



1.0 INTRODUCTION

Many people who accept an appointment as a company director or secretary are completely unaware of the potential risks they face from personal liability, civil penalty or criminal conviction. These risks arise primarily from failing to comply with statutory duties contained within the Corporations Act 2001 ("the Act") that largely mirror those duties which have been enshrined in the Common Law. In addition to those duties, there are a plethora of obligations imposed upon directors by other state and federal legislation such as taxation laws, employment standards, work health and

safety regulations, environmental protection measures, consumer protection strategies, Australian Stock Exchange listing rules for publicly listed companies and privacy protocols.

In short, a person acting as a director should take his or her duties seriously. This is especially true in times of financial difficulty. This newsletter will concentrate on the duties of directors, other officers and in some cases employees as set out in the Act and the potential liability for breaching those duties.

Duty	Relevant Information
Care & Diligence Section 180(1)	An officer of a company must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would in the same circumstances.
Defence Section 180(2)	Business Judgement Rule - A person who makes a "business judgment" does not breach their duty, if they: <ul style="list-style-type: none"> (i) make the judgment in good faith for a proper purpose; and (ii) do not have a material personal interest in the subject matter of the judgment; and (iii) make an informed decision; and (iv) rationally believe that the judgment is in the best interests of the corporation.
Good Faith Section 181	An officer of a company must exercise their powers and discharge their duties in good faith in the best interests of the company and for a proper purpose.
Use of Position Section 182	A person who is an officer or employee of a company must not improperly use their position to: <ul style="list-style-type: none"> (i) gain an advantage for themselves or someone else; or (ii) cause detriment to the company
Use of Information Section 183	A person who obtains information because they are, or have been, an officer of a company or an employee must not improperly use that information to: <ul style="list-style-type: none"> (i) gain an advantage for themselves or someone else; or (ii) cause detriment to the company.

2.0 WHO HAS A DUTY TO COMPLY?

It is important to consider the persons who are obligated to comply with their statutory duties. Section 9 of the Act defines "officer" to include a director, secretary or any person who acts in the position of a director, regardless of the name that is given to their position. A person who acts in the position of a director is often referred to as a "shadow-director". It is worth noting that external administrators are similarly subject to the same duties as officers.

3.0 DIRECTORS DUTIES

3.1 General Duties – Civil Obligations

Set out in the table on page 1 are the duties of company officers which if contravened, give rise to civil obligations.

If a person does not meet these requirements, and the Court is satisfied that the person has contravened one of the sections, then the Court can make a declaration of contravention pursuant to section 1317E of the Act, and:

- (i) impose a fine of up to \$200,000 (section 1317G of the Act); and
- (ii) disqualify a director from managing companies (section 206C of the Act).

The Courts are also able to impose other remedies for breach of duty. Section 598(2) of the Act provides that where the Court is satisfied that a person is guilty of fraud, negligence, default, breach of trust, or breach of duty and the company has suffered or is likely to suffer loss or damage as a result, then the Court may, on the application of either the Australian Securities and Investments Commission ("ASIC"), an Administrator, a Liquidator or a person nominated by ASIC, make an order pursuant to section 598(4) of the Act directing that person:

- (a) to pay money or transfer property to the company; and
- (b) to pay to the company the amount of the loss or damage.

3.2 General Duties – Criminal Offences

Section 184 of the Act effectively states that an offence is committed if a person recklessly or dishonestly breaches sections 181, 182 or 183 of the Act. Persons who commit these offences may be criminally liable and be fined amounts

up to \$220,000 and/or be imprisoned for up to five years.

3.3 Insolvent Trading

Section 588G(1) of the Act imposes a duty on directors to prevent their companies from trading whilst insolvent. This section applies if a person was a director of a company at the time when the company incurs the debt and is insolvent at that time or becomes insolvent as result of that transaction and the director had reasonable grounds to suspect the company was insolvent or would become insolvent as a result of entering that transaction.

Breaching this duty can result in ASIC seeking from the Court a declaration of contravention against a director and the imposition of a civil penalty pursuant to sections 1317E and 1317G of the Act. In addition and on an application for a civil penalty order, the Court has the power pursuant to section 588J of the Act to make orders:

- (i) disqualifying a person from managing companies (section 206C of the Act); and
- (ii) requiring a person to pay to the company compensation equal to the loss or damage suffered by the company.

A breach of this duty is a criminal offence pursuant to section 588G(3) of the Act if the failure to prevent the company from incurring the debt was dishonest. Furthermore and in the event of liquidation, if a director has breached this section, then pursuant to section 588M(2) of the Act, the company's liquidator may recover from the director, as a debt due to the company, an amount equal to the loss or damage suffered by the company. Alternatively, a creditor of the company, may with the consent of the liquidator, begin proceedings pursuant to section 588M(3) of the Act to recover from a director as a debt due to the creditor, an amount equal to the loss and damage suffered by the creditor directors who are the subject of claims in relation to insolvent trading may be able to avail themselves of the defences which are set out in section 588H of the Act.

3.4 Maintenance of Proper Books & Records

Section 286(1) of the Act imposes an obligation on company directors to maintain adequate books and records that;

- (i) correctly record and explain its transactions and financial position and performance;
- (ii) enable true and fair financial statements to be prepared and audited.

