



## Directors' Duties - Personal Liability for Insolvent Trading

*Tough economic times spells warning signs for directors with the increased risk of incurring personal liability for insolvent trading.*

The current global financial crisis has placed directors in a precarious position. While there may be assets on the company's books which they consider to be very valuable, the present difficulties in obtaining access to funding to borrow against them or attracting interest from buyers or investors at appropriate values may have ramifications for the company's solvency.

In the context of uncertain financial times, directors who have debts falling due may find that their company has become insolvent and, consequently, they must consider their willingness to expose themselves to the risk of insolvent trading.

The duty imposed upon directors to prevent insolvent trading arises under section 588G of the Corporations Act 2001 (the Corporations Act). A director will engage in insolvent trading in breach of the Corporations Act if the company incurs a debt and:

1. the company is insolvent at the time of incurring the debt or becomes insolvent by incurring the debt;
2. at the time the debt is incurred, there are reasonable grounds for suspecting that the company is insolvent or will become insolvent;
3. the director is aware of such grounds or a reasonable person in a like position in a company in the circumstances of the company would be so aware; and
4. the director fails to prevent the company from incurring the debt.

A company is insolvent if it is unable to pay all of its debts as and when they become due and payable.

There are serious consequences for breaching the insolvent trading provisions of the Corporations Act including a monetary penalty for the director personally of up to \$200,000 and possibly disqualification by ASIC of the director from the management of companies. In some cases where dishonesty is involved, criminal liability may apply including a fine of up to \$200,000 or possible imprisonment for up to five years, or both.

In the event the company is wound up, a claim may be brought against the directors by a liquidator, a creditor (with the consent of the liquidator) or ASIC seeking compensation for the company in an amount equal to the debts incurred in contravention of the insolvent trading provisions of the Corporations Act.

If you are a director of a company which is incurring debts and you are concerned about the company's ability to meet the debts, you should seek appropriate advice to minimize the risk of personal liability for insolvent trading.

Madgwick's is a prominent legal adviser in insolvency and asset protection strategies and regularly advises insolvency practitioners, directors and creditors on various aspects of insolvency and litigation matters. We would be happy to review and advise clients on whether their trading terms and conditions are adequate. For further information please contact Angelo Conti, Partner, on (03) 9242 4757 or at email [angelo.conti@madgwicks.com.au](mailto:angelo.conti@madgwicks.com.au) or contact John Caridakis, Lawyer, on (03) 9242 4754 or at [john.caridakis@madgwicks.com.au](mailto:john.caridakis@madgwicks.com.au)

- ▶ For information on Madgwick's Insolvency & Reconstruction group, please [click here](#).
- ▶ For information on Angelo Conti, please [click here](#).