

# Making Company Directors Liable: A Comparative Analysis of Wrongful Trading in the United Kingdom and Insolvent Trading in Australia

*Andrew Keay<sup>a,\*</sup> and Michael Murray<sup>b,†</sup>*

*<sup>a</sup>Professor of Corporate and Commercial Law and Director of the Centre for Business Law and Practice,  
School of Law, University of Leeds, UK*

*<sup>b</sup>Faculty of Law, University of Sydney, Australia*

## Abstract

The separate legal entity doctrine in corporate law means that directors are not generally liable for their company's liabilities. However, there have been actions taken by governments and courts to make directors liable in certain cases. This article examines and compares legislative provisions in the United Kingdom and Australia to make directors liable for the debts of their companies. These provisions, namely section 214 of the UK's Insolvency Act 1986 (wrongful trading) and section 588G of the Australian Corporations Act 2001 (insolvent trading), had the same starting point, but now differ substantially, even though, arguably, they retain very similar objectives. The article investigates: the reasons for these differences; the criteria on which each of the provisions focus; and the ramifications for the different approaches. It also endeavours to evaluate the strengths and weaknesses of the respective approaches adopted in each country. Copyright © 2005 John Wiley & Sons, Ltd.

## I. Introduction

Notwithstanding the longevity of the separate legal entity doctrine in corporate law around the world, the law in many countries has come under pressure from various parts of society to make directors personally liable, in certain cases, for some or all of the liabilities of their companies.<sup>1</sup> This is well exemplified in the United Kingdom and Australia. This article examines and compares the most publicised and signifi-

\*E-mail: a.r.keay@leeds.ac.uk

†E-mail: murlong@bigpond.net.au

1. Of course this is not necessarily limited to the

non-payment of company debts, but also embraces other issues, such as environmental and tortious claims.

cant provisions that have been enacted in these countries to make directors liable for the debts of their companies, namely section 214 of the UK Insolvency Act 1986 (wrongful trading) and section 588G of the Australian Corporations Act 2001 (insolvent trading). Although having the same starting point, the laws in the UK and Australia now differ substantially, although arguably having similar objectives. Both jurisdictions have, over the years, moved away from relying upon fraudulent trading, based on criminal intent, and introduced their own distinctive provisions to address the failure of directors to deal with their companies' financial malaise. In doing this they have focused on different criteria. Comparing the legislation in the two jurisdictions is helpful and instructive as the UK and Australia are both common law jurisdictions with similar corporate law regimes, and this enables us to focus on the differences in the respective laws without the impediment of having to take into account differences in the structure of the respective legal systems.<sup>2</sup> For ease of exposition, this article refers to wrongful trading and insolvent trading collectively as "illicit trading." There has been a change in focus of the law on illicit trading over the last 50 years, initially from one of being limited in scope and merely reactive to the ills of illicit trading to one of imposing an all pervasive obligation on directors to be proactive in ensuring that illicit trading does not occur.

The provisions discussed in the article remain exceptions to the fundamental principle of corporate law that a company, and it alone, is liable for its debts. This rule is based on the inveterate principle emanating from the House of Lords' decision in *Salomon v. Salomon & Co Ltd*<sup>3</sup> that a company is a legal entity which is separate from its members and controllers and consequently it, and not its directors, is liable, *inter alia*, for its contracts and debts generally. But the provisions discussed here now encroach significantly on that principle in the context of a company's insolvency.

## II. Background

The legislative history of the present law is instructive in demonstrating what issues have been discarded, and adopted, in seeking to implement insolvency law policy. That history reveals an initial focus on a criminal standard, with relevant intent required to be proved. Even when civil liability was introduced, there was a

2. The article does not seek to discuss the theoretical justification for the respective provisions. For theoretical examinations of the provisions, see J. Mannolini, "Creditors' Interest in the Corporate Contract: A Case for the Reform of our Insolvent Trading Provisions" (1996) 6 *Australian Journal of Corporate Law* 14; M. Whincop, "Taking the Corporate Contract More Seriously: The Economic Cases Against, and a Transaction Cost Rationale for, the Insolvent Trading Provisions" (1996) 5 *Griffith Law Review* 1; D. Oesterle, "Corporate Directors' Personal Liability for 'Insolvent Trading' in Australia, 'Reckless Trading' in New Zealand and

'Wrongful Trading' in England: A Recipe for Timid Directors, Hamstrung Controlling Shareholders and Skittish Lenders" in I. M. Ramsay (ed), *Company Directors' Liability for Insolvent Trading* (Melbourne, Centre for Corporate Law and Securities Regulation and CCH Australia, 2000); D. Morrison, "The Economic Necessity for the Australian Insolvent Trading Prohibition" (2003) 12 *International Insolvency Review* 171; R. J. Mokal, "An Agency Cost Analysis of the Wrongful Trading Provisions: Redistribution, Perverse Incentives and the Creditors' Bargain" (2000) 59 CLJ 335.

3. [1897] AC 22.

requirement that a criminal conviction must first be obtained. Also, civil liability was first restricted as being available only to each creditor, in respect of its own losses, and not available to the liquidator, or creditors generally. Finally, the law gave a reactive emphasis to the problem of illicit trading; only in recent times has there been the duty imposed on directors to prevent illicit trading occurring. That latter element is significant. The present law primarily seeks not to have creditors compensated through laws proscribing illicit trading, but to try to ensure that illicit trading does not occur in the first place so that such compensation is unnecessary.

The history of the provisions reveals that as early as the first quarter of the twentieth century there was dissatisfaction at the ease with which the protection of limited liability could be abused by those who managed companies. In 1926 in the UK the Greene Committee on Company Law Reform<sup>4</sup> recommended that a new section should be inserted in companies' legislation providing that where, in the course of winding up a company, it appeared that any business of the company had been carried on with intent to defraud creditors of the company, the court should have power, on application by the liquidator or any creditor or contributory, to declare that the directors responsible should be subjected to unlimited personal liability in respect of the debts or other liabilities of the company. Nevertheless, the elements necessary for personal liability to be imposed on directors were high, with an intent to defraud creditors being required to be proved, at the criminal standard. A similar fraudulent trading provision was enacted in Australia at that time, in the State of Queensland in 1931, and later in other Australian states.<sup>5</sup>

By the 1960s, there was a change in emphasis in Australia in respect of fraudulent trading. The criminal element remained, but there was no need to prove a fraudulent intent. The new criminal offence of a company officer being "knowingly a party to the contracting of a debt" who "had no reasonable or probable ground of expectation . . . of the company being able to pay the debt . . ." was enacted. This was introduced into the Uniform Companies Act 1961.<sup>6</sup> It was not until 1964 that civil liability for such conduct was introduced, in the State of New South Wales,<sup>7</sup> but it was dependent on a criminal conviction being first obtained. The liquidator, any creditor or any contributory was entitled to apply for relief against a director.

