
Insolvent trading defences after Hall v Poolman

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The decision in Hall v Poolman (2007) 215 FLR 243; 65 ACSR 123 examined liability for decisions made by experienced businesspeople years earlier in times of financial hardship. Palmer J exercised his discretion under s 1318 to relieve the director from liability for insolvent trading. However, he narrowed the review of "all the circumstances" to whether the action was commercially reasonable. Directors must be able to make decisions, which inevitably involve some degree of commercial risk, if the economy is to be advanced. The currently available defences to the duty to prevent insolvent trading in ss 588H and 1318 are both underutilised and rarely successful. A more general defence should be introduced to allow directors greater flexibility in attempting informal work-outs of distressed companies.

THE DUTY TO PREVENT INSOLVENT TRADING

Section 588G of the *Corporations Act 2001* (Cth) (the Act) imposes a positive duty upon directors to ensure that their company does not trade while it is insolvent. This duty to prevent insolvent trading contains four distinct elements.

- First, the duty applies only to a person who was a director at the time when the company incurred a debt.¹
- Secondly, the company must have been insolvent at that time, or became insolvent by incurring that debt, or by incurring at that time debts including that debt.²
- Thirdly, at that time there were reasonable grounds for suspecting that the company was insolvent, or would so become insolvent, as the case may be.³
- Fourthly, the director must be aware at the time that there are such grounds for suspecting insolvency or a reasonable person in a like position in a company in the company's circumstances would be so aware.⁴

In the wake of the global financial crisis, directors and executives have to meet numerous challenges which were not present when the insolvent trading provisions were last the subject of debate including:

- the difficulty in forecasting earnings and the need for stress testing in wildly fluctuating conditions;
- the difficulty in ascertaining the market value of assets where the market has not been tested or is non-existent;
- the difficulty in valuing contingent and other long-term liability;
- the complexity of financial arrangements and covenants and hedging, reserve and other provisions; and
- the fact that the above difficulties make it almost impossible to draw any clear dividing line between a temporal lack of liquidity and insolvency.

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Editor's comment: The subject matter of this article relates to very important proposed developments in the law linked to the statutory business judgment rule. For an interesting review of the business judgment rule and its application in *Australian Securities and Investments Commission v Rich* [2009] NSWSC 1229, see Lumsden A, "The Business Judgment Defence: Insights from ASIC v Rich" (2010) 28 C&SLJ 164.

¹ *Corporations Act 2001* (Cth), s 588G(1)(a).

² *Corporations Act 2001* (Cth), s 588G(1)(b).

³ *Corporations Act 2001* (Cth), s 588G(1)(c).

⁴ *Corporations Act 2001* (Cth), s 588G(2).



In these conditions, it is important to ensure that appropriate defences are available to directors where the company is unable to maintain solvency while a work-out is attempted or where they continue to operate with the reasonable belief that they can trade out of financial difficulty.

On 19 January 2010, the Minister for Financial Services, Superannuation and Corporate Law announced the release of a discussion paper on the operation of Australia's insolvent trading laws in the context of attempts at business rescue outside of external administration.⁵ It is important to note that there are defences available currently in the *Corporations Act* to allegations of insolvent trading. These, together with the power of the court to grant relief from liability, might suggest that there is already enough "protection" in the law in this context. This article outlines the scope and application of these defences in s 588H and highlights key inadequacies for dealing with situations where directors honestly try to restructure and trade out of financial difficulties.

It has been argued that s 1318 should give some comfort to directors. In *Hall v Poolman* (2007) 215 FLR 243; 65 ACSR 123, Palmer J recognised that decisions made by active and diligent directors, at times when companies face financial difficulties, need to be carefully evaluated and not seen in a negative light when companies fail. In this case he exercised his discretion to relieve a breach of duty on the part of the director under s 1318 of the *Corporations Act*. However, his reformulation of s 1318 as a defence of honest entrepreneurialism potentially takes that provision too far and ignores other relevant factors in determining whether the defendant ought fairly to be excused.

An examination of s 588H and *Hall v Poolman* is now highly relevant, given the release of that discussion paper and the deficiencies in the present insolvent trading regime.

REORGANISATION ATTEMPTS OUTSIDE OF EXTERNAL ADMINISTRATION

Directors trying to rescue companies that are close to insolvency have, to date, effectively faced a position where their options have all been negative:

- placing the company into liquidation or into some form of external administration; or
- resigning their position if they do not want to expose themselves to potential personal liability for debts; and
- prosecution by ASIC.⁶

A review of insolvent trading legislation in a number of other common law jurisdictions add credence to Chief Justice Martin's view that:

The laws of Australia which expose directors to personal liability in the event that a company trades while insolvent are arguably the strictest in the world.⁷

In the United Kingdom there are two civil liability provisions under the *Insolvency Act 1986* (UK):

- fraudulent trading, where a director is knowingly a party to operating the company for the purpose of defrauding creditors;⁸ and
- wrongful trading, which allows the court to order that the director make contribution to the assets of a company in liquidation.⁹

Wrongful trading is triggered when a director "knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation".¹⁰ The United

⁵ Treasury, *Insolvent Trading: A Safe Harbour for Reorganisation Attempts Outside of External Administration* (19 January 2010).

⁶ Baxt R, "Insolvency Law Reform and the Business Judgment Rule: Some Mixed Messages from the Government" in "Directors' Duties and Corporate Governance" (2010) 28 C&SLJ 147 at 147.

⁷ Martin W, CJ, "Official Opening Address", 2009 IPA Conference, 28 May 2009.

⁸ *Insolvency Act 1986* (UK), s 213.

⁹ *Insolvency Act 1986* (UK), s 214.

¹⁰ *Insolvency Act 1986* (UK), s 214(2).



Kingdom provision focuses on a lack of reasonable prospects of saving the company from liquidation, in contrast to the Australian provision which imposes liability even where incurring debt was done in an attempt to save the business.¹¹

In New Zealand, the *Companies Act 1993* (NZ) provides a reckless trading prohibition to prevent the business trading in a manner likely to create a substantial risk of serious loss to the company's creditors.¹² However, it has been interpreted so as to draw a distinction between legitimate and illegitimate business-taking risks.¹³ This distinction is based on whether the company had any prospects of continuing to trade profitably in accordance with ordinary commercial practice.¹⁴ Both the United States and Canada lack statutory insolvent or reckless trading provisions and there is doubt that deepening insolvency is a stand-alone cause of action.¹⁵

Germany is the only other major jurisdiction imposing a similar liability to those in Australia. It traditionally had a strict insolvent trading prohibition for circumstances where a company becomes "over-indebted" (on a balance sheet assessment) or subject to illiquidity (defined as insufficient cash to pay debts that are already due).¹⁶ However, in late 2008, in response to the global financial crisis, these provisions were suspended to provide that over-indebtedness will not be shown where the continuation on the company's business is predominately likely.¹⁷

The current Australian insolvent trading laws lack this flexibility and nuance. Once the operation of the law is triggered and a director is unable to form a positive expectation that the company is solvent, the director must cease incurring debts, with the likely result that administrators will be appointed. This is even though professional advice suggests it may be in the best interest of the creditors that the company explore an informal work-out or restructuring.

