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Sample Pages **section 588G**

Robson's Annotated Corporations Legislation

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The sample annotations for s 588G of the *Corporations Act 2001* are extracted from the commentary on Part 5.7B, written by **Jason Harris** BA LLB (UWS), LLM (ANU) FCIS.

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Division 3 – Director’s duty to prevent insolvent trading

Navigation:
 Detailed running
 heads show
 precise location
 within Act

[Cross-reference:

ASIC: RG 166: Licensing: Financial requirements; RG 207: Credit licensing: Financial requirements.]

588G Director’s duty to prevent insolvent trading by company

(1) [Application] This section applies if:

- (a) a person is a director of a company at the time when the company incurs a debt; and
- (b) the company is insolvent at that time, or becomes insolvent by incurring that debt, or by incurring at that time debts including that debt; and
- (c) at that time, there are reasonable grounds for suspecting that the company is insolvent, or would so become insolvent, as the case may be; and
- (d) that time is at or after the commencement of this Act.

(1A) [Debt table] For the purposes of this section, if a company takes action set out in column 2 of the following table, it incurs a debt at the time set out in column 3.

When debts are incurred		[operative table]
	Action of company	When debt is incurred
1	paying a dividend	when the dividend is paid or, if the company has a constitution that provides for the declaration of dividends, when the dividend is declared
2	making a reduction of share capital to which Division 1 of Part 2J.1 applies (other than a reduction that consists only of the cancellation of a share or shares for no consideration)	when the reduction takes effect
3	buying back shares (even if the consideration is not a sum certain in money)	when the buy-back agreement is entered into
4	redeeming redeemable preference shares that are redeemable at its option	when the company exercises the option

Legislation text at hand:
 Current version of
 Corporations Act provision
 immediately precedes
 annotation commentary for
 ease of use

When debts are incurred		[operative table]
	Action of company	When debt is incurred
5	issuing redeemable preference shares that are redeemable otherwise than at its option	when the shares are issued
6	financially assisting a person to acquire shares (or units of shares) in itself or a holding company	when the agreement to provide the assistance is entered into or, if there is no agreement, when the assistance is provided
7	entering into an uncommercial transaction (within the meaning of section 588FB) other than one that a court orders, or a prescribed agency directs, the company to enter into	when the transaction is entered into

(2) **[Failure to prevent debt]** By failing to prevent the company from incurring the debt, the person contravenes this section if:

- (a) the person is aware at that time that there are such grounds for so suspecting; or
- (b) a reasonable person in a like position in a company in the company's circumstances would be so aware.

Note: This subsection is a civil penalty provision (see subsection 1317E(1)).

(3) **[Where person commits offence]** A person commits an offence if:

- (a) a company incurs a debt at a particular time; and
- (aa) at that time, a person is a director of the company; and
- (b) the company is insolvent at that time, or becomes insolvent by incurring that debt, or by incurring at that time debts including that debt; and
- (c) the person suspected at the time when the company incurred the debt that the company was insolvent or would become insolvent as a result of incurring that debt or other debts (as in paragraph (1)(b)); and
- (d) the person's failure to prevent the company incurring the debt was dishonest.

[Subs (3) am Act 117 of 2001, s 3 and Sch 1 item 142, with effect from 15 Dec 2001]

(3A) **[Absolute liability s 588G(3)(a) offence]** For the purposes of an offence based on subsection (3), absolute liability applies to paragraph (3)(a).

Note: For *absolute liability*, see section 6.2 of the *Criminal Code*.

[Subs (3A) insrt Act 117 of 2001, s 3 and Sch 1 item 143, with effect from 15 Dec 2001]

← Legislation history:
Clear details of amendments

(3B) [Strict liability s 588G(3)(aa) and (b) offence] For the purposes of an offence based on subsection (3), strict liability applies to paragraphs (3)(aa) and (b).

Note: For *strict liability*, see section 6.1 of the *Criminal Code*.