¹ <http://asic.gov.au/for-business/running-a-company/company-officeholder-duties/what-books-and-records-should-my-company-keep/>

WHY WOULD ANYONE WANT TO BE A DIRECTOR? A GUIDE TO DIRECTOR'S DUTIES

This obligation extends to transactions undertaken by a company as a trustee¹.

Section 286(2) requires that the books and records of the Company be maintained for a period of seven years. Pursuant to sections 344 and 1317E of the Act, the penalties for breaching these duties may include:

- (a) the imposition of a fine of up to \$200,000 (section 1317G of the Act);
- (b) disqualification from managing companies (section 206C of the Act).

Section 588E(4) of the Act provides that where a company is being wound up, and in circumstances where that company has failed to maintain proper records or retain them for the requisite period, then the company will be presumed to be insolvent for the period for which the records are not available. This can give rise to serious consequences where it is being alleged that a director has allowed a company to trade whilst insolvent.

3.5 Trust Liabilities

Corporate trustees are very common. Pursuant to section 197 of the Act, where a company is acting as or purporting to act as trustee and incurs a liability which it cannot meet, a director of that company can be held liable to discharge the whole or part of the liability if the company is not entitled to be fully indemnified against the liability out of trust assets because of one or more of the following:

- (i) the company has breached its trust;
- (ii) the company was acting outside the scope of its powers as trustee;
- (iii) a term of the trust denying, or limiting, the company's rights to be indemnified against the liability.

3.6 General Requirements

In addition to the foregoing, the Act requires directors to:

- (i) update the company database maintained by ASIC as required to ensure its accuracy in accordance with sections 142, 146, 168, 205B, and 205D of the Act.
- (ii) comply with all reasonable requirements and provide proper assistance to validly appointed external administrators pursuant to sections 475 and 530A of the Act.
- (iii) refrain from acting as a director of a company,

whether formally appointed or not, if excluded from doing so pursuant to sections 206B and 206C of the Act. This most relevantly excludes bankrupts or anyone who has entered into a personal insolvency agreement under Part X of the Bankruptcy Act 1966.

- (iv) disclose to other directors of their companies any potential material conflicts of interests that they might have in relation to the conduct of their duties as director in accordance with sections 191 – 195 of the Act.

4.0 EXTERNAL ADMINISTRATORS' OBLIGATION TO REPORT TO ASIC

A liquidator, in carrying out an investigation into the affairs of a company and the conduct of its principles, has a statutory duty pursuant to section 533 of the Act to file a report with ASIC if the expected dividend is less than 50 cents in the dollar, setting out any identified potential offences or breaches of duty committed by officers, employees or shareholders of a Company. At its discretion, ASIC may require the liquidator to submit a supplementary report particularising the alleged offences or breaches of duty, and may also provide funding for that purpose. Similar provisions apply to a voluntary administrator or receiver if appointed.

5.0 CONCLUSION

If company officers and employees adopt ethical and prudent business practices, then they are unlikely to breach their statutory duties. ASIC has issued an explanatory memorandum as to the general duties of directors and other officers, those duties being summarised above. In the summary², ASIC advises that company officers can greatly reduce their exposure by having appropriate insurance, and if they carry out their duties by;

- (i) being honest and careful in their dealings.
- (ii) remaining active and involved in the company's operations.
- (iii) making sure that their companies can pay their debts on time.
- (iv) maintaining proper financial records.
- (v) acting in the best interests of their companies.

As always, directors should take appropriate professional advice from their accountants, solicitors and advisors if they are in any doubt as to their duties, or as to the consequences of potential breaches.

² <http://asic.gov.au/for-business/running-a-company/company-officeholder-duties/your-company-and-the-law/>



OUR SERVICES

Corporate Insolvency

- Voluntary Administration
- Deeds of Company Arrangement
- Receiverships
- Court Liquidation
- Members' Voluntary Liquidations
- Creditors' Voluntary Liquidations
- Provisional Liquidations
- Official Liquidations

Personal Insolvency

- Bankruptcy
- Part X Personal Insolvency
- Agreements
- Trustee appointments pursuant to Section 66G of the Conveyancing Act
- Part XI Deceased Estate Administration

Other Services

- Business Recovery
- Business Viability Reviews
- Prelending/Refinancing Reviews
- Security Reviews
- Management Reporting
- Cash-Flow Management
- Turnaround and Growth Strategies

Without obligation or cost, we are available for an initial consultation. Please contact:

Chris Palmer	cpalmer@obp.com.au
Liam Bailey	lbailey@obp.com.au
Andrew Cowled	acowled@obp.com.au
Sandra Ciganda	sciganda@obp.com.au
Craig Tinkler	ctinkler@obp.com.au



INSOLVENCY & BUSINESS ADVISORY

SYDNEY

Level 14, 9 Hunter Street, Sydney NSW 2000 | GPO Box 3385, Sydney NSW 2001
Telephone +61 2 9232 3322 | **Facsimile** +61 2 9232 3388

BATHURST

103 Piper Street, Bathurst NSW 2795 | PO Box 2153, Bathurst NSW 2795
Telephone +61 2 6338 2650 | **Facsimile** +61 2 9232 3388

This information memorandum is of necessity general in nature and its brevity could lead to misinterpretation and misunderstanding. No responsibility can be accepted for those who act on its contents without first consulting us and obtaining specific advice.

Copyright © 2015 O'Brien Palmer

Liability limited by a scheme approved under Professional Standards Legislation.