There are many recent examples of directors citing the insolvent trading laws as a reason for the appointment of administrators where a restructuring or informal work-out was possible. One example is the Henry Walker Eltin group, where directors, citing concerns regarding insolvent trading liability, placed the company into administration.¹⁸ Ultimately, all creditors were paid 100 cents in the dollar but the shareholders experienced the destruction of the value of the business.

Voluntary administration can be seen as providing a "safe harbour" from insolvent trading liability. The directors can appoint an independent and suitably qualified person to take control of the company.¹⁹ They can do this speedily and without reference to the courts, shareholders or creditors and, practically speaking, the directors' usual incentive is to avoid personal liability for insolvent trading.²⁰ Section 588H(5) and (6) provides that in the event of a breach of s 588G (insolvent trading), it is a defence if the director in question has taken "reasonable steps" to prevent the company from incurring debts. Steps taken with a view to installing an administrator will be considered as evidence

¹¹ Harris J, "Directors' Liability for Insolvent Trading: Is the Cure Worse Than the Disease?" (2009) 23 AJCL 266 at 277-278.

¹² *Companies Act 1993* (NZ), s 135.

¹³ *Lower v Traveller* [2005] 3 NZLR 479.

¹⁴ *Re South Pacific Shipping Ltd (in liq)* (2004) 9 NZCLC 263 at 570.

¹⁵ *Re SI Restructuring Inc* 532 F 3d 355 (2008); *Trenwick America Litigation Trust v Ernst & Young LLP* 906 A 2d 168 (2006); *Re Propex Inc* 2009 WL 562595 (2009); McDonald H, Fishman T and Martin L, "Lafferty's Orphan: The Abandonment of Deepening Insolvency" (2007) ABIJ 1; Girgis J, "Deepening Insolvency in Canada?" (2008) 53 McGill LJ 167.

¹⁶ *Insolvenzordnung (German Insolvency Act)*, ss 17-19.

¹⁷ *Gesetz zur Umsetzung eines Maßnahmenpakets zur Stabilisierung des Finanzmarktes (Act for the Implementation of Measures to Stabilise the Financial Market) (Finanzmarktstabilisierungsgesetz (Financial Market Stabilisation Act))* of 17 October 2008, BGBl. I p 1982.

¹⁸ Law Council of Australia, Insolvency Practitioners Association of Australia, and Turnaround Management Association Australia, "Joint Submission in Relation to Insolvent Trading Safe Harbour Options" (2 March 2010) pp 7-8.

¹⁹ *Corporations Act 2001* (Cth), s 436A.

²⁰ D'Angelo N, "What Directors Need to Consider Before Calling in an Administrator – And It's Not Just Solvency..." (2006) 24 C&SLJ 7 at 12.



of these steps.²¹ This contrasts with informal work-outs which leave directors exposed because they will often be required to keep the company trading pending the development of a work-out plan, which raises the possible exposure of directors to liability for insolvent trading.

The administrator's function is to investigate, as soon as practicable, the company's business, property, affairs and financial circumstances and form an opinion whether it would be in the creditors' interests that:

- the company execute a deed of company arrangement; or
- the company be wound up; or
- the administration be ended.²²

If the administrator can negotiate a work-out, this is then put to a vote of the creditors in the form of a deed of company arrangement.²³

A key aspect of voluntary administration is that once the administrator is appointed, the powers of all officers of the company are suspended.²⁴ However, the directors are arguably in a better position to understand the company's business, property, affairs and financial circumstances than an external administrator or creditors. This removal of the directors in the current provisions, in contrast with the situation under Ch 11 in the United States where directors retain control of the company subject to close court supervision, seems to assume that for a company to become insolvent is indicative of the failure of management and is to be regarded as reprehensible.²⁵

The role of company directors in the context of insolvent trading provisions should be considered in line with entrepreneurialism and its encouragement, which has been the subject of a number of commentaries by judges over the last 15 years.²⁶ The comments made by Palmer J in *Hall v Poolman* as to how the court should assess directors' attempts to rescue companies in financial difficulties fit within this more general philosophy.²⁷ In *Ingot Capital Investments Pty Ltd v Macquarie Equity Capital Markets* (2007) 63 ACSR 1, McDougall J, after referring to a number of these earlier cases, noted (at 292) that, in dealing with questions of whether directors should be penalised because of certain circumstances, often judged by way of hindsight, it was necessary to

recognise that in some circumstances it may be appropriate for directors to "display entrepreneurial flair and accept commercial risks to produce a sufficient return on capital invested", and that the foreseeability of harm does not of itself dictate that the question must be answered adversely to the directors in this case. It is necessary to balance risk and reward.

This endorsement of entrepreneurialism had been espoused in earlier cases by Ipp J in *Vrisakis v Australian Securities Commission* (1993) 9 WAR 395 and Young CJ in *Edwards v Attorney-General (NSW)* (2004) 60 NSWLR 667. McDougall J in *Ingot Capital* was also willing to be generous in evaluating the duties of directors and noted (at 291):

In determining whether a director has exercised the necessary degree of care and skill, it is necessary to bear in mind that risk and benefit are often two sides of the same coin, or two possible consequences of the same course of conduct, and that risk and return are an integral part of industry and commerce.

While this quote was not directly related to a case involving a breach of a director's duty, McDougall J's message and his later warning of using hindsight too blindly, is a reminder of just how important it is to provide appropriate defences to directors.

²¹ See Hodgson G and McEvoy D, "Voluntary Administrations: Are They Really Working?" (1995) *Business Imperatives Series No 1* at 21; Hodgson G and McEvoy D, "Is the Voluntary Administration Process Open to Abuse?" (1996) 7 *Butterworths Company Law Bulletin* 4.

²² *Corporations Act 2001* (Cth), s 438A.

²³ *Corporations Act 2001* (Cth), s 439A.

²⁴ *Corporations Act 2001* (Cth), s 437C.

²⁵ Goode R, "Insolvent Trading Under English and Australian Law" (1998) 16 C&SLJ 170 at 175.

