

# ***BUSINESS ORGANISATIONS LAW GUIDEBOOK***

## ***SECOND EDITION***

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### **CHAPTER 7**

#### **PROBLEM QUESTION**

Marc, Charlie and Jennifer are the directors of Online Invest Pty Ltd. Marc is a plumber without prior experience in conducting a business and managing a company. He is married to Jennifer. Like Marc, Jennifer has never been a director in any other company, nor does she have any business experience. She accepts the position at her husband's request. Because of the trust and confidence she has in him, she does not participate in the management of Online Invest Pty Ltd. Charlie is a highly qualified businessman appointed as a non-executive director. He believes that his appointment is largely ceremonial since he is not receiving any fees. He relies on Marc to advise him if the company gets into financial difficulty.

Online Invest Pty Ltd's business is not going well. Proper financial records have not been maintained. Marc is aware that the company is in financial trouble but he thinks that the company will be all right if it continues trading. He keeps allowing the company to enter into more debts. Both Jennifer and Charlie are unaware of the company's financial position. The company goes into liquidation on 10 October 2009. The liquidator takes action against the directors for breaching their duties to prevent insolvent trading.

- 1 What is the consequence of not keeping proper financial records in relation to s 588G?
- 2 Assuming that s 588G has been breached, do the directors of the Online Invest Pty Ltd have any defences to escape liability under s 588G?

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#### **ANSWER**

The fact that the company is not keeping proper financial record means that the company will be presumed insolvent (s 588E) for the purpose of s 588G. This presumption is rebuttable.

2 There are a number of defences under s 588H:

**Reasonable expectation of solvency** (s 588H(2))

In this case the company is in financial difficulty. Marc is aware that the company is in financial trouble. His belief that the company's situation will improve does not seem to be based on any particular evidence. It is more a hope. However, as it was noted in *Tourprint International Pty Ltd v Bott* (1999) 32 ACSR 201 and *Metropolitan Fire System v Miller* [1997] 23 ACSR 699, expectation requires more than hope and as a consequence Marc cannot rely on this defence. Jennifer and Charlie are not aware of the financial situation of the company. As stated in *Tourprint International Pty Ltd v Bott* (1999) 32 ACSR 201, their ignorance is not a defence. Accordingly, none of the directors can use the reasonable expectation of solvency defence.

**Reasonable reliance on others** (s 588H(3))

Marc and Jennifer did not rely on anyone so they cannot use the reliance defence. Charlie relies on Marc. However, Marc is not a competent person. He has no experience on how to run a company. Further, he is not keeping proper financial records.

Even if Marc were a competent person, Charlie cannot use this defence because no information was provided that would have allowed Charlie to expect that the company was solvent, and would remain solvent, even if it incurred a debt. Charlie expected Marc to advise him if the company was in trouble. Accordingly, Charlie cannot use this defence.

**Absence from management** (s 588H(4))

Marc is not absent from management so he cannot use this defence. Jennifer and Charlie are not involved in the management. However, they do not have a good excuse for their lack of involvement (*DCT v Clark* (2003) 57 NSWLR 113 and *Statewide Tobacco Services v Morley* (1990) 2 ACSR 405). Directors cannot be 'sleeping directors' even if they are not receiving remuneration for their position (*Commonwealth Bank of Australia v Eise and Freidrich* (1991) 9 ACLC 946).

**Reasonable steps to prevent the company incurring the debt** (s 588H(5))

It does not seem from the fact of the problem that the directors took any steps to prevent the company from incurring the debt. Marc actually believed that the company would be all right if it continued trading.

Accordingly, none of the directors can use of the defences under s 588H.