

## A Lesson Learnt, or is it yet to be Learned?

By Schon G Condon RFD

A little over a week ago, I received notification from the Senate that the Senate Inquiry into the Insolvency industry would be delaying the publishing of their report due to the fact that the Federal Parliament had been paroured for the calling of the General Election. The proposed new date was to be the middle of September. Given the now known result of last month it will be interesting to see if there is any further change. I do hope it is not rushed.

Well the election result has left many amazed, but whilst it was not openly backed, the result was in many ways predictable. There has become an almost automation to the process that in essence two substantial opponents revolve around a cycle of head butting and promises ultimately seeking the authority to control the process for a following term. The differences between the players have over time become blurred and the general populace appears to have waned from the consistent onslaught of NDP's. (Non Deliverable Promises)

Minority governments are a very common occurrence throughout Europe and in some countries it is almost the norm. It is likely to provide a genuine opportunity for those that govern to actually focus centrally, and as a unified group on the core issues that confront the country. As has begun to come out a little more in recent times, there is an increasing fear that the worst of the GFC may not yet be over, and as one pundit put it that there will be no "stimulus funds" available to prop it up the next time. One thing is for sure that to successfully conquer such obstacles a unified approach is required. Consequently Australia may well have elected exactly the Parliament it needs to deal with the crisis ahead; one that may actually deal with it rather than merely blaming the other side on the basis that the circumstances are actually their fault.

So what is the relevance to our Inquiry, with so much political turbulence at the moment and a media environment that seems to focuses on daily (or even hourly<sup>1</sup>) headlines there

is every chance that a document that could have a genuine impact on our industry could get washed away in the flood of party political turmoil.

How we approach this now could well have very short term consequences if those that predict a second serve of GFC are correct. If the Insolvency industry approaches such an issue with a modern perspective then it will be about preserving value not destroying it.

One thing is for sure we live in interesting times. What we must focus on is that we all learn from the experiences as we go and adapt to the ever changing environment, not just the natural, but also financially, politically and internationally.

Alas, there are some though that already believe they know the answers because they have been trained!! Let us hope that those who are in control have the capacity to do so with open eyes and an intent on preservation and growth rather than historical process.

## Sponsorship

Legacy Week is upon us. Legacy is an organisation devoted to the "welfare of the widows, children and dependants of deceased Australian defence force personnel" (*Legacy Promotional Material 2010*). Between the 29th of August and the 4th of September 2010, you can help support Legacy by purchasing badges, camouflage bands, pens, or by simply donating money. Condon Associates are proud supporters of Legacy Week, and will be wearing our badges and bands all week!

### Inside this issue:

- ASIC Guidelines to Directors Duties
- Personal Guarantees and Director's Exposure
- Important Changes to Director Penalty Notices

<sup>1</sup> How long was the death of Farrah Fawcett's news again?



# ASIC Guidelines to Directors Duties

By Maggie Lau

Directors of companies are the brains of the organisations. They determine how their companies are run and control the direction of the companies. Attached to the domineering powers that Directors enjoy are onerous duties, one of which is the duty to prevent insolvent trading.

The idea behind setting up a company is so that the business has its own separate legal entity and shareholders and the Directors of the Company are not held personally liable for liabilities of the company. However, Section 588G of the Corporations Act 2001 provides an avenue for Creditors to pierce this corporate veil and pursue the Director of an insolvent company personally if it can be proven that the Director has traded the company whilst insolvent.

Section 588G of the Corporations Act 2001 (Cth) provides that a company Director may be liable to civil liability and/or criminal penalty if:

- they are a Director of a company at the time when the company incurs a debt;
- the company is insolvent at that time, or becomes insolvent by incurring that debt; and
- at that time, there are reasonable grounds for suspecting that the company is insolvent, or would become insolvent.

Directors who breach insolvent trading laws can face pecuniary penalties of up to \$200,000, plus disqualifications from acting as a Director or managing a company, and/or an order requiring the payment of compensation.

Where a Director intended to defraud Creditors, a Director can be liable to a maximum penalty of \$220,000 or five years imprisonment, or both on top of any civil penalties.

According to statistics portrayed on the Australian Securities and Investments Commission's ("ASIC") website, it is evident that the recent economic downturn has attributed to a significant rise in the number of corporate collapses. It is believed that Directors, and particularly Directors of small to medium size enterprises, do not fully understand their duty to prevent insolvent trading.

Whilst there are defences provided in Section 588H (2)-(6) of the Act which may be used by a Director accused of trading whilst insolvent, such defences are often costly and/or difficult for a Director to prove in legal proceedings. Things can be much simpler if precautionary steps are taken.