In the 1980s, in both the UK and Australia, corporate insolvency law was subject to major review. That review included appraisal of the laws on illicit and fraudulent trading. In the UK, the Insolvency Law Review Committee, in its 1982 report, *Insolvency Law and Practice* (generally referred to as "the Cork Report"),<sup>8</sup> was of the opinion that the fraudulent trading provision as then set out in section 332 of the 1948 Companies Act, possessed significant inadequacies in dealing with irresponsible trading.<sup>9</sup> These inadequacies included the fact that the criminal burden of

4. Report of the Company Law Amendment Committee, Cmnd 2697, HMSO, London, 1926. See, in particular, para 61.

5. See the Australian Law Reform Commission, *General Insolvency Inquiry*, Report No 45, Canberra, 1988, (known as "the Harmer Report") at para 278.

6. The actual date of the UCA for each state differed.

7. Section 304(1A) of the Companies Act 1961.

8. Cmnd 858, HMSO, (1982).

9. Paras 1776–1780.

proof applied to civil actions and, also, that applicants for orders against directors were required to establish actual dishonesty.<sup>10</sup> Consequently the Cork Committee recommended that a new provision be introduced to allow for civil actions for unreasonable trading where only the civil burden of proof would apply.<sup>11</sup> The concern of the Committee was to provide in legislation that the director, otherwise honest but who sees insolvency coming and does nothing to arrest it, should lose the benefits of limited liability along with those directors who are fraudulent.<sup>12</sup> To this end the Committee advocated an objective test to determine liability.<sup>13</sup> Criminal liability would continue to apply in relation to fraudulent trading. The UK government resisted the inclusion in a new Insolvency Act (in 1985) of a section in the terms actually envisaged by the Cork Report, for the reason that it was regarded as imposing too severe a responsibility on directors for their companies' liabilities. When a civil liability provision was finally enacted, in the form of section 214 of the Insolvency Act 1986, it introduced liability for "wrongful trading," but this concept was more limited than that recommended by the Cork Committee and reflected a legislative caution against watering down the law of limited company liability. The provision focused on the making of directors liable for creditor losses when the former failed to take appropriate steps where the avoidance of insolvent liquidation was not a reasonable prospect.

Although Australia had abandoned the concept of fraudulent trading in the early 1960s, it also encountered substantial difficulty with its illicit trading provision. The difficulties and deficiencies of the provision introduced in the 1960s, led to its repeal and ultimate replacement by section 374D<sup>14</sup> which, despite its obvious connection with the earlier provision, differed from it in certain important respects.

Section 374D(1) maintained the power of the court to impose on individuals a personal liability for debts of the company, but it remained the case that this applied only where there had first been a conviction for an offence under section 374C. Under section 374C,<sup>15</sup> this criminal liability was imposed if the company officer was "knowingly a party to the contracting of a debt," and at that time had "no reasonable or probable grounds or expectation . . . of the company being able to pay the debt."<sup>16</sup> Section 374D allowed an application by the relevant Minister or a prescribed person, which included a creditor; and the court had a discretion "if it thinks proper to do so" to declare that the defendant is "personally responsible . . . for amounts up to the payment to the company of such amount as is required to satisfy all or any of the debts of the company as the Court directs."

10. *Re Patrick and Lyon Ltd* [1933] Ch 786.

11. Para 1777.

12. A Walters, "Enforcing Wrongful Trading—Substantive Problems and Practical Incentives" in BAK Rider (ed), *The Corporate Dimension* (Bristol, Jordans, 1998) at 146.

13. Paras 1782–1783.

14. Tasmania retained the original provision, but in an amended form.

15. See UCA, section 374E. This included (but is not confined to) a company which was in the course of being wound up: see *MacPherson v. Carrigan; Ex parte Carrigan* (1978) 3 ACLR 880. It was not necessary that the debtor company be in liquidation: *3MAust. Pty Ltd v. Watt* (1984) 2 ACLC 621.

16. See UCA, section 374C(1). See *Corporate Affairs Commission v. Karounos* (1985) 3 ACLC 410.

This was followed by section 556 of the Companies Code that was introduced into the companies' legislation of each Australian state from 1981 until the advent of the Corporations Law in 1990. This section provided that if the company incurred a debt when there were reasonable grounds to expect that the company would not be able to pay all its debts as and when they fell due, a director of the company or any person who took part in the management of the company at the time, was guilty of an offence.<sup>17</sup> Criminal penalties, including imprisonment, were imposed. In addition, the company and that person were jointly and severally liable for the payment of the debt. The section then gave creditors of the company a personal civil right of action against the directors<sup>18</sup> whether or not any criminal conviction had been obtained, provable on the balance of probabilities.<sup>19</sup> The right of action of creditors was theirs alone—it could not be exercised by the liquidator on their behalf.<sup>20</sup>

Australian insolvency law was substantially reviewed by the Australian Law Reform Commission in its 1988 *General Insolvency Inquiry*.<sup>21</sup> The Commission's report (commonly known as 'the Harmer Report') criticised the Australian law as it then stood, and stated:

"At no stage since its introduction in 1961 has the liability of a director for incurring debts without a reasonable prospect of payment been in a form appropriate for giving creditors (considered as a class) a suitable remedy."<sup>22</sup>

The Harmer Report listed the various deficiencies, including: that there was a need to obtain a criminal conviction before civil liability could be imposed; that criminal and civil proceedings were lengthy; the liquidator could not take action for all creditors; and that there could therefore be the prospect of a multiplicity of actions by each creditor in respect of their particular debts.

The Report stated the philosophy that has become the cornerstone of Australian insolvent trading law, by saying that the responsibility of a director for insolvent trading:

"has not, thus far, [in 1988] been expressed as a positive duty owed to the company to prevent the company from engaging in that activity. Former and existing legislation has centred upon the incurring of a particular debt or debts and subjecting a director to notional joint responsibility for the debt or debts. This produces a series of isolated examinations of each instance of the incurring of a debt. Yet the real abuse is permitting the company to trade after a point where, on an objectively considered basis, the company is unable to pay all its debts."<sup>23</sup>

A new provision, now section 588G, was enacted to provide primarily for civil liability, with criminal liability being retained for actual dishonesty. Insolvent

17. Section 556(1).

18. *Watt v. 3M Aust. Pty Ltd* (1984) 9 ACLR 524. The creditors concerned had no cause of action under section 556 of the Code until the company was wound up or was in the course of being wound up: *Bush v. Wright* (1984) 3 ACLC 311.

19. Section 556(3).

20. *Ross McConnell Kitchen & Co. Pty Ltd (in liq.) v. Ross (No. 2)* (1985) 3 ACLC 326.

21. Report No 45, 1988—see <www.alrc.gov.au>

22. Para 279.

23. Para 280.

trading is also subject to a civil penalty regime whereby the corporate regulator [the Australian Securities and Investments Commission (“ASIC”)] may itself pursue an insolvent trading claim against directors for the imposition of a civil penalty, up to A\$200 000, as well as civil compensation. Such claims are required to be proved at the civil standard only.<sup>24</sup>

One of the main features of section 588G is that it imposes a positive duty on directors to prevent debts being incurred by the company whilst it is insolvent. Hence, it imposes an obligation on directors to be proactive in monitoring the company’s performance and ensuring that debts are not being improperly incurred, to prevent the company from engaging in insolvent trading.