²⁶ Baxt R, "The Business Judgment Rule – Have We Reached at Safe and Sensible Landing" (2006) 2(4) *Baxt Report* 5.

²⁷ Baxt R, "'Encouraging' Entrepreneurialism: What Parts Do/Should the Courts Play" in "Company Law and Securities" (2008) 36 ABLR 62 at 64.



The current insolvent trading law, with its lack of appropriate defences, limits the options available to deal with financial distress. We need to ensure that companies are not placed into external administration prematurely or in circumstances where external administration is not appropriate, by directors who fear personal liability if the company engages in insolvent trading while attempting some sort of informal work-out or attempting to reasonably trade out of difficulties.

Another recently cited example is the General Motors restructuring in the United States. GM traded for many months while insolvent in order to enable the detailed and complex negotiations with unions, bondholders and the government to be completed.²⁸ A fully negotiated restructure plan was then presented to the Bankruptcy Court at the commencement of the formal process and adopted. Damage to the brand was minimised. In contrast, it is argued that had this occurred in Australia, the insolvent trading laws would probably have compelled the directors to appoint administrators many months earlier, at a time when there was no agreement with the government, bondholders or unions. Putting the company into external administration would have greatly harmed the GM name. This damage would have increased the amount of money needed from the government and greater concessions would have been required from unions and bondholders. This would have rendered any restructuring of the nature entered into in the United States increasingly unviable. In short, it is argued that a restructure of this type almost certainly could not have occurred in Australia under the current insolvent trading regime.²⁹

DEFENCES TO LIABILITY UNDER SECTION 588H

Even if a director breached s 588G there might be a defence for the director. Section 588H contains four defences. These are:

- reasonable grounds to expect solvency;
- reasonable reliance on information provided by others;
- absence from management; or
- taking reasonable steps to prevent incurring of debt.

Reasonable grounds to expect solvency

It is a defence if it is proven that, at the time the debt was incurred, the director had reasonable grounds to expect, and did expect, that the company was solvent and would remain solvent.³⁰

The director can point to facts that the director took into account. However, not all facts regarded by directors will be seen by a court as justifying an expectation of solvency. It is not appropriate to base an expectation of solvency upon the prospect that the company might trade profitably in the future, thereby restoring its financial position. The question is not whether the company might be able to pay its debts in the future if given time to trade profitably, but whether at the relevant time it is able to pay its debts as they become due.³¹ Reliance by directors on special trading terms allowed by a creditor to the company may be held to be misplaced. Nor will a creditor's perceived delay in enforcing a debt justify the required expectation.³²

Additional facts that the director ought reasonably to have known are made relevant by the expression "reasonable grounds".³³ Sleeping directors or directors who fail to take those steps to

²⁸ Law Council of Australia, Insolvency Practitioners Association of Australia, and Turnaround Management Association Australia, n 18, p 10.

²⁹ Law Council of Australia, Insolvency Practitioners Association of Australia, and Turnaround Management Association Australia, n 18, p 10.

³⁰ *Corporations Act 2001* (Cth), s 588H(2).

³¹ *Sheahan v Hertz Australia Pty Ltd* (1995) 16 ACSR 765 at 769; *Hall v Poolman* (2007) 215 FLR 243; 65 ACSR 123 at 181.

³² *Carrier Air Conditioning Pty Ltd v Kurda* (1993) 11 ACSR 247; *Lee Kong v Pilkington (Aust) Ltd* (1997) 25 ACSR 103.

³³ *Commonwealth Bank of Australia v Friedrich* (1991) 5 ACSR 115 at 128-130.



acquire information about the company's financial state that could be reasonably required of company directors in their position will have difficulty in proving s 588H(2).³⁴

An important point to note about this defence is that it requires reasonable grounds to expect solvency while a contravention of s 588G requires reasonable grounds to suspect insolvency. It is not enough that there are reasonable grounds for making a prediction of solvency;³⁵ it is necessary to prove a reasonable basis for a degree of confidence that it is likely to turn out that the company is solvent.³⁶ In *Tourprint International Pty Ltd v Bott* (1999) 32 ACSR 201, Austin J explained (at 215) that expectation of solvency meant

a higher degree of certainty than "mere hope or possibility" or "suspecting". The defence requires an actual expectation that the company was and would continue to be solvent, and that the grounds for so expecting are reasonable. A director cannot rely on a complete ignorance of or neglect of duty and cannot hide behind ignorance of the company's affairs which is of their own making or, if not entirely of their own making, has been contributed to by their own failure to make further necessary enquiries.

In *Hall v Poolman* (2007) 215 FLR 243; 65 ACSR 123 Palmer J considered the issue in the context of an argument that asset sales would need to have been effected to ensure the solvency of a company. His Honour held that, as a "broad general rule", a director would be justified in "expecting solvency" if an asset could be realised to pay accrued and future creditors in full within about 90 days. His Honour continued (at 305-306; 181-182):

The position becomes murkier the less certain the outcomes. The market value of the asset may not be ascertainable until the market is tested, so that it is not certain that the realisation will pay in full both existing debts and those to be accrued during the realisation period. The time at which the proceeds of realisation become available may depend upon the state of the market and the complexity of the transaction.

There comes a point where the reasonable director must inform himself or herself as fully as possible of all relevant facts and then ask himself or herself and the other directors: "How sure are we that this asset can be turned into cash to pay all our debts, present and to be incurred, within 3 months? Is that outcome certain, probable, more likely than not, possible, possible with a bit of luck, possible with a lot of luck, remote, or is there no real way of knowing?"

If the honest and reasonable answer is "certain" or "probable", the director can have a reasonable expectation of solvency.

If the honest and reasonable answer is anywhere from "possible" to "no way of knowing", the director can have no reasonable expectation of solvency.

If the honest and reasonable answer is "more likely than not", the director runs the risk that a court will hold to the contrary in an insolvent trading claim.

If the honest and reasonable answer is "no way of knowing yet, we need more information", the director must then ask: "How long before we have the information so that we can give a final answer?"

If the honest and reasonable answer to that question is: "By a definite date which will not extend the realisation period (if there is to be one) beyond 3 months", the director may reasonably say: "let's wait until then before deciding".

If the honest and reasonable answer is "there is no way of knowing yet when we will have the information to make a decision", the director must say: "Then there is no way that we can now have a reasonable expectation of solvency and there is no way we can reasonably justify continuing to trade without knowing when we will know whether the company is insolvent. Call the administrators". By this series of questions and answers I do not mean to lay down some pro forma test of directors' liability for insolvent trading. Each case depends on its particular facts. These questions and answers merely serve to illustrate that when a company is struggling to pay its debts, the directors must face up

³⁴ *Metal Manufacturers v Lewis* (1986) 11 ACLR 122; *Statewide Tobacco Services Ltd v Morley* (1990) 2 ACSR 405; *Carrier Air Conditioning Pty Ltd v Kurda* (1993) 11 ACSR 247; *Credit Corp Australia Pty Ltd v Atkins* (1990) 30 ACSR 727.