On 29 July 2010, ASIC released "Regulatory Guide 217 Duty to prevent insolvent trading: Guide for Directors". The Regulatory Guide seeks to provide guidance to Directors to understand, comply with, and minimise the risk of breaching their duty to prevent insolvent trading which is imposed by section 588G of the Act.

ASIC Commissioner Michael Dwyer said, "It is important that directors focus on their obligations to prevent insolvent trading and we expect this guidance will assist Directors of small to medium enterprises, in particular, to fulfil this fundamental responsibility."

There are four principles which ASIC considers Directors, in particular Directors of companies under strain, should follow when seeking to meet their duty to prevent insolvent trading. Although not legally binding on Directors, the objective of the principles is to make Directors aware that they need to remain properly and fully informed about the financial affairs of the company at all times so they can reasonably form a view about the company's present financial viability and the impact of incurring any further debts.

The four principles as discussed in the Regulatory Guide are as follows:-

Key Principle	Explanation
<b>Directors should keep themselves informed about the company's financial affairs and regularly assess the company's solvency.</b>	This involves:- <ul style="list-style-type: none"><li>• Ensuring that the company maintains proper financial records and prepares relevant financial information.</li><li>• Making all reasonable inquiries to enable them to have an understanding of the financial position and cash flow requirements of the company at all times.</li><li>• Relying solely on financial statements at the end of each financial year is not sufficient.</li><li>• Where a Director is not involved directly in overseeing the company's day-to-day activities, they should ensure that appropriate systems are in place, that they make adequate inquiries to keep informed about the financial position and affairs of the company, and that it is appropriate to rely on the information and advice provided to them.</li></ul>
<b>Directors should investigate financial difficulties immediately once they identify concerns about the company's financial viability.</b>	This involves:- <ul style="list-style-type: none"><li>• Confirming the company's financial position and realistically assess the options available to deal with the company's financial difficulties so the company can meet its obligations.</li><li>• Ensuring that systems are in place to carefully consider the company's solvency before the company incurs each new debt.</li></ul>

Key Principle	Explanation
<p>Directors should obtain appropriate professional advice to help address the company's financial difficulties.</p>	<p>This involves:-</p> <ul style="list-style-type: none"> <li>• Obtaining appropriate advice from a suitably qualified, competent and reliable person about the financial position of the company and how the financial difficulties can be addressed.</li> <li>• A Director is only able to rely on advice where the adviser is given full, complete, accurate and up-to-date instructions by, or on behalf of, the Director to enable the adviser to properly and adequately provide competent advice.</li> <li>• A Director may obtain appropriate professional advice from a number of sources, including an appropriately experienced accountant, lawyer or other person whose business involves advising Directors and companies about solvency issues and the options available for dealing with financial difficulties.</li> </ul>
<p>Directors should consider and act appropriately on the advice received and in a timely manner.</p>	<p>This involves:-</p> <ul style="list-style-type: none"> <li>• If the company is at risk of becoming insolvent in the near future, the Director should take immediate steps. This may include obtaining further advice and preventing the company from incurring further debts.</li> <li>• The Director should continue to monitor the financial position of the company closely and be prepared to take further action as soon as they suspect the company's ability to meet its debts as they fall due is deteriorating.</li> <li>• If the Director knows, or has reasonable grounds to suspect, that the company is insolvent, they should take all reasonable steps to prevent incurring further debts. These steps must be clear, positive and unequivocal.</li> </ul>

By following the key principles, Directors are more likely to be able to demonstrate that they took reasonable steps to comply with their duty. However, following these four principles does not provide the Director of a collapsed company immunity from further prosecution.

Commissioner Dwyer said that the Regulatory Guide "in no way affects any action that may be taken by Creditors or a Liquidator against Directors who may have traded whilst insolvent. The Courts ultimately determine whether a Director has breached their duty to prevent the company from incurring debts when insolvent..."

Nonetheless, the Regulatory Guide will be a valuable guidance for the less than informed Directors regarding their duty to prevent insolvent trading.

## Personal Guarantees and Director's Exposure

By Bruce Huynh

A Personal Guarantee is a legally binding agreement between a third party and a Creditor, whereby the guarantor is required to settle obligations of the Debtor toward the Creditor.

Personal guarantees are usually entered into by the Director(s) of a Company agreeing to meet a debt owed by the Company to the Creditor when the Company is unable to meet its obligations.

A guarantee is usually entered into when a Company requires a credit facility or lease agreements by financial institutions or providers. The guarantee section is most commonly contained in the terms and conditions of the facility sought, however on some occasions a separate individual document in relation to a personal guarantee may be provided.