This imposition of a positive duty on directors goes beyond the mere lifting of the corporate veil. A director who has no or limited involvement in the company’s incurring of a debt, may not have been liable under the old law if there was no positive action on their part upon which liability could be attached. Under the current Australian law, inactivity or lack of involvement will not matter, if the director cannot show that positive steps were taken to prevent the insolvent trading occurring. Likewise under the UK provision, a director might be held liable for failing to do something that seeks to minimise the potential loss to the company’s creditors.<sup>25</sup>

### III. The Provisions

It is appropriate and helpful for purposes of exposition to briefly explain the critical parts of the respective provisions.

Section 214 provides, in effect, that the liquidator of a company that is in insolvent liquidation (effectively a company’s assets are not sufficient to pay its debts at the time of liquidation<sup>26</sup>) may commence proceedings against any of the company’s directors, and these proceedings may seek an order that the director(s) against whom proceedings are brought make such contribution to the company’s assets as the court thinks proper.<sup>27</sup> A director may only be liable where at some time before the commencement of the winding up of the company, he or she knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation.<sup>28</sup> Courts are not to make an order against directors if satisfied that after the directors first concluded or ought to have concluded that there was no reasonable prospect that the company would avoid going

24. A recent example is *ASIC v Plymin* [2003] VSC 123, and [2003] VSC 230.

25. Mannolini (above n 2 at 18) has said this shows that Australia has been “far bolder than the United Kingdom in adopting an interventionist strategy in the regulation of managerial misconduct in corporations.” However, while that might be true as far as the way that the courts have interpreted the Australian provision, that conclusion cannot be drawn just from a study of the respective legislation.

26. Section 214(6). “Insolvent liquidation” in this sub-section means that the company is insolvent on a balance sheet basis. This involves the company’s assets being less in value than its debts and the costs of its liquidation. Hence, for a director to escape liability the company must be able to discharge all of its debts and cover the costs of its liquidation.

27. See section 214(1).

28. See section 214(2).

into insolvent liquidation, they took every step with a view to minimising the potential loss to the company's creditors as they ought to have taken.

In contrast, section 588G is but one of many sections that deals with insolvent trading. Section 588H through to section 588Y provide the legislative regime that seeks to regulate insolvent trading. The legislation provides that directors have a duty to prevent their companies incurring debts at the time of insolvency. The broad scheme of the insolvent trading regime is that the liquidator of the company may recover from the director "an amount equal to the amount of the loss or damage" suffered by the company as a result of the insolvent trading.<sup>29</sup> Such an amount is then available for the company's unsecured creditors, that is, in priority to any secured claims.<sup>30</sup> Significantly, a creditor may itself pursue the directors for insolvent trading, with the liquidator's consent or with leave of the court.<sup>31</sup> A further significant feature of the insolvent trading regime is that it contains provisions imposing liability on a holding company for the insolvent trading of its subsidiary. Australian law, like that in the UK and many other jurisdictions, makes no allowance for the insolvency of a corporate group—insolvent trading has to be assessed on a company by company basis.<sup>32</sup>

One comparison worth noting at the outset is that while the Australian provisions actually refer to insolvent trading, there is no reference to "wrongful trading" in the UK provision, save in the heading to the section. Further, while the Australian provisions establish what insolvent trading amounts to, the UK provision does not explain what constitutes wrongful trading. The provision does set out what will lead to an action under section 214, but it is highly debatable as to whether a breach of section 214 involves trading that is "wrongful". As Marion Simmons QC has noted,<sup>33</sup> the Oxford Dictionary definition of "wrongful" is "full of wrong, injustice, or injury; marked . . . by wrong, unfairness or violation of equity." This definition seems to suggest that there is a need to establish blame, something that the Cork Committee never envisaged.

While each jurisdiction started virtually from the same place, each has gone off on its own journey, and while there are clear similarities between the provisions, there are patent differences that we wish to explore in the following parts of the article. Leaving aside fraudulent trading, while the UK, since 1980, has only had one attempt at constructing an acceptable wrongful trading provision, the Australian legislatures have made several attempts. This could mean a number of things. It could mean that the UK lawmakers are content with the provision that applies and that it is just about right, or they have neglected the need to change. The state of affairs existing in Australia could mean that the tack on which the legislature has set itself is wrong or that the legislature has been gradually perfecting the insolvent trading provision.

29. Section 588M(2).

30. Section 588Y.

31. Section 588R.

32. Section 588V, which can impose liability on the

holding company.

33. "Wrongful Trading" (2001) 14 *Insolvency Intelligence* 12.

## IV. The Legislative Aims

The aim of the illicit trading provisions in the UK and Australia is to stop directors from continuing to trade while their companies are on the slide into insolvency, thereby, hopefully, reducing the potential loss suffered by creditors.

The intention behind the legislation in both countries was to place greater responsibility on directors when their company is in financial strife,<sup>34</sup> and to permit liquidators to seek recompense for creditors in relation to the actions of honest, but reckless and cavalier, directors<sup>35</sup> when they failed to demonstrate responsibility, or where directors merely sat passively while their company collapsed around them. It is also probably permissible to see the introduction of the provisions as a deterrent: to deter directors, by threat of civil liability or civil or criminal penalty, from allowing their company to incur debts and otherwise failing to take action to prevent or limit damage to creditors.<sup>36</sup> The intention of the respective legislatures was to encourage directors to monitor the financial affairs of their companies.

So, there is with both approaches a positive requirement of directors that they are to prevent losses, which may well damage the interests of creditors. The provisions exist to encourage a commercially moral standard of conduct from directors of companies,<sup>37</sup> and by so doing improve the standards of directors,<sup>38</sup> and to protect creditors from the abuse of the limited liability principle.

## V. Conditions for Liability

The Australian provisions focus on the incurring of debts by the director against whom insolvent trading proceedings have been mounted. The Cork Committee had in fact recommended something akin to section 588G. But this approach was rejected by the UK government, with the end result that a person may be held liable for wrongful trading without incurring further debts, or conversely a director might not be held liable even if further debts were incurred. The latter situation might occur where directors reasonably believe that if there was a halt to business and a forced sale of assets, creditors would be prejudiced, and it would be better to go on and either take action to rescue the company's business or sell assets in any orderly, and beneficial, fashion. The fact is that the UK provision is potentially broader and can encompass a greater range of conduct, because all sorts of activity can lead to liability, such as selling company assets at an undervalue and the payment of excessive remuneration to directors,<sup>39</sup> as well as inactivity.

To be liable pursuant to the Australian provisions, several elements need to be proved, namely:

34. For example, see Explanatory Memorandum to the Companies Bill 1982 (Cth) at para 1219.

35. Cork Report at para 1782.

36. D. Morrison, "The Australian Insolvent Trading Prohibition—Why Does It Exist?" (2002) 11 *International Insolvency Review* 153 at 161.

37. See *Re D'Jan of London Ltd* [1993] BCC 646; *Wood-*

*gate v. Davis* [2002] NSWSC 616.

38. P. Godfrey and S. Nield, 'The wrongful trading provisions—all bark and no bite' (1995) 11 *Insolvency Law & Practice* 139.

