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LIABILITY OF DIRECTORS: A VERY BRIEF SYNOPSIS By Justin Cotton, Partner, Lovegrove & Lord Lawyers

A Company, and its Directors, are different entities. A Company can be "a person" in itself.

If a contract is entered into by a Company, only the Company can be sued, not the director. (Exception: personal guarantees).

A director can be personally liable to a Company's creditors in some circumstances.

A "director" includes a person who exerts control on the management of a company, even if that person has not been formally appointed.

A director is under a duty to act in the best interests of the Company.

Examples of personal liability

Personal Guarantees: for example, as provided in contracts of building companies with suppliers. Some contracts provide for the directors to sign personal guarantees even though the Company is "the builder".

The personal guarantee remains even if the company is wound up.

Insolvent trading: i.e. if a director allows a Company to incur debts which director suspects, or should have suspected, the Company is unable to pay.

"Insolvent" means unable to pay debts as they become due and payable.

The Company must either be insolvent when it incurs the debt, or become insolvent when the debt arises.

A liquidator may decide to take action against directors if concerns arise about insolvent trading.

Unreasonable director related transactions: i.e. if a Company enters into a transaction that proves to be detrimental to the Company AND is director related.

The transaction would involve payment of money, transfer of property, or issue of securities, by the Company.

If there is no benefit to the Company, it could be unreasonable. For example, sale of shares for less than market value.

Failure to pay Company's Tax: if a Company fails to pay its tax and fails to reach an agreement with the ATO, or take an insolvency step.

A director can become liable to pay a penalty equal to the unremitted tax amount.

Breach of OH & S Regulations: this can be relevant to building companies, which often deal with health and safety.

Directors can be liable for a Company's breach of the OH&S Regulations.

Has to be shown that a director's deliberate conduct or "wilful omission" caused a particular incident.

Or for example, if a director is also the registered builder for the site.

Can lead to criminal charges or the incurring of personal fines.

Loss of Employee Entitlement claims: under the *Corporations Act*, a person must not enter into a transaction with the intention of:

- (i) reducing the recoverable entitlements of a Company's employees, or
- (ii) preventing the recovery of their entitlements.

Can lead to liability to the Liquidator or even the employee personally.

Insolvent Trading

A director has a duty to prevent the Company trading while insolvent.

If a Company is insolvent, or there is a real risk of insolvency, a director's duties are expanded to include the



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interests of creditors (including employees and other creditors).

How to know if it's insolvent?

Signs of financial difficulty include:

- (i) ongoing losses
- (ii) poor cashflow
- (iii) problems obtaining finance and
- (iv) unpaid creditors outside usual trading terms

If one were to suspect that the company is in financial difficulty one should get proper accounting and legal advice as early as possible.

What if it is insolvent?

Do not allow a Company to incur further debt if insolvent.

There are various penalties against directors for insolvent trading, including compensation proceedings, civil penalties and even criminal charges.

Unless it is possible to promptly restructure, refinance or recapitalise the Company, one's options will really only be to appoint a voluntary administrator or liquidator.

If one were to have existing building contracts, and the Company was a contracting party, this would lead to the termination procedures being enacted.

Insolvency

The three most common insolvency procedures are:

- (i) voluntary administration
- (ii) liquidation
- (iii) receivership

Justin is a partner in the dispute resolution sector of the firm. To find out more about Justin click here.

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