD;* or
- the officer was reckless to the fact:
 - that the company was making a CDD; and
 - that the company was insolvent or that the CDD would cause the company to become insolvent, enter external administration or cease to carry on business.**

* civil penalty

** criminal

Offence of Procuring a Creditor Defeating Disposition

- A person;
- engages in conduct which procures, incites, induces or encourages a company to make a CDD;
- in any of the following circumstances:
 - when the company is insolvent;
 - which causes the company to become insolvent; or
 - less than 12 months before the relation-back day or the company ceases to carry on business as a direct or indirect result of the disposition; and
- the person knows or a reasonable person in the person's position would know that the disposition was a CDD;* or
- the person was reckless to the fact:
 - that the company was making a CDD; and
 - that the company was insolvent or that the CDD would cause the company to become insolvent, enter external administration or cease to carry on business.**

* civil penalty

** criminal

Defences/ Exception

Existing defences under s 588H:

- the defendant had a **reasonable expectation** that the company was **solvent**;
- the defendant took **all reasonable steps to prevent** the CDD;
- because of illness or other good reason, the defendant, being a director, did not **take part in the management of the company's affairs**.

and s 588GA exception:

- the defendant reasonably expected that the disposition was likely to lead to a better outcome for the company (**safe harbour**).

Summary of CDD Reforms

- A creditor defeating disposition is a transfer of company property for less than market value or the best price reasonably obtainable for the property.
- A creditor defeating disposition may be declared void by ASIC or the court if it is made while the company is insolvent, causes the company to become insolvent, or made 12 months before the company ceases to operate due to the disposition.
- It is a civil penalty provision and offence to cause or procure a company to make a creditor defeating disposition. Whether the conduct is civil or criminal depends on the individual's state of mind.
- A person who contravenes a civil penalty or offence provision is liable to compensate the creditors.

Case Study

1. Company A supplies concrete and building materials. The company comes under financial stress and the directors engage a turnaround advisor (TA).
2. On the advice of the advisor, the directors sell Company A's building materials business to Company B for \$450,000, 90% of the then-market price.
3. Unbeknownst to the directors of Company A, TA is the primary shareholder of Company B.
4. Company A carries on its concrete business for six months while insolvent. The company honours its obligations to its employees and the ATO.

Will the CDD reforms be effective?

- Duplicates existing provisions and remedies.
- Unnecessarily complex and confusing.
- Possibility of circumventing the CDD provisions.
- Difficulties in proving external administration/closing of business caused by CDD.
- Does ASIC have adequate funding to fulfil its functions?

Conclusion

- Directors' duties in insolvency are demanding, and the consequences of non-compliance are more serious than ever.
- Directors can now take advantage of the safe harbour exception to avoid liability for insolvent trading, but it applies in only limited circumstances.
- The CDD provisions, if enacted, will add another layer of complexity.

Questions?

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