[Subs (3B) insrt Act 117 of 2001, s 3 and Sch 1 item 143, with effect from 15 Dec 2001]

(4) [Provisions additional] The provisions of Division 4 of this Part are additional to, and do not derogate from, Part 9.4B as it applies in relation to a contravention of this section.

[S 588G am Act 117 of 2001

Cross-reference:

ASIC:

- RG 16: External administrators: Reporting and lodging;
- RG 34: Auditor’s obligations: reporting to ASIC;
- RG 109: Assetless Administration Fund: Funding criteria and guidelines;
- RG 115: Audit relief for proprietary companies;

Takeovers Panel:

- GN 14: Funding arrangements.]

Legislation shaded to distinguish it clearly from the commentary

Cross-references identify related regulations and practice materials like ASIC documents

Annotations structured to help locate relevant commentary via para numbers and Table of Contents

Section 588G Commentary

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Key concepts referenced back to the specific legislation provision

[588G.10] Outline

"Outline" annotation positions the provision into its practice context

Section 588G provides a statutory exception to the corporate veil that exists between the company as a separate entity and its directors. Where the directors act as the decision-making organ of the company, they are not liable for the debts incurred by the company because it is the company that has incurred them. Liability for insolvent trading is a statutory exception to this principle.

See Pt 5.8 (the predecessor to Div 3) for commentary on analogous provisions.

[588G.20] Concepts: Debt – s 588G(1)(a)

See the annotations to s 95A.

Cross-referencing to related provisions minimises repetition

Paragraph numbers align with section numbers

[588G.30] Concepts: Incurs a debt – s 588G(1)(a)

Commentary addresses statutory concepts applied by case law

A debt will be incurred when the company subjects itself to an unavoidable obligation to pay a sum of money at a future time: *Hawkins v Bank of China* (1992) 26 NSWLR 562; 10 ACLC 588; 7 ACSR 349 at 572 (NSWLR) per Gleeson CJ.

Section 588G(1A) includes a list of deemed debts and specifies when they are incurred. If a debt does not fall within the scope of deemed debts it will be necessary to examine the nature of the relationship between the parties including any contractual or relevant statutory provisions.

The following are examples of common debts:

Commentary identifies judicial treatment of relevant transactions

- *Contracts for the sale of goods* – debts are incurred at the last time when the order could have been cancelled without incurring substantial damages (*Leigh-Mardon Pty Ltd v Wawn* (1995) 13 ACLC 1,244; 17 ACSR 741). This may depend upon the type of good that is to be supplied, so that ordering commonly manufactured goods might only give rise to a debt upon acceptance of delivery, whereas specially made goods will give rise to a debt when the goods are produced under the terms of the order (*Playspace Playground Pty Ltd v Osborn* [2009] FCA 1486 [CA s 588G 2004]);
- *Leases* – these debts are incurred at the time the lease is executed rather than when each instalment of rent is due (*Russell Halpern Nominees Pty Ltd v Martin* [1987] WAR 150; (1986) 4 ACLC 393; 10 ACLR 539);
- *Penalty interest (for example, on default of rent)* – this will be incurred at the time the company engages in conduct that gives rise to the obligation to pay interest (*Bans Pty Ltd v Ling* (1995) 13 ACLC 524; 16 ACSR 404);
- *Bill facilities* – not necessarily where the facility is rolled over if the original amount remains outstanding, in which case when the original facility was entered into (*Standard Chartered Bank of Australia Ltd v Antico (Nos 1 and 2)* (1995) 38 NSWLR 290; 131 ALR 1; 13 ACLC 1,381; 18 ACSR 1);
- *Guarantee* – when the contract of guarantee is executed, even where it is uncertain as to whether the guarantor will need to pay anything under the guarantee (*Hawkins v Bank of China* (1992) 26 NSWLR 562; 10 ACLC 588; 7 ACSR 349);
- *Quantum meruit claims* – when the work commences on the common understanding that a valid contract will be entered into which will provide for payment for the work done (*Edwards v ASIC* (2009) 235 FLR 207; 264 ALR 723; 76 ACSR 369; [2009] NSWCA 424 [CA s 588G 2005]). The debt will be incurred when the amount payable for the work undertaken is ascertainable (*Versteeg v The Queen* (1988) 36 A Crim R 68); and
- *Utilities debts* – these debts are incurred when the electricity or other commodity is used: *ASIC v Plymin (No 1)* (2003) 175 FLR 124; 21 ACLC 700; 46 ACSR 126; [2003] VSC 123 at 799 (ACLC); appeal dismissed *Elliott v ASIC* (2004) 10 VR 369; 185 FLR 245; 22 ACLC 458; 48 ACSR 621; [2004] VSCA 54 [CL s 588G 1999].