The personal guarantee is a separate agreement between the Director and the Creditor. Therefore the Company does not have to be in Liquidation, or even insolvent, for the Creditor to pursue the Director.

If the Company goes into Liquidation this means that the Company has/will default and the Personal Guarantee can be exercised. It is further noted that the Creditor is not obliged to await the outcome of the Liquidation; they can pursue the debt immediately, regardless of any proposed distribution from the Liquidation.

In the case whereby the Company is placed into Voluntary Administration, the Creditor cannot exercise or seek to enforce the personal guarantee whilst the Company remains in Voluntary Administration. After the Voluntary Administration is terminated, the Creditor may seek to pursue the Director(s) to meet any obligations the Company failed to satisfy.

If the Director is able to satisfy all the debt owed to the Creditor in relation to the guarantee, "subrogation" takes place, whereby the Director can assume any legal rights the Creditor may have had in respect of a particular claim over the Company. Therefore, the Director will be eligible to submit a Proof of Debt in relation to the debt they have paid out.

## Important Changes to Director Penalty Notices

By Hiteshi Dekhtawala

Director Penalty Notices ("DPN") have undergone some significant changes with effect from 1 July 2010.

The DPN regime will be familiar to many. Just briefly, a Director of a Company that has a tax debt to the Australian Taxation Office ("ATO") for unremitted PAYG withholdings may be served with a DPN. The aim of a DPN is to enforce a personal liability on the Directors for the unremitted PAYG Withholdings.

In order to understand the recent changes, they will be discussed with further commentary as to how the DPN provisions formerly were administered prior to the new regime coming into effect.

- The most significant amendment is the amount of time in which a Director has to comply with a DPN. The Director is now granted 21 days to attend to the DPN, and the 21 days commences from the time when the notice is posted by the ATO. Under the old regime a Director had 14 days to comply, however the 14 days did not commence until such time as it was deemed to be received by the Director.
- Under the old regime a DPN allowed the recipient to comply with the Notice in four different ways. These were by either paying the tax debt in full, entering into an instalment arrangement or by appointing a Voluntary Administrator or a Liquidator before the 14 days expired.

In accordance with the new regime, the option to enter into an instalment repayment arrangement to comply with a DPN and avoid personal liability has been removed. Now, if a Director who has been issued with a DPN enters into an instalment agreement he or she will simply delay the ATO from commencing the recovery proceedings.

As noted above, the Director has 21 days to comply with the notice.

In light of the amendments, if Directors are to seek to avoid a personal liability for the Company's unremitted PAYG withholding obligations, they may now only have 3 options within the 21 day notice period, i.e. either pay the full amount outstanding to the Commissioner or appoint a Voluntary Administrator or Liquidator to the Company.

Whilst a Director will not escape personal liability if a repayment arrangement is entered into, the amendments provide that if a

repayment arrangement is entered into during the 21 day period and the arrangement is strictly complied with, the Commissioner of Taxation will be precluded from taking enforcement action against the Director whilst that payment arrangement is adhered to.

- Under the new provisions, the ability for a Director to rely on the defence to the DPN that they did not take part in the management of the Company because of "illness or other good reason" has become more difficult as there is now a greater onus of proof on the person seeking to rely upon this defence.

The Director must establish that he or she was ill, or that there was a good reason why he or she did not participate in the management of the Company while the relevant tax liability fell due. In addition, the regime requires the Director to also establish that it would have been unreasonable to expect the Director to have taken part in the management of the Company at that time.

Given the possibility of a vast personal obligation which could be imposed on the Director for failing to comply with a DPN, it is imperative that advice is sought as soon as possible so that appropriate actions may be taken to mitigate the possible personal liability.

## Joke Corner

A man heard a knock at the door; he answered it only to be confronted by a well-dressed young man carrying a vacuum cleaner.

"Good Morning," said the young man. "If I could take a couple of minutes of your time, I would like to demonstrate the very latest in high-powered vacuum cleaners".

"Go away! I haven't got any money! I'm broke!" and proceeded to close the door. Quick as a flash, the young man wedged his foot in the door and pushed wide open...

"Don't be too hasty!" he said. "Not until you have at least seen my demonstration." And with that, he emptied a bucket of horse manure onto the hallway carpet. "If this vacuum cleaner does not remove all traces of this horse manure from your carpet, I will personally eat the remainder."

The householder stepped back and said, "Well I hope you've got a good appetite, because they cut off my electricity this morning...What part of 'broke' don't you understand?"

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