³⁵ *3M Australia Ltd v Kemish* (1986) 10 ACLR 371 at 378.

³⁶ *Commonwealth Bank of Australia v Friedrich* (1991) 5 ACSR 115 at 127; *Carrier Air Conditioning Pty Ltd v Kurda* (1993) 11 ACSR 247; *Metropolitan Fire Systems Pty Ltd v Miller* (1997) 23 ACSR 699 at 711.



to the issue of insolvent trading directly and with brutal honesty: they must not shirk from asking themselves the hard questions and from acting resolutely in accordance with the honest answers to those questions.

Reasonable reliance on information provided by others

It is a defence if it is proved that, at the time the debts were incurred, the director:

- (a) had reasonable grounds to believe, and did believe:
 - (i) that a competent and reliable person (the other person) was responsible for providing to the first-mentioned person adequate information about whether the company was solvent; and
 - (ii) that the other person was fulfilling that responsibility; and
- (b) expected, on the basis of information provided to the first-mentioned person by the other person, that the company was solvent at that time and would remain solvent even if it incurred that debt and any other debts that it incurred at that time.³⁷

The defence substantially implements a recommendation of the Harmer Report which considered that such a defence is “clearly necessary in the case of larger companies in which it cannot be expected that directors will have control over every action taken in the conduct of the company’s business”.³⁸ It is contemplated that such a defence would encourage a proper system of financial management.³⁹ However, there is no test of whether the reliance was reasonably necessary which seems to leave scope for directors of small companies to avoid liability, even though they could be expected to have a better knowledge of their company’s finances than directors of a large company.

The first element in s 558H(3)(a) requires a director to establish the belief in the existence of an adequate system for monitoring the company’s solvency and in its continuing functioning, a belief which in either case is founded upon reasonable grounds. The director does not have to prove that the delegate was actually competent and reliable and fulfilling the delegated responsibilities, but only that the director’s actual belief was based on reasonable grounds that compliance was occurring. However, this defence will not be available if the defendant director has been put on inquiry as to whether duties are being performed and does not make inquiries and receive reasonable assurances.⁴⁰

The second element in s 588H(3)(b) requires the director to establish an expectation of continuing solvency which is founded upon the basis of information provided by the delegate. Under this limb an expectation is required rather than belief which is the test under the first limb. The terms of this section do not require the expectation to be based on reasonable grounds; this seems to leave open a defence where there is an aberration in the service by a normally competent and reliable provider of information and the director has nevertheless expected solvency where a reasonable person seeing that information would not.

Absence from management

It is a defence if it is proved that, at the time the debt was incurred, the director did not take part in the management of the company because of illness or for some other good reason.⁴¹

The New South Wales Court of Appeal in *Deputy Commissioner of Taxation v Clark* (2003) 57 NSWLR 113 at 142 held that this defence operates under the assumption that every director is under a duty to guide and monitor the management of the company. The words “other good reason” must be read down so that they do not conflict with that general obligation. The defence is not confined to cases where non-participation in management of the company is shown to be unavoidable (at 143). However, reasons which cause the director never to participate in management is not capable of constituting “good reason” for not participating at a particular point in time. Further, the words “good

³⁷ *Corporations Act 2001* (Cth), s 588H(3).

³⁸ Australian Law Reform Commission, *General Insolvency Inquiry, Report No 45* (1988) at [307] (Harmer Report).

³⁹ *Manpac Industries Pty Ltd v Ceccattini* (2002) 20 ACLC 1304 at 1310.

⁴⁰ *Australian Securities and Investment Commission v Plymin* (2003) 175 FLR 124; 46 ACSR 126 at 259.

⁴¹ *Corporations Act 2001* (Cth), s 588H(4).



reason” do not extend to such general matters as duress, undue influence, or misleading or unconscionable conduct (at 144), the focus being on proper standards of conduct for directors as a matter of company law (at 150).

Reasonable steps to prevent incurring of debt

It is a defence if it is proven that the director took all reasonable steps to prevent the company from incurring the debt.⁴² In *Statewide Tobacco Services Ltd v Morley* (1990) 2 ACSR 405, Ormiston J said that a non-executive director, who cannot prevent the company from incurring a debt without the concurrence of a majority of the board, was still obliged to take all practical steps relevant to prevent the company from trading while insolvent. If the director was unable to persuade the other directors to withdraw the company’s authority to incur debts while it was insolvent, the director should seek to have the company wound up or resign. Those remarks have been approved in the context of the present legislation.⁴³

Inadequacies of section 588H

In theory, four defences covering varying situations which may be faced by directors at the time of insolvency appear positive. In practice, case law in Australia has shown that these defences are very difficult to establish.⁴⁴ Empirical research in this area found that in 63% of the insolvent trading cases examined, the defendant directors argued that they had fulfilled the requirements of one or more of the defences.⁴⁵ Yet, in only seven (10.8%) of the 65 cases in which the defence was argued, was the director held to satisfy the defence.⁴⁶ Of course, this evidence does not necessarily identify a fault with the current defences, as the study did not evaluate the merits of the decisions; it simply collated the statistics from insolvent trading cases.

The first and second defences in s 588H(2) and 588H(3) have been very hard to invoke as they require a reasonable expectation of solvency. In situations where a company is exploring an informal work-out or restructuring because of debt issues, it will be difficult to establish this expectation. The third defence in s 588H(4) has rarely been successful because those who seek to claim protection under it have failed to act with due care and diligence. The fourth defence in s 588H(5) is not suitable for effective corporate restructuring because it requires directors to take every reasonable step to avoid the company incurring debts. This is of little assistance where directors attempt to trade out of difficulty. While trading may offer the best prospect of saving the value of the business and allowing it to turn around or be sold, under the current provisions, trading on involves increased potential liability for insolvent trading.

None of the defences provide protection to directors who attempt to rescue companies facing difficult financial positions while avoiding the risk of insolvent trading liability under the *Corporations Act*. There is no defence where the director recognises the financial problems faced by the company and incurs debts during an attempt to rescue the business from formal insolvency proceedings. It is no defence that the director was of the opinion that it was in the interests of the company or creditors that the company should trade while insolvent.⁴⁷

RELIEF FROM LIABILITY UNDER SECTIONS 1317S AND 1318

Hall v Poolman

Under s 1318 if, in any civil proceedings against a certain type of person for “negligence, default, breach of trust or breach of duty”, the defendant demonstrates to the court that he or she has acted

⁴² *Corporations Act 2001* (Cth), s 588H(5).