Commentary addresses issues of substance and practical use

Detailed case citations aid further research - authorised and specialised reports and MNC references included

Legislation references for case law specify relevant provisions judicially considered

Statutory liability under taxation legislation is incurring a debt: *Powell & Duncan (Noelx Yachts Aust Pty Ltd) v Fryer* (2001) 159 FLR 433; 37 ACSR 589; [2001] SASC 59 [CL s 588E 1994].

The determination of when a company incurs a debt is to be undertaken using practical and commercial realities: *Standard Chartered Bank of Australia Ltd v Antico (Nos 1 and 2)* (1995) 38 NSWLR 290; 131 ALR 1; 13 ACLC 1,381; 18 ACSR 1. In *Harrison v Lewis* (2001) 19 ACLC 566; [2001] VSC 27 at [27] [CL s 588G 1998], Mandie J said:

Commentary addresses issues of substance and practical use

[A] debt may in appropriate circumstances be incurred within the meaning of the section at a time later than the entry of the contract under which the debt arises or may arise. Although it is necessary to consider the terms of the relevant contract, the question when the debt is incurred within the meaning of the section does not depend on strict legal analysis but turns on when, in substance and commercial reality, the company is exposed to the relevant liability.

[588G.40] Concepts: Insolvent – s 588G(1)(b)

It is common for the liquidator in a s 588M action to call expert evidence from a chartered accountant on the question of whether the company was solvent at certain dates. If the *Evidence Act 1995* applies, then this evidence is admissible if the insolvency is not obvious from the financial records; otherwise, it is inadmissible. If it is inadmissible, then all of the financial records must be put in evidence and the judge must be able to detect the insolvency from the records: *Quick v Stoland Pty Ltd* (1998) 87 FCR 371; 157 ALR 615; 29 ACSR 130 [CL s 588G 1994]; *Cadwallader v Bajco Pty Ltd* (2001) 189 ALR 370; [2001] NSWSC 1193. See further the annotations to s 95A as to the meaning of solvent and insolvent.

Cross-refers to relevant other annotations

[588G.50] Concepts: Reasonable grounds for suspecting company is insolvent – s 588G(1)(c)

Commentary addresses statutory concepts applied by case law

This requires an objective assessment of whether the director made herself or himself sufficiently familiar with the company’s affairs so as to be able to make a proper judgment about its financial position: *Kenna & Brown Pty Ltd v Kenna* (1999) 17 ACLC 1,183; 32 ACSR 432; [1999] NSWSC 533 [CL s 588G 1994]; *Metropolitan Fire Systems Pty Ltd v Miller* (1997) 23 ACSR 699.

Suspicion was defined (in a different context) by the High Court in *Queensland Bacon Pty Ltd v Rees* (1966) 115 CLR 266; 40 ALJR 13; [1966] ALR 855; [1966] HCA 21 at 303 (CLR) per Kitto J in the following terms:

Contextual comments provided

A suspicion that something exists is more than a mere idle wondering whether it exists or not; it is a positive feeling of actual apprehension or mistrust, amounting to “a slight opinion, but without sufficient evidence”, as Chambers’s Dictionary expresses it. Consequently, a reason to suspect that a fact exists is more than a reason to consider or look into the possibility of its existence ... [it is] something which in all the circumstances would create in the mind of a reasonable person in the position of the payee an actual apprehension or fear.