39. S. Griffin, *Personal Liability and Disqualification of Company Directors* (Oxford, Hart Publishing, 1999) at 64.

- A respondent was a director when the company incurred the debt;<sup>40</sup> the section is limited to directors, although the definition of directors is broad enough to encompass *de facto* and shadow directors;<sup>41</sup>
- the company was insolvent at the time when the debt was incurred or became insolvent as a result of the incurring of the debt;<sup>42</sup>
- at the time when the debt was incurred there were reasonable grounds for suspecting that the company was insolvent or would become insolvent as a result of the debt incurred. Suspicion must involve “a positive feeling of actual fear or misgiving amounting to an opinion which is not supported by sufficient evidence”<sup>43</sup> and is a lower threshold than expecting or knowing that the company was insolvent;<sup>44</sup>
- the director was aware at the time of the incurring of the debt that there were grounds for suspecting the insolvency of the company or a reasonable person in a like position in a company in the company’s circumstances would have been aware of the company’s insolvency.<sup>45</sup>

The section is contravened by the director “failing to prevent the company from incurring the debt” in the circumstances described.

The conditions for liability in the UK counterpart are:<sup>46</sup>

- The company is in insolvent liquidation.<sup>47</sup>
- At some time prior to the commencement of winding up, the respondent knew or ought to have concluded, that there was no reasonable prospect of the company avoiding going into insolvent liquidation; and
- the respondent was at that time a director of the company. Like the Australian provision, *de facto*<sup>48</sup> and shadow directors<sup>49</sup> are covered.

The second of these conditions warrants some comment. It means that the conclusions which a director ought to reach, are those which would be known or ascertained by a reasonably diligent person having both the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as carried out by the director in relation to the company, and the general knowledge, skill and experience that the director personally possesses.<sup>50</sup>

Both the UK and Australian provisions factor objective elements into the liability question. In Australia a director will be liable if there were, when debts were

40. Section 588G(1)(a).

41. See for example *Deputy Commissioner of Taxation v. Austin* (1998) 16 ACLC 1555.

42. Section 588G(1)(b). Insolvency in Australia is based on the cash flow test, being an inability to pay all debts as and when they fall due. For a discussion of the provision that provides for a definition of insolvency (section 95A of the Corporations Act), see A Keay, “The Insolvency Factor in the Avoidance of Antecedent Transactions in Corporate Liquidations” (1995) 21 *Monash University Law Review* 305; J. Duns, “Insolvency: Problems of Concept, Definition and Proof” (2000) 28 *Australian Business Law Review* 20; A. Keay and M. Murray, *Insolvency:*

*Personal and Corporate Law and Practice*, 4th ed, (Sydney, Law Book Co, 2002) at 13–17.

43. *Queensland Bacon Pty Ltd v. Rees* (1966) 115 CLR 266.

44. Section 588G(1)(c).

45. Section 588G(2).

46. Section 214(2).

47. Although it is not stated in the Australian provisions, liability for insolvent trading can only arise on the formal insolvency of the company.

48. *Re Hydrodam (Corby) Ltd* [1994] BCC 161.

49. Section 214(7).

50. Section 214(4).

incurred, reasonable grounds merely to suspect that the company was or would become insolvent.<sup>51</sup> The UK standard is higher, in that it must be demonstrated that the director ought to have concluded that there was no reasonable prospect of the company avoiding going into insolvent liquidation. In determining what standard has to be adhered to, the following can be taken into account by a court in determining liability: the facts which a director ought to know or ascertain, the conclusions which ought to have been reached, and the steps that ought to have been taken are those which would be known, ascertained or taken by a reasonably diligent person who has the knowledge, skill and experience that may be reasonably expected of a person carrying out similar functions.<sup>52</sup>

But, besides the objective element just adverted to, UK courts are also to take into account a subjective element, namely the general knowledge, skill and experience of the director. The inclusion of the subjective element does not serve to reduce the standard of knowing or ascertaining, rather it heightens it if the director is experienced. Hence, a director who is well-qualified and with significant experience cannot escape liability simply by demonstrating that a reasonable director would not have concluded that insolvent liquidation was inevitable, if a person with his or her credentials would have seen insolvent liquidation coming. Conversely, if a director is not very experienced or has qualities that do not match that of the reasonable director, he or she is not able to take advantage of that and be protected from liability. All of this means that a director will be judged by two tests and the director has to attain the higher standard set by the tests. There is no subjective element present in the Australian provisions, (save for the defences available, which we discuss late), with the result that provided a director meets the objective standard, it matters not that he or she was a very experienced director and did not do what a reasonably diligent person with his or her experience would have done. Nevertheless the Australian provisions are based on the lower level of needing to prove only that there was reasonable suspicion in the mind of the director that the company was insolvent.

As we have discussed, both the UK and the Australian provisions require positive action from directors. However, the positive action required is, of course, different in each case. A reasonable step for directors to take in the UK might well be refraining from incurring any more debts, while failing to do so in Australia would constitute a breach of section 588G. However, the UK provision appears to allow some greater latitude to directors in determining their company's fate without the danger of personal liability as they are not specifically forbidden from incurring further debts.

That latitude also has the potential for producing uncertainty for UK directors. Put another way, the point at which liability is attracted seems to be more definite in the Australian provisions. They identify it as either the point where a debt is incurred at a time when the company is insolvent, or the point where a debt is

51. Section 588G(1)(c).

52. Section 214(4).

incurred that will cause the company to become insolvent.<sup>53</sup> In contrast, the point of liability under the UK provision is most imprecise, being when the director knew or ought to have concluded that there was no reasonable prospect of the company avoiding going into insolvent liquidation.<sup>54</sup>

While the threshold point at which liability is attracted seems to be more definite in the Australian provisions, this is perhaps illusory given the potential lack of precision of the two elements involved. The particular point in time that insolvency occurs, on a cash flow basis, can be difficult to establish,<sup>55</sup> as much in retrospect by a liquidator in a claim for insolvent trading as at the time when the company is experiencing financial difficulties, and the directors have to assess the company's position. It will often be a matter of establishing the insolvency of the company through expert evidence, given by the liquidator in the insolvent trading proceedings; and it will often be a matter of directors obtaining expert guidance and advice, if they so choose, at the time that debts are being incurred.

In addition, even if the point of insolvency can be proved, there are other uncertainties in the Australian provisions. Proof of reasonable grounds for suspecting the company's insolvency, of which the director is or reasonably should have been aware, can be difficult, although these will often readily flow from proof of the company's insolvency. As well, the actual time of the incurring of a debt can be difficult to establish, for example in relation to the entry into a guarantee, or an insurance contract, or the incurring of tax liabilities.<sup>56</sup> Nevertheless, these are matters of commercial and legal reality. Australian law in effect is definite as to when liability will arise; it expects that directors will take heed of this potential liability in their conduct. This would properly involve a conservative approach to any assessment of insolvency and a proactive and continued assessment of the financial position of the company. A director's duty is to prevent insolvent trading occurring and, taken alone, the law allows little scope for directors to do other than cease trading.