⁴³ *Elliott v Australian Securities and Investments Commission* (2004) 10 VR 369; 48 ACSR 621 at 644-650.

⁴⁴ Baxt, n 27 at 62.

⁴⁵ James P, Ramsay I and Siva P, “Insolvent Trading – An Empirical Study” (2004) 12 *Insolv LJ* 210 at 234.

⁴⁶ James, Ramsay and Siva, n 45 at 234-235.

⁴⁷ A more recent decision dealing with the inadequacies of s 588H of the *Corporations Act 2001* (Cth) is that of Goldberg J in *McLellan v Carroll* (2009) 76 ACSR 67; [2009] FCA 1415.



honestly and that, having regard to all the circumstances of the case including those connected with their appointment, the defendant ought fairly to be excused for the negligence, default or breach, the court may relieve the defendant wholly or partly from liability on such terms as the court thinks fit. *Hall v Poolman* (2007) 215 FLR 243; 65 ACSR 123 explored the role of the courts in “forgiving” directors who have breached certain duties.

The case concerned the insolvency of the Reynolds Group of Companies, and in particular two companies in the Group, Reynolds Wines Ltd and its subsidiary, Reynolds Vineyards Pty Ltd. The chairman of both companies was Mr Irving, a very experienced and well-known company director and investment banker (at 252; 130). The insolvent trading claim arose because the whole group faced significant financial difficulties, and these had been further heightened by the fact that the Commissioner of Taxation had issued large taxation assessments against the companies in March 2001 (at 251; 130). Mr Irving accepted that, if the disputed tax debts were taken into account, the companies were certainly insolvent and could not have repaid their creditors after the tax assessments. It is clear that the genuinely disputed tax debts are still debts and should be taken into account in determining insolvency.⁴⁸ The court found that after the issue of the tax assessment, the directors failed to prevent the company incurring debts during insolvency.

Scope of section 1318

The court has the power to make an order granting relief from liability in two situations:

- first, in respect of liability arising under the civil penalty regime;⁴⁹ and
- secondly, a general power to relieve liability arising out of “negligence, default, breach of trust or breach of duty”.⁵⁰

The provisions do not operate to remove the breach but rather to excuse the contravener.⁵¹ Any difference between the two provisions does not affect the substantive role of the courts as the relevant considerations are the same.⁵² The power to grant relief extends both to claims brought by the company and third parties against the directors and officers.⁵³ Relief cannot be given in respect of criminal liability.⁵⁴

In both situations, the defendant director bears the onus of satisfying the court that the defendant has acted honestly and that, having regard to all the circumstances of the case, including those connected with the person’s appointment, the person ought fairly to be excused ... [and] the court may relieve the person either wholly or partly from liability on such terms as the court thinks fit.⁵⁵

The provision serves the public interest by balancing the need to make directors accountable for their conduct, while not deterring able people from offering their services for want of appropriate protection.⁵⁶ It is not the case that the power to grant relief should only be used in extreme circumstances of injustice or oppression.⁵⁷

In *Commonwealth Bank of Australia v Friedrich* (1991) 5 ACSR 115, Tadgell J declined to apply s 1318 to a predecessor of s 588G on the basis that proceedings for insolvent trading were not proceedings for “negligence, default, breach of duty or breach of trust” as required by s 1318. This

⁴⁸ *Deputy Commissioner of Taxation v Broadbeach Properties Pty Ltd* (2008) 237 CLR 473.

⁴⁹ *Corporations Act 2001* (Cth), s 1317S.

⁵⁰ *Corporations Act 2001* (Cth), s 1318.

⁵¹ *Deputy Commissioner of Taxation v Dick* (2007) 226 FLR 388; 242 ALR 152 at 164 (Santow JA).

⁵² *Australian Securities and Investments Commission v Vines* (2005) 65 NSWLR 281.

⁵³ *Edwards v Attorney-General (NSW)* (2004) 60 NSWLR 667.

⁵⁴ *Lawson v Mitchell* [1975] VR 579; *Deputy Commissioner of Taxation v Dick* (2007) 226 FLR 388; 242 ALR 152 at 157 (Spigelman CJ).

⁵⁵ *Corporations Act 2001* (Cth), ss 1317S(2), 1318(1).

⁵⁶ *Commonwealth Bank of Australia v Friedrich* (1991) 5 ACSR 115 at 198.

⁵⁷ *Australian Securities and Investments Commission v Vines* (2005) 65 NSWLR 281.



interpretation was followed in *Standard Chartered Bank of Australia Ltd v Antico* (1995) 38 NSWLR 290 and *Southern Star Group Pty Ltd v Byron* (1995) 123 FLR 368. However, *Kenna & Brown Pty Ltd (in liq) v Kenna* (1999) 32 ACSR 430 held that s 588G now imposes a duty upon a director to prevent insolvent trading such that s 1318 is capable of applying to insolvent trading.

Beyond the decision in *Hall v Poolman*, a focus of this article is on the potential operation of s 1318. Palmer J adopted the broader interpretation of s 1318 enunciated by the New South Wales Court of Appeal in *Deputy Commissioner of Taxation v Dick* (2007) 226 FLR 388; 242 ALR 152.⁵⁸ In that case, the majority of the court, Santow and Basten JJA, ruled that s 1318 should be interpreted broadly to apply not only to contravention of the *Corporations Act* or breaches of the common law, but should extend to other statutory liabilities imposed on directors outside of the *Corporations Act*.⁵⁹

In *Dick*, the relevant director had claimed relief from liability in relation to a penalty that had been imposed by the court pursuant to the operation of the *Income Tax Assessment Act 1936* (Cth). The majority ruled that, in principle, there was no reason why s 1318 should not apply to penalties but on this occasion felt that the policies behind the operation of the *Income Tax Assessment Act* meant that s 1318 could not be applied by the court in Mr Dick's favour.⁶⁰

Palmer J had no similar difficulty in *Hall v Poolman*; he ruled that s 1318 could be applied by the court in the context of insolvent trading. In his view (at 315; 191), the section could be applied by the court to relieve directors "against liability deriving from their office not only under general law but also contraventions of the Act".

Case law on "acted honestly"

The meaning of the phrase "to act honestly" has been considered in many decisions. Rulings concerning the relief provisions and their predecessors have consistently stated that it is impossible to formulate a general test to prove honesty. This is because proof of honesty is based on a subjective assessment of the defendant that will differ in each case.⁶¹

Clearly, if a defendant knew that her or his conduct contravened the law, or had an intention to deceive or defraud others, including the company's unsecured creditors,⁶² the defendant would be unable to establish that he or she acted honestly.⁶³ It has been said that to act honestly is to act in a subjective state free from any intention to deceive or defraud.⁶⁴ It is clear that conduct exhibiting moral turpitude may be said to be dishonest.⁶⁵ However, it is not necessary to establish that the defendant knew he or she was contravening the law to support a finding that the defendant failed to act honestly.⁶⁶ Nor is it necessary to prove an intention to deceive or defraud in order to fail to establish honesty.⁶⁷

⁵⁸ Baxt, n 27 at 63.

⁵⁹ *Deputy Commissioner of Taxation v Dick* (2007) 226 FLR 388; 242 ALR 152 at 171-172 (Santow JA).

⁶⁰ *Deputy Commissioner of Taxation v Dick* (2007) 226 FLR 388; 242 ALR 152 at 174 (Santow JA); at 177-178, 180 (Basten JA).

⁶¹ *Maelor Jones Investments (Noarlunga) Pty Ltd v Heywood-Smith* (1989) 54 SASR 285 at 292; *Re Voets Investments Pty Ltd* (1962) 79 WN (NSW) 670 at 677; *Dominion Insurance Co of Australia Ltd (in liq) v Finn* (1988) 7 ACLC 25 at 33.

⁶² *Powell v Fryer* (2001) 159 FLR 433 at 450.

⁶³ *Re Voets Investments Pty Ltd* (1962) 79 WN (NSW) 670 at 677 (Jacobs J); *Dominion Insurance Co of Australia Ltd (in liq) v Finn* (1988) 7 ACLC 25 at 34.

⁶⁴ *Dominion Insurance Co of Australia Ltd (in liq) v Finn* (1988) 7 ACLC 25 at 33.

⁶⁵ *Commonwealth Bank of Australia v Friedrich* (1991) 5 ACSR 115 at 196; *Australian Securities and Investments Commission v Vines* (2005) 65 NSWLR 281 at 293; *Australian Securities and Investments Commission v Edwards (No 3)* (2006) 57 ACSR 209.

⁶⁶ *Dominion Insurance Co of Australia Ltd (in liq) v Finn* (1988) 7 ACLC 25 at 33-34.

⁶⁷ *Australian Securities and Investments Commission v Edwards (No 3)* (2006) 57 ACSR 209.



A finding of honesty will not be established merely by failure of the court to declare that the defendant's conduct was dishonest.⁶⁸ In *Hall v Poolman*, Palmer J ruled that it was important not to dismiss claims by directors under s 1318 which relied on them showing that they had acted honestly and reasonably in the context of a breach of duty. For a court to be too ready to hold that dishonesty applied would be very dangerous. This would automatically follow if the court ruled that the director had not made out the claim that he or she was acting honestly. Palmer J noted (at 318; 193-194):

[T]he Court should be concerned only with the question whether the person has acted honestly in the ordinary meaning of the term, ie, whether the person has acted without deceit or conscious impropriety, without intent to gain improper benefit or advantage for himself, herself or for another, and without carelessness or imprudence to such a degree as to demonstrate that no genuine attempt has been [made] to carry out the duties and obligations of his or her office imposed by the *Corporations Act* or general law. A failure to consider the interests of the company as a whole, or more particularly the interests of creditors, may be of such a degree as to demonstrate failure to act honestly in this sense. However, if failure to consider the interests of the company as a whole, including the interests of creditors, does not rise to such a high degree but is the result of an error of judgment, no finding of failure to act honestly should be made.

Palmer J had previously highlighted that a finding of dishonesty where the circumstances suggested an error of judgment, even though that might be quite significant in terms of financial implications, would be unfair on directors. In addition, such a ruling would subject directors to harsh community judgment which would follow by having the stigma of dishonesty attributed to them. The chairman, Mr Irving, was a very experienced and well-known company director and investment banker. Palmer J added (at 317; 193) that if he were to say

that Mr Irving had failed to act honestly for the purposes of a defence under [ss 1317S and 1318] when all I had found was that, although with good intentions, Mr Irving had made errors of commercial judgment and had not paid sufficient regard to the interests of creditors of [the two companies] ... the phrase failed to act honestly would almost surely be picked up by the financial and other press. Mr Irving has a high profile in the business world. Being publicly branded as "having failed to act honestly", out of context, would be most hurtful, damaging and unfair to him and anyone in his position.

Case law on "ought fairly to be excused"

It is important to consider the way in which the breach occurred,⁶⁹ including the seriousness of the contravention.⁷⁰ Of course, the court is not limited to these considerations alone.⁷¹ The courts have a wide discretion to relieve in whole or in part.⁷² The notion of forgiveness being "fair" in the circumstances requires consideration of the effect of the contravening conduct for which the forgiveness is sought. There is substantial public interest in publicly condemning misconduct by refusing relief for conduct which clearly breaches the law. This may be contrasted where the conduct of the defendant was merely inadvertent.⁷³ The court will not grant relief from liability for reckless behaviour.⁷⁴ The presence or absence of contrition by the defendant is also a relevant consideration.⁷⁵

⁶⁸ *Australian Securities and Investments Commission v Adler* (2002) 42 ACSR 80 at 123.

⁶⁹ *Advanced Bank Australia Ltd v FAI Insurances Ltd* (1987) 9 NSWLR 464 at 491; *Circle Petroleum (Qld) Pty Ltd v Greenslade* (1998) 16 ACLC 1577 at 1598.

⁷⁰ *Vines v Australian Securities and Investments Commission* (2007) 73 NSWLR 451; 62 ACSR 1 at 108.

⁷¹ *Maelor Jones Investments (Noarlunga) Pty Ltd v Heywood-Smith* (1989) 54 SASR 285.

⁷² *Daniels v Anderson* (1995) 37 NSWLR 438 at 525.

⁷³ *Duke Group Ltd (in liq) v Pilmer* (1998) 144 FLR 1 at 71; *Investa Properties Ltd v Westpac Property Funds Management Ltd* (2001) 187 ALR 462.

⁷⁴ *Powell v Fryer* (2001) 159 FLR 433 at 450.

⁷⁵ *Australian Securities and Investments Commission v Vines* (2005) 65 NSWLR 281 (affirmed on appeal *Vines v Australian Securities and Investments Commission* (2007) 73 NSWLR 451; 62 ACSR 1).



If the director gained a personal benefit from the transaction should also be a relevant consideration in determining whether relief ought to be given.⁷⁶ Similarly, where the director has also been harmed by the conduct should be taken into account.⁷⁷

Under the provisions in the trustee legislation and under earlier companies legislation from which s 1318 is derived, before the court could exercise liability it had to find that the person liable had acted both honestly and reasonably. Since the 1981 legislation, there is no express requirement of a finding that a person acted reasonably. However, where the defaulting director acted reasonably, this may weigh in favour of granting relief.⁷⁸ Presumably, the degree of care with which a person acted should be relevant to whether he or she ought fairly to be excused. Whether a director has exercised care could be relevant to the court's exercise of discretion under s 1318 in a case involving a breach of the duty to act in the best interests of the company or a breach of the duty to act for a proper purpose.

It has been suggested that it is difficult to understand how a negligent officer could be held to have acted reasonably.⁷⁹ In *Australian Securities and Investments Commission v Vines* (2005) 65 NSWLR 281 the court stated that a finding that the defendant's conduct had contravened the statutory duty of care and diligence implied that the conduct was not reasonable. However, it is relevant to the exercise of the court's discretion in s 1318 to consider the degree to which the defendant's conduct had fallen short of the statutory standard of reasonable care and diligence (at 290-291). Therefore, it is possible that a director or officer may be found liable in respect of the duty of care, which involves acting unreasonably, and yet still obtain relief from the court (at 291).⁸⁰

Reasonableness may be better proved where the director has received independent advice before entering the transaction,⁸¹ and where the advice was reasonably relied upon in the circumstances.⁸² In assessing the behaviour of Irving and his colleagues, Palmer J noted (at 320; 196) that they had at all times relied on the advice of external experts in assessing the commercial difficulties of the various companies and what might be done to rescue them. There were difficult commercial judgments that had to be made; the claim brought by the Commissioner of Taxation had to be factored into the equation and the company had significant assets that it did not wish to liquidate in order to pay for the relevant debts because this would then undermine the ability of the company to trade its way out of difficulties (at 320; 195).

His Honour considered whether Irving should be granted relief from liability for insolvent trading, even though he was aware that the company was insolvent. His Honour's starting point (at 318-319; 194) is significant for this article:

It is sometimes a difficult decision for a director of a trading corporation suffering from liquidity problems to decide whether, and when, to abandon hope of a change in the company's fortunes and to summon the administrators. There are often pressing interests involved in the decision: the jobs of employees will be lost, the investment of shareholders will evaporate, and a promising venture in which a great deal of personal effort may have been expended will end in failure. On the other hand, the livelihood of creditors whose businesses depend on reasonably prompt payment may also be ruined if the company continues to trade while insolvent. When confronted with the necessity of making a

⁷⁶ *Gamble v Hoffman* (1997) 24 ACSR 369 at 387; *Pace v Antlers Pty Ltd (in liq)* (1998) 80 FCR 485 at 511; *Green v Wilden Pty Ltd* [2005] WASC 83 at [542].

⁷⁷ *Circle Petroleum (Qld) Pty Ltd v Greenslade* (1998) 16 ACLC 1577.

⁷⁸ *Commonwealth Bank of Australia v Friedrich* (1991) 5 ACSR 115 at 197; *Circle Petroleum (Qld) Pty Ltd v Greenslade* (1998) 16 ACLC 1577 at 1598; *Kenna & Brown Pty Ltd (in liq) v Kenna* (1999) 32 ACSR 430.

⁷⁹ *Diamond Manufacturing Co Ltd v Hamilton* [1969] NZLR 609 at 645.

⁸⁰ *Pace v Antlers Pty Ltd (in liq)* (1998) 80 FCR 485 at 511; *Downey v Crawford* (2005) 51 ACSR 182 at [195].

⁸¹ *Maelor Jones Investments (Noarlunga) Pty Ltd v Heywood-Smith* (1989) 54 SASR 285; *Australian Securities and Investments Commission v Vines* (2005) 65 NSWLR 281 (affirmed on appeal *Vines v Australian Securities and Investments Commission* (2007) 73 NSWLR 451; 62 ACSR 1).

⁸² *Commonwealth Bank of Australia v Friedrich* (1991) 5 ACSR 115 at 197; *Kenna & Brown Pty Ltd (in liq) v Kenna* (1999) 32 ACSR 430.



decision involving these factors, a director cannot afford to procrastinate or to avoid confronting realities. He or she must ask and honestly answer [hard questions regarding how, and when, the company will be able to pay its debts].

This passage demonstrates that the court is prepared to be flexible in its application of the insolvent trading provisions. This is consistent, albeit a more explicit statement, with judicial consideration of the concept of corporate insolvency. In recent years, the courts have developed an approach of “commercial reality” which takes into account all of the circumstances of the company and aims not to allow a temporary cash flow to condemn the company to legal insolvency and the adverse legal consequences that may follow for the directors involved.⁸³ As his Honour noted (at 319; 195):

Experienced company directors such as Mr Irving would appreciate that, in some cases, it is not commercially sensible to summon the administrators or to abandon a substantial trading enterprise to the liquidators as soon as any liquidity shortage occurs. In some cases a reasonable time must be allowed to a director to assess whether the company’s difficulty is temporary and remediable or endemic and fatal. The commercial reality is that creditors will usually allow some time for payment beyond normal trading terms, if there are worthwhile prospects of an improvement in the company’s position.

Palmer J found (at 320; 196) that Irving ought fairly to be excused from liability from the insolvent trading until it became clear that the negotiations with the Tax Office could not be resolved quickly. At a meeting on 5 February 2003 between the company, its advisers and the ATO, it was clear that the matter would be ongoing for at least another three months, with no certainty of a positive outcome. It had to be borne in mind that many of the company’s debts were already three months or more overdue. Thus, having attempted, seemingly in vain, to save the company in the short term by negotiating with the ATO, without any positive success, it would have been clear to a reasonable director that trading could not go on indefinitely.

Palmer J granted relief to Irving for the period of insolvent trading up until 5 February 2003, while he was liable for debts incurred after that date (at 320; 196). Palmer J’s assessment of “all the circumstances” focused on entrepreneurial ideas of trading out of difficulty in the context of insolvent trading. He did not explore many of the other factors elucidated by Austin J in *Australian Securities and Investments Commission v Vines*. Following *Hall v Poolman*, the test becomes whether the defendant acted honestly, in the ordinary sense of the word, and in a reasonable commercial context. This is potentially broader than previous decisions have indicated and beyond the provision’s intent. The provision is reconceptualised, in the context of insolvent trading, as protection for honest entrepreneurialism.

Inadequacies of section 1318

Despite its successful application in *Hall v Poolman*, since the commencement of the *Corporations Act* there are very few reported cases in which s 1318, or the equivalent provisions in s 1317S, have been used successfully in the context of claims of this kind.⁸⁴ Empirical research in this area found that the section has not been successfully relied upon to fully exonerate a company officer, and partial relief resulted in three out of 23 cases (13%) in which s 1318 was substantially relied upon as a defence.⁸⁵ In far more cases, relief was refused because the company officer failed to “act honestly” (34.8%). Palmer J felt that the court should be generous in assessing whether a defendant acted honestly and this approach could result in more successful applications of s 1318.

However, even if more successful, is this interpretation of s 1318 an adequate substitute for a broad defence available to directors who honestly try to restructure and trade out of financial difficulties? In this author’s opinion, it is not. There is considerable difference between a doctrine

⁸³ *Chartered Bank of Australia Ltd v Antico* (1995) 38 NSWLR 290; *Southern Cross Interiors Pty Ltd (in liq) v Deputy Commissioner of Taxation* (2001) 53 NSWLR 213; *Lewis v Doran* (2004) 184 FLR 454.

⁸⁴ Baxt R, “Forgiving Directors for Insolvent Trading – Some Promising Signs” (February 2008) *Company Director* 48.

⁸⁵ Wong S, *Forgiving a Director’s Breach of Duty: A Review of Recent Decisions* (Centre for Corporate and Securities Regulation – Research Reports and Research Papers, 2009).



which prevents liability and a discretionary power given to the court which only arises once a finding of breach of duty is made.⁸⁶ As Tadgell J said in *Commonwealth Bank of Australia v Friedrich* (1991) 5 ACSR 115 at 197, “in considering whether relief under [predecessor of s 1318] should be granted, I am to assume, ex hypothesi, that [the director] has been guilty of a default or breach of duty”. The director therefore has the dual impediment of the stigma of the adverse decision, as well as the cost of bringing the exculpatory application under s 1318.

While the test in *Hall v Poolman* seems to be whether the director acted honestly, in the ordinary sense of the word, and in a reasonable commercial context, s 1318 gives the court a broad discretion whether to excuse, as it sees fit.⁸⁷ It involves a relatively unstructured equitable decision. For example, in *Australian Securities and Investments Commission v Vines* (2005) 65 NSWLR 281 at 293-294, Austin J held that a relevant consideration in determining whether a director ought fairly to be excused under s 1318 was the presence or absence of contrition. While this might be entirely appropriate for a relief provision, it is not if we construe the section as having a defensive purpose in the absence of a more robust, general defence.

The formulation of s 1318 in *Hall v Poolman* as honest entrepreneurialism seems to confuse the section’s purpose. The decision is imbued with the justification of protecting well-meaning directors from after-the-fact assessments of their commercial decisions. However, the rationale behind s 1318 is not the need to protect entrepreneurial risk-takers but relief from oppression. The purpose is

to excuse company officers from liability in situations where it would be unjust and oppressive not to do so, recognising that such officers are businessmen and women who act in an environment involving risk in commercial business decision-making.⁸⁸

Some commentators have also praised the decision as a promising move by the courts to forgive directors and encourage entrepreneurialism.⁸⁹ However, the relief provision does not remove the breach but merely excuses the contravention. So, while s 1318, and the *Corporations Act* in general, should be interpreted in the spirit of entrepreneurialism, this is not an adequate rationale for a discretionary relief provision designed to protect against unjust outcomes.

While Palmer J’s decision in *Hall v Poolman* offers some encouraging signs for directors, neither the application nor purpose of s 1318 is that of a general defence. It is an equitable relief provision designed to avoid the oppressive and unjust operation of the law. It is not designed to offer broad comfort or encourage entrepreneurial risk-taking. Honest entrepreneurialism is not an adequate substitute for specific defences.⁹⁰

CONCLUSION

The discussion paper on the operation of Australia’s insolvent trading laws, in the context of attempts at business rescue outside of external administration, recognised that an individual company’s response to current or imminent insolvency depends on a range of factors, such as the severity of its illiquidity, the ability or willingness of creditors to delay or suspend payment of their claims, the effect on the company’s assets by continuing to trade, and the sanctions which can result from a breach of the law.⁹¹

As discussed above, the specific defences in s 588H have been quite limited in their application. Section 1318 is a judicial discretion to avoid oppressive outcomes rather than a defence. While it

⁸⁶ Farrer J, “Corporate Governance, Business Judgment and the Professionalism of Directors” (1993) 6 *Corporate and Business Law Journal* 1 at 21-22.

⁸⁷ DeMott D, “Directors’ Duty of Care and the Business Judgment Rule: American Precedents and Australian Choices” (1992) 4 *Bond L Rev* 133 at 143.

⁸⁸ *Daniels v Anderson* (1995) 37 NSWLR 438 at 525.

⁸⁹ Baxt, n 27 at 63; Baxt, n 84; Harris J, “Relief from Liability for Company Directors: Recent Developments and Their Implications” (2008) 12 *University of Western Sydney Law Review* 152 at 166.

⁹⁰ For an interesting decision in which s 1317S (which is in similar terms to s 1318) has been applied successfully see Goldberg J in *McLellan v Carroll* (2009) 76 ACSR 67; [2009] FCA 1415.

⁹¹ Treasury, n 5.



should be interpreted in light of commercial reality, it is not an appropriate mechanism for encouraging entrepreneurial risk-taking. There is no effective safe harbour for directors of companies attempting a work-out outside of external administration, or where they continue to operate with the reasonable belief that they can trade out of financial difficulty.

The discussion paper outlined two options for this safe harbour: a business judgment rule for insolvent trading or a moratorium on insolvent trading.⁹² Even with an expanded defence, there will still be a reluctance on the part of directors to take risks. However, at least there will be a window of opportunity given to directors in some cases to take the necessary risks that are commensurate with the existence of an entrepreneurial spirit, which may lead to greater success and fewer company collapses rather than more cases which have to be taken to the courts to assess the alleged breach of directors' duties.⁹³ In this time of economic uncertainty, directors need a strong, effective and broad "safe harbour" when the public comes looking for a "body to kick and soul to damn".⁹⁴

⁹² Treasury, n 5.

⁹³ Baxt, n 26 at 12.

⁹⁴ Coffee J, "'No Soul to Damn: No Body to Kick': An Unscandalized Inquiry into the Problem of Corporate Punishment" (1981) 79 Mich L Rev 386 at 401-402, citing the line by Edward, First Baron Thurlow (1731-1806): "Did you ever expect a corporation to have a conscience, when it has no soul to be damned, and no body to be kicked?"