Quotation from judgments for immediate access to key judicial statements

[588G.60] Concepts: Failing to prevent – s 588G(2)

Inactivity or failing to attempt to prevent the company from trading or incurring the debt is sufficient proof and thus the fact that the entire board acquiesced simply proves the case against the entire board, including a non-executive director, even in a listed entity. There is no onus to prove that the director failed to take any particular step. Nor is there any onus to

examine each debt individually: *ASIC v Plymin (No 1)* (2003) 175 FLR 124; 21 ACLC 700; 46 ACSR 126; [2003] VSC 123 at 777 (ACLC); appeal dismissed *Elliott v ASIC* (2004) 10 VR 369; 185 FLR 245; 22 ACLC 458; 48 ACSR 621; [2004] VSCA 54 [CL s 588G 1999].

[588G.70] Concepts: Aware at that time that there are such grounds for so suspecting – s 588G(2)(a)

This does not require proof of actual suspicion, nor proof of an awareness that the facts within the person's knowledge constituted grounds for suspecting solvency. It requires proof of a subjective awareness of grounds that are objectively reasonable grounds for suspecting insolvency: *ASIC v Plymin (No 1)* (2003) 175 FLR 124; 21 ACLC 700; 46 ACSR 126; [2003] VSC 123 at 780 (ACLC); appeal dismissed *Elliott v ASIC* (2004) 10 VR 369; 185 FLR 245; 22 ACLC 458; 48 ACSR 621; [2004] VSCA 54 [CL s 588G 1999].

Commentary addresses statutory concepts applied by case law

[588G.80] Concepts: Reasonable person in like position – s 588G(2)(b)

This is an alternative to s 588G(2)(a). Even if the particular director was not aware of the facts that constituted insolvency, if a reasonable person in the position of that director would have been aware of those grounds, then the case is proved. Hence, s 588G(2)(a) is not superfluous, as proof of that case may affect the nature and quality of the contravention: *ASIC v Plymin (No 1)* (2003) 175 FLR 124; 21 ACLC 700; 46 ACSR 126; [2003] VSC 123 at 780 (ACLC); appeal dismissed *Elliott v ASIC* (2004) 10 VR 369; 185 FLR 245; 22 ACLC 458; 48 ACSR 621; [2004] VSCA 54 [CL s 588G 1999].

Structured annotations with clear headings ease the task of finding commentary and cases of relevance

This catches a director who relies on the other directors and the accountant to explain the company's financial position, but who does not seek out that explanation; and it also negates the defences in s 588H(2) and (3): *Kenna & Brown Pty Ltd v Kenna* (1999) 17 ACLC 1,183; 32 ACSR 432; [1999] NSWSC 533 [CL s 588G 1994]. A reasonable non-executive director of a listed entity will obtain regular aged lists of debtors and creditors, profit and loss statements, and cashflow statements: *ASIC v Plymin (No 1)* (2003) 175 FLR 124; 21 ACLC 700; 46 ACSR 126; [2003] VSC 123 at 784 (ACLC); appeal dismissed *Elliott v ASIC* (2004) 10 VR 369; 185 FLR 245; 22 ACLC 458; 48 ACSR 621; [2004] VSCA 54 [CL s 588G 1999]. A reasonable person will press forcefully for financial information about a company before taking up an appointment to its board: *Tourprint International Pty Ltd (in liq) v Bott* (1999) 17 ACLC 1,543; 32 ACSR 201; [1999] NSWSC 581 [CL s 588G 1993].

Succinct statements of principle, supported by case authority

If a director is aware that the company may be insolvent, remembering that liability in s 588G attracts only where a reasonable suspicion may arise, then the director must stop the company from continuing to incur further liabilities or resign from the board: *Morley v Statewide Tobacco Services Ltd* [1993] 1 VR 423; (1992) 10 ACLC 1,233; 8 ACSR 305 at 439 (VR) per Ormiston J.

Legislation shaded to distinguish it from annotation commentary

588H Defences

(1) [Application] This section has effect for the purposes of proceedings for a contravention of subsection 588G(2) in relation to the incurring of a debt (including proceedings under section 588M in relation to the incurring of the debt).