In that regard, it may be said, and in comparison with the UK provision, that the Australian approach unduly restricts the ability of directors to deal with their company's financial situation in a flexible and entrepreneurial manner. Perhaps, there should be some latitude allowed to a director to continue to trade in a reasonable expectation that, although the company is insolvent, it is most likely to be able to trade out of its difficulties. With particular reference to the UK provision, the latitude allowed to the UK director is that, despite immediate insolvency, if there were some prospect, even if minor, that the company would avoid going into insolvent liquidation, the director could continue to allow the company to incur debts without being concerned about personal liability. Further, that concern could be allayed even if there were no reasonable prospects of avoiding liquidation, if, in allowing the company to continue to trade, the directors "took every step with a view to minimising the potential loss to the company's creditors as... (they)

53. Section 588G(3)(b). See text above accompanying notes 39–44.

54. Section 214(2)(b).

55. See Keay, "The Insolvency Factor" above n 42.

56. N. Coburn, *Insolvent Trading: A Practical Guide*, 2nd edn, (Sydney, Law Book Co, 2003) at 45–52.

ought to have taken.” The strictness of the obligation on a director to prove that “every step” was taken is discussed later.

The question may really come down to how severely law and society should regard illicit trading. In Australia, where the provisions most clearly state that a company shall not be allowed to incur one debt whilst it is insolvent, the law obviously takes a severe view. Whilst that restrictive regime may serve to provide some clear protection to creditors, it may not ultimately serve their purposes if some other more flexible arrangement would have produced a financially more favourable result.

At this point we should explain the broader context in which the Australian insolvent trading provision operates. This may serve to counter any criticism of perceived inflexibility of the Australian provisions.

### **A. The Australian context**

The Australian provisions should really be seen in the broader context of legal policy and of Australian attitudes to insolvency. To a large extent, these are the same as in the UK. Thus, whilst insolvency is accepted as an inevitable occurrence, and a “fresh start”<sup>57</sup> ought to be allowed to those who suffer it, Australian law expects those who seek to benefit from the discharge of their liabilities to have acted properly during their company’s demise. If that conduct was not acceptable, the benefits of formal insolvency may be foregone. The UK position is no different.

But while Australian law has high expectations of what is expected of directors, and is relatively inflexible in terms of when that liability arises, it also has sympathetic and readily accessible arrangements whereby directors can be assisted when their company is in distress. That assistance is provided through the voluntary administration processes of Part 5.3A of the Corporations Act.

In Part 5.3A, section 435A provides:

“The object of this Part is to provide for the business, property and affairs of an insolvent company to be administered in a way that:

- (a) maximises the chances of the company, or as much as possible of its business, continuing in existence; or
- (b) if it is not possible for the company or its business to continue in existence—results in a better return for the company’s creditors and members than would result from an immediate winding up of the company.”

Directors of an insolvent company, or even a company that is ‘likely’ to become insolvent, can place their company into administration on a board resolution being passed. The company immediately comes under the control of the administrator (a registered company liquidator) who, in consultation with the directors

---

57. This is a concept of insolvency law that is aimed at ensuring that the insolvent’s debts are discharged

in exchange for some benefit for creditors. It has its genesis in the English Act of 1705 (3 Anne c 17).

and the creditors, seeks to save the company or otherwise resolve its fate. Any personal liability of the directors for the company's trading after that date may be negated; any liabilities for insolvent trading or other liabilities incurred in the period leading up to the company's entry into administration may also be stopped.

In contrast, while the threshold of liability being imposed on UK directors appears to be higher and more flexible in scope as to the timing of its application, there have been, certainly hitherto, less flexible arrangements available for those directors when they do decide to respond to their companies' financial stress.

Thus, while insolvent trading in Australia is seen as a significant breach of the law, enough to warrant high civil damages, and civil and criminal penalties, and is more precisely imposed, the voluntary administration processes give significant recourse to directors to address the insolvency in an ordered way.

In terms of the purposes of insolvency law, the Australian provisions, and the context in which they operate, may in fact be seen as more flexible and useful than the UK equivalent. This may change, depending on the way that the new administration scheme introduced in the UK recently, by the Enterprise Act 2002, works out in practice. The new scheme does embrace some of the aspects of the Australian voluntary administration regime, including the possibility of the appointment of administrators without the need for a court order.

There is a further legislative context in which the insolvent trading provisions operate in Australia. This context relates to other legislative prohibitions on directors allowing their companies to trade, in effect, whilst insolvent, even in the absence of incurring additional debt. Australian taxation legislation imposes personal liability on company directors in respect of their unpaid company taxes payable in respect of their employees' income tax. This personal liability of directors was introduced in 1993 as, in effect, a trade-off for the loss of the Commissioner of Taxation's right to priority in insolvencies.<sup>58</sup> The liability is imposed on company directors personally if the company's tax is unpaid. The regime provides for the issue of a notice by the Commissioner of Taxation—a "director's penalty notice"—which specifies the liability and gives the directors four options: to have the company pay the tax; to compromise the payment of tax owed; to place the company into liquidation; or to place the company into voluntary administration. If any of those four options are not adopted, within the 14 days, the directors may then be sued personally for the liability.<sup>59</sup>

Under this regime, there is therefore a definite incentive for directors to at least ensure their companies' taxes are paid. The fact that they are not paid may or may not indicate insolvency. In Australia, and in the UK, it is not uncommon for directors to use the collected taxes of their employees as a float or "cash cow" before remitting them, somewhat delayed, to the Tax Commissioner. That may indicate an unwillingness to pay rather than an inability to pay, in terms of the definition of insolvency in Australia. Nevertheless, it is also often the case, and is the subject of

<sup>58</sup>. This is something that has recently occurred in the UK: Enterprise Act 2002, section 251.

<sup>59</sup>. See Income Tax Assessment Act 1936 Part VI Division 9.

frequent judicial comment, that unpaid tax liabilities are often an early indicator of insolvency.<sup>60</sup>

In the context of our assessment of insolvent trading, these tax provisions are significant in the sense that they provide another overlay of responsibility for directors, enforced by the threat of personal liability, for the financial distress of their companies. Not only must directors be aware of their potential liability for insolvent trading, but also for non payment of tax liabilities.

That tax regime in itself can operate beneficially. Whilst there is limited direct regulation of insolvent trading at the time of its occurrence,<sup>61</sup> the Tax Commissioner will often serve notices on the directors at any time in the company's financial history. In that regard, the Tax Commissioner often serves as a *de facto* regulator of the insolvency laws. The notices serve as a reminder to the directors that in respect of that creditor at least, they must act financially correctly, and this includes acting in accord with what is expected of directors of an insolvent, or likely to become insolvent, company. That is, on being served with a penalty notice, a director may well focus on the fact that the company is in fact insolvent, and respond by putting the company into some formal insolvency regime. The reality often is that service of such penalty notices will often coincide with the company's more general financial difficulties which the actions of the Commissioner will bring to the fore.

Whilst this tax provision appears to be severe, it must be seen in the context of what Australian law seeks to achieve, that is, the proper and measured response of directors to their company's financial difficulties.<sup>62</sup>

This broader context in which insolvent trading sits in Australia should be further explained in terms of available defences to insolvent trading and tax liability provisions. These reinforce the emphasis that Australian law gives to ensuring directors seek to prevent insolvent trading by providing defences linked to the decision to put the company into administration. They are discussed later in section VIII, under the "Defences."

While under Australian law there is the "stick" of severe consequences for directors who fail to respond to their company's insolvency, the law also provides the "carrot" for directors, that is, the ready access to Part 5.3A, however unpalatable that may be in terms of facing up to the company's poor financial position. With this "carrot and stick" approach of Australian law, it may be little wonder that voluntary administrations exceed liquidations in number.<sup>63</sup>

In sum, if Australian law on insolvent trading existed on its own with no refinement, it may be, in comparison to its UK counterpart, fairly criticised for unduly

60. See *Didovich v. ASIC* [1998] NSWSC 534.

61. ASIC's insolvent trading program, based in part on analysis of accounts of trading companies, is one attempt to enforce and regulate insolvent trading in the period before any liquidation: see <www.asic.gov.au> The ASIC will itself wind up an insolvent company: *ASIC v. ACN102556098 Pty Ltd* (2004) 48 ACSR 350.

62. An additional provision in respect of tax liabil-

ities is section 588FGA of the Corporations Act, by which directors indemnify the Commissioner in respect of any repayments he may be ordered to make to a liquidator that were made by the company as avoidable preferences.

63. There were 638 administrations in the three months from January to March 2004, compared with 500 court-ordered liquidations: see <www.asic.gov.au>

restricting directors, or at least be criticised for not adequately pursuing the policy aims of insolvency law in seeking to uphold proper conduct of directors, but that is, as explained earlier, not the case.

## B. The UK approach

This positive comment on Australian law should be tested by an examination of the UK provision in its best light. There is some validity in the comment that the UK provision:

“provides directors with more latitude to continue with the company’s activities where the company has fallen on hard times. It allows them to take a long-term view of the situation and, so long as there is reasonable prospect of recovery, there will be no contravention of the provision even though the company continues while insolvent.”<sup>64</sup>

The recent decision in the English High Court in *Re Continental Assurance Co Ltd*<sup>65</sup> seems to bear this out. This was a case that lasted for 72 days and “required the court to grapple with a welter of complex issues, both factual and legal.”<sup>66</sup> The result was a mammoth judgement delivered by Park J. The company involved, a small insurance company, entered liquidation in early 1992. It had experienced heavy losses during 1990. The liquidator’s argument against the directors was that the company should have terminated trading in mid-1991, which was about the time when the losses were first reported. The question in the case was whether in mid-1991 the directors knew or ought to have concluded that there was no reasonable prospect of the company avoiding insolvent liquidation. Park J found for the directors. He held, *inter alia*, that the company was not technically insolvent in mid-1991 and that the directors had acted reasonably in taking the view that the company could continue to trade while a buyer for its insurance business was sought.

Theoretically directors in the UK are able to engage in more risk-taking and a longer term view than those in Australia, and in fact are able to continue to trade while insolvent, carefully juggling their companies’ competing liabilities. With financially intelligent directors, and some good luck, the UK regime will often work. The directors may properly and sensibly seek financial assistance and advice as they tread the fine lines set for them by section 214. But the reality may be that many UK directors will fail in this task, and this will be so for many because they will not be able to deal with the difficulties encountered. This contrasts with the Australian position that in effect puts an insolvency administrator in charge of that financial juggling, bringing to bear on the company the benefit of his or her insolvency experience and expertise and in circumstances where creditors are required to stand back while a solution is examined. Nevertheless this does involve a formal insolvency administration the entry into which, in itself, may bring about the untimely end of the company. It must be noted that the UK has had an

64. VCS Yeo and JLS Lin, ‘Insolvent trading—a comparative and economic approach’ (1999) 10 *Australian Journal of Corporate Law* 216 at 220–221.

65. [2001] BPIR 733.

66. A. Walters, “Wrongful Trading: Two Recent Cases” [2001] *Insolvency Lawyer* 211 at 211.

administration regime<sup>67</sup> available to struggling companies, that are either insolvent or likely to become so, but it has not been used frequently, compared with the scheme in Australia, because it has not been readily accessible, due to the need for a court order. Things are likely to change as the law has been amended to permit appointments of administrators extra-judicially,<sup>68</sup> and there has been an increase in the number of administrations since the advent of the new type of regime.<sup>69</sup> But in contrast to Australia it has not been a deliberate policy of government to see administration as a way-out for directors who are concerned about wrongful trading. We must add that putting the company into administration may not save directors from being liable for illicit trading in either the UK or Australia if liquidation follows administration, as it might well do.

## VI. Compensation

Under section 214 the compensation that may be ordered by a court has been said to be the amount by which the net deficiency of the company increased between two dates. First, the date when the directors know or ought to have known that insolvent liquidation was unavoidable, and second, the date of the start of the liquidation.<sup>70</sup> The fact of the matter is that judges are granted a wide discretion by section 214. They do not have to order that the director make a payment, even if he or she has engaged in wrongful trading. A judge may, if deciding that a payment should be made, determine the actual amount. All of this makes it difficult for a liquidator to gauge a likely award by a court.<sup>71</sup>

It has been suggested that as the court has been given a wide discretion under section 214 in deciding on the amount of contribution that is to be paid,<sup>72</sup> it could consider the culpability of the director in the wrongful trading, with the effect that an honest, naïve director might be viewed with leniency while a reckless director might evoke little sympathy. With respect, this is questionable as the intention behind section 214 is to provide compensation for creditors rather than penalise directors, and in *Re Produce Marketing Consortium Ltd*,<sup>73</sup> while the court said that the amount of compensation to be ordered to be paid is in the discretion of the courts,<sup>74</sup> it was said that the section 214 jurisdiction was compensatory and not penal.

67. Part II of the Insolvency Act. The scheme has been amended substantially by the Enterprise Act 2002.

68. Pursuant to the Enterprise Act 2002. Now see Insolvency Act, paras 14 and 22 of Schedule B1.

69. The new scheme for administrations became operative on 15 September 2003. In the last quarter of 2003 (in England and Wales) there were 233 administrations. In the first quarter of 2004 there were 331 administrations, with 392 administrations in the second quarter and in the third quarter there have been 421 administrations. (See <<http://www.dtistats.net/sd/insolv/table3.htm>>). In the quarters preceding the introduction of the corporate

insolvency provisions of the Enterprise Act there was a steady increase in the use of administrations (from 1997), but the highest numbers were in 2001 with 698 administrations. If the figures for the rest of 2004 continue in the same vein as for the first three quarters, there will be nearly twice as many administrations in 2004 as there were in 2001.

70. *Re Produce Marketing Consortium Ltd* (1989) 5 BCC 569.

71. Above n 12 at 152.

72. Above n 39 at 83.

73. (1989) 5 BCC 569.

74. *Ibid.* at 597.

Hence, it is likely that the amount of compensation will not depend on the state of mind of directors, but on the loss sustained by the company, and the ultimate prejudice to creditors.<sup>75</sup>

The criticism of the present system of compensation in the UK has been that the persons who have been the real victims of the wrongful trading, namely those who became creditors subsequent to the time when wrongful trading commenced, do not receive all of the compensation, for some of it will go to persons who had become creditors prior to the advent of wrongful trading.<sup>76</sup> The same position applies in Australia. That is, moneys recovered in respect of an insolvent trading claim go to meet all unsecured creditors of the company, not only those creditors who have suffered the loss or damage in respect of which the claim was brought. However the Australian provision allows less latitude to the courts in how the loss or damage is assessed, compared with the broad discretion given under section 214.

## VII. Applicants

Although the Cork Report recommended that applications should be made by liquidators, receivers and administrators, the fact is that the only person who is able to act as the applicant for an order under section 214 is the liquidator. In practice this is the case in Australia. However, as indicated earlier, it is possible in Australia, where no application has been made by a liquidator, for a creditor to seek to take proceedings. To do so the creditor must obtain the consent of the liquidator<sup>77</sup> or give notice to the liquidator after six months from the commencement of the winding up that it is intended to begin proceedings against a director and asking the liquidator to give to the creditor, within three months, either a consent or a statement of reasons why the liquidator is of the opinion that proceedings should not be initiated.<sup>78</sup> If no consent is given within the three months the creditor may proceed against the director.<sup>79</sup> If a reason for not proceeding is given by the liquidator, it must be produced to the Court in the action in which proceedings have been or are initiated.<sup>80</sup>

At least under the Australian provision a creditor may be able to take action if the liquidator fails to do so,<sup>81</sup> but in the UK there is no such opportunity and this might prejudice creditors, for instance where a liquidator is unduly cautious about

75. Note that Dr Fidelis Oditah says that "the absence of a fraudulent intent is not, on its own, a reason for fixing the amount at a nominal or low figure." ("Wrongful Trading" [1990] LMCLQ 205 at 215).

76. A. Hicks, "Advising on Wrongful Trading: Part 1" (1993) 14 *Company Lawyer* 16 at 17.

77. Section 588R. An example of a case where a creditor obtained the consent of the liquidator is *Fabric Dyeworks (Aust) Pty Ltd v. Benharron* (unrep, Vic

Sup Ct, Smith J, 29 May 1998). Under the predecessor provision, section 592, creditors were permitted to bring proceedings.

78. Section 588S.

79. Section 588T(2). For a case where proceedings were initiated by a creditor, see *Metropolitan Fire Systems Pty Ltd v. Miller* (1997) 23 ACSR 699.

80. Section 588T(3).

81. Although such claims by individual creditors are rarely pursued in practice.

instituting proceedings.<sup>82</sup> As well, the corporate regulator in Australia, ASIC, may itself institute proceedings for insolvent trading, and obtain not only civil penalties against the directors, but also orders for civil compensation that will benefit the creditors.

A further drawback with only the liquidator being permitted to initiate proceedings is that he or she will only be concerned about how much money can be obtained to benefit the creditors. Consequently, the public function of the provisions (discussed later<sup>83</sup>) will not be fulfilled.

## VIII. Defences

The defences that are provided for in the provisions in both countries are based on objective tests. The solitary defence to wrongful trading proceedings is found in section 214(3) and involves the director having to satisfy the court that after becoming aware that the company was bound for insolvent liquidation, he or she took “every step with a view to minimising the potential loss to the company’s creditors as ought to have been taken.”

In contrast, under the Australian provision there are four alternative defences available. These are contained in section 588H. To defend successfully an action a director must prove *one* of the following:

- that when the debt was incurred the director had reasonable grounds to expect (not merely suspect) that the company was solvent and would remain solvent even if the debt was incurred;<sup>84</sup>
- that when the debt was incurred the director had reasonable grounds to believe, and he or she did believe, that a subordinate was competent, reliable and responsible for providing adequate information about the company’s solvency and the director expected, on the basis of this information, that the company was solvent and would remain solvent;<sup>85</sup>
- that when the debt was incurred the director, because of illness or for some other good reason, did not take part in the management of the company at that time;<sup>86</sup> or
- that the director took all reasonable steps to stop the company from incurring the debt.<sup>87</sup>

82. It is possible that creditors could apply to the courts for a review of the decision of the liquidator not to proceed with an action. This could be done pursuant to section 168(5) of the Insolvency Act 1986 for compulsory liquidations, and under section 112 of the Act for voluntary liquidations. See, A Keay, “The Supervision and Control of Liquidators” [2000] *The Conveyancer and Property Lawyer* 295.

83. See text late relating to notes 119–128.

84. Section 588H(2). Coburn submits that the standard of reasonableness likely to be applied is the

level of competence and care of a director for the relevant corporate position: above n 56 at 72. The section 588H(2) defence was first considered in *Stargard Security Systems Pty Ltd v. Goldie* (1994) 13 ACSR 805; see also *Fryer v. Powell* (2002) 139 *Federal Law Reports* 433.

85. Section 588H(3). As Coburn notes, the defence does not indicate what inquiries should be made of a person’s competence (above n 56 at 82).

86. Section 588H(4).

87. Section 588H(5).

The UK provision seems to be considerably less generous. The use of the words ‘every step’ in section 214(3) might be said to be too strong, for if one wanted to be strict, the defence is, except in rare cases, almost impossible to establish. For instance, if a company has entered into insolvent liquidation it is quite possible that while a director took steps to minimise creditor loss, he or she did not take ‘every possible step’ or else insolvent liquidation would not have occurred. The provision fails to cater for the position where a director is unable to take every step to minimise potential loss to creditors. For example, what if a director is ill or overseas? In the Australian case of *Androvin v. Figliomeni*,<sup>88</sup> a director was held not to be liable for debts incurred while he was overseas. The director had indicated to the other directors, before his departure, that he would not be in a position to act as a director or accept any responsibilities during his absence. As a result there had been a fundamental change in the working operations of the company. It is very likely that a British director would not, in similar circumstances, be saved from liability.

The Australian provision sets out the circumstances where a defence might be sustained while the UK’s is extremely vague. What constitutes “every step”? There is no indication whatsoever from the legislation as to its meaning and, in any event, it is likely to depend on each facts situation. Taking advice (and recording the fact that meetings took place) from appropriate professionals, and acting on it, is probably a good starting point.<sup>89</sup> Resignation might be considered by individual directors, but it is not guaranteed to extricate a director from liability because if he or she resigns then it is not possible for the director to take action to minimise losses for creditors.<sup>90</sup> The termination of business, while it may seem to be the most sensible and proper thing to do, can in fact be the worst thing, especially in the short term, as it may be detrimental for all concerned, particularly the creditors. Trading on the basis of cash purchases may well not be regarded as sufficient as overheads will still mount up.<sup>91</sup> Commentators have hazarded suggestions as to what might be sufficient to excuse a director, but the fact is that they can only be seen as suggestions and nothing more than that.<sup>92</sup>

A Cork Report recommendation that was disregarded by the government, would have attenuated the strictness of section 214. This was that a director should be able to apply to a judge in Chambers for relief in advance.

“The Court will have power to declare that, however matters turn out, future trading of the kind which it has sanctioned should not be capable of giving rise to any claim for wrongful trading.”<sup>93</sup>

One can understand why the government was apprehensive about implementing such a recommendation. It might well have been seen to be unworkable and

88. (1996) 14 ACLC 1461.

89. Especially in light of the recent case of *The Liquidator of Marini Ltd v. Dickens* [2003] EWHC 334 (Ch); [2004] BCC 172.

90. A. Hicks, “Advising on Wrongful Trading: Part 2” (1993) 14 *The Company Lawyer* 55 at 58.

91. Above n 75 at 214.

92. For example, see R. Goode, *Principles of Corporate Insolvency Law*, 2nd edn., (London, Sweet and Maxwell, 1997) at 472–473.

93. Para 1798.

holding a court as a hostage to fortune, but it would have had the advantage of providing comfort to an honest and conscientious director.

Perhaps it would be fairer if the UK provision adopted the Australian wording of “reasonable steps” rather than the stricter and more severe, “every step.” The Australian provision also has the further definition that the taking of reasonable steps is to be assessed in terms of the directors’ availing themselves of the Part 5.3A administration regime. Now that the UK has introduced what appears to be a more flexible and accessible administration regime, this option is now viable.

Notwithstanding all of this, there is, it would appear from the recent case law, and somewhat ironically, more chance of making out a defence under section 214 compared with section 588H.<sup>94</sup> Speaking generally, Australian courts have tended to be strict in interpreting the defences available under section 588H,<sup>95</sup> while UK courts have been rather liberal, erring on the side of directors.

## IX. Relief from Liability

A further contrast may be drawn between the respective legislation when one considers whether courts can relieve a director who has been found to be liable for wrongful or insolvent trading. Both the Companies Act 1985 in the UK (section 727) and the Corporations Act 2001 (section 1317S) in Australia permit courts, in their discretion, to relieve directors of liability where they have acted honestly and reasonably and ought to be given relief.<sup>96</sup> Yet this provision, whilst able to be employed in Australia, cannot be invoked in the UK,<sup>97</sup> because the tests applied to section 214 and 727 are not compatible. This is, it has been asserted, because the former involves, essentially, an objective test while the latter involves an essentially subjective approach. Yet section 214 and 727 in fact both involve subjective and objective tests, and so there should be no bar to the application of section 727 and 214.

## X. Funding<sup>98</sup>

Mounting and prosecuting wrongful trading actions in the UK is not a cheap process. Anecdotal evidence indicates that a sum in the region of £50 000 is needed, even for relatively small claims.<sup>99</sup> Liquidators will, understandably, refrain from commencing legal proceedings unless there are funds available to cover not only

94. This is manifested somewhat by the decisions in *Re Continental Assurance Co Ltd* [2001] BPIR 733 and *The Liquidator of Marini Ltd v. Dickens* [2003] EWHC 334 (Ch); [2004] BCC 172.

95. See *Fryer v. Powell* (2002) 139 FLR 433; *Tourprint International Pty Ltd v. Bott* (1999) 32 ACSR 201.

96. Somewhat significantly the appointment by directors in Australia of a voluntary administrator is a relevant issue in the exercise of the court’s discretion (section 1317S(3)).

97. *Re Produce Marketing Consortium Ltd* (1989) 5 BCC

569.

98. Much of the discussion that follows is not limited to claims under section 214 or 588G. It applies equally to other actions available to liquidators, e.g. claims in relation to preferences. See A. Keay, “Pursuing the Resolution of the Funding Problem in Insolvency Litigation” [2002] *Insolvency Lawyer* 90.

99. P. Fidler, “Wrongful trading after Continental Assurance” (2001) 17 *Insolvency Law & Practice* 212 at 212.

the costs incurred by the liquidator himself or herself, but also the costs of the party from whom recovery is sought in case the liquidator's case fails.

As far as liquidations entered into after 1 January 2003, liquidators in the UK are able to claim their own expenses of running litigation under section 214 from company funds (ranking with the liquidation costs and expenses).<sup>100</sup> Liquidators must not, however, engage in litigation without creditor approval.<sup>101</sup> Whether an adverse costs order made against the liquidator or the company in favour of the director against whom proceedings were brought, will be able to be paid out of company funds is not clear.<sup>102</sup> Given the present uncertainty, liquidators will probably want to ensure that they are covered in case of an adverse costs order. There are avenues that liquidators can pursue in order to protect themselves, but they are limited. These avenues might also be considered even if an adverse costs order could be paid out of company funds, where the funds might not be sufficient to meet a future award.<sup>103</sup>

Secured creditors with floating charges over company property are not entitled to the proceeds of a successful claim under section 214, at least in priority to the unsecured creditors, so they are unlikely to offer to cover any liability. It is open to the liquidator to call for indemnities from creditors in relation to costs, and prudent liquidators have in the past obtained indemnities.<sup>104</sup> However, creditors are not always keen, or able, to provide such indemnities.<sup>105</sup> Another avenue is where a person or company agrees to cover the costs of the liquidator's litigation in exchange for a premium. There are various packages that are arranged but the most common one involves the premium payable being a specified portion of any moneys recovered by the liquidator pursuant to the litigation. This kind of funding has been used successfully by Australian liquidators seeking to bring insolvent trading cases, but in relation to wrongful trading cases, in particular, UK liquidators have struck snags.

The problem which confronts liquidators in both the UK and Australia, where this type of cover is arranged, is, *inter alia*, that it may be able to be categorised as indulging in maintenance and/or champerty. The former is the assistance or encouragement of proceedings by someone who has no interest in the proceedings nor any motive recognised by the law as justifying interference in the proceedings. The latter is a form of maintenance in that assistance or encouragement of proceedings is provided in exchange for a promise to provide a share of the proceeds of the

100. Insolvency Rules 1986, r 4.218(1)(a)(i) as amended by r 23 of Insolvency (Amendment) (No2) Rules 2002.

101. Insolvency Act 1986, Schedule 4, cl 3A.

102. For a discussion of this point, see Gleghorn, "Re MT Realisations Ltd; recovering costs from an insolvent company" (2004) 20 *Insolvency Law & Practice* 105; Gregorian and Butler, "Liquidators litigation expenses, funding arrangements and the amendment to rule 4.218" (2004) 20 *Insolvency Law & Practice* 151.

103. Of course, determining the quantum of any

adverse costs order is notoriously difficult to estimate.

104. The Court of Appeal in *Re Exchange Travel (Holdings) Ltd (in liq)* (No3) ([1997] 2 BCLC 579 at 588) sanctioned the giving of indemnities by creditors and said that it was permissible for the liquidator to agree that any fruits of the litigation would be used first to defray litigation costs paid for by creditors giving indemnities.

105. See Keay n 98 for a discussion of the ways that a liquidator can secure funding support.

action. The policy behind the outlawing of champerty is to stop a person from intermeddling in others' disputes where he or she has no interest, is not justified in intermeddling and does so with a view to obtaining a part of the spoils.<sup>106</sup> While these doctrines may be archaic<sup>107</sup> they still hold some sway. However, over time some exceptions to the doctrines have developed. One of these exceptions is the rule that an insolvency administrator, such as a liquidator or a bankruptcy trustee, is able to assign lawfully any of the bare causes of action of the insolvent on the basis that the administrator is to receive a share of any proceeds of ensuing litigation.<sup>108</sup> This exception is based on the idea that the legislature has granted to the insolvency administrator the power to realise the assets of the insolvent, and the transfer of an action to an underwriter in return for the financing of it and the payment of a part of the proceeds has been treated as a sale of property.<sup>109</sup> The House of Lords in *Norglen Ltd (in liq) v. Reeds Rains Prudential Ltd*<sup>110</sup> and various Australian courts<sup>111</sup> have clearly accepted that the assignment of a chose in action involves an exception to the law against champerty.

The problems that UK liquidators have encountered in relation to funding are encapsulated in the case of *Re Oasis Merchandising Services Ltd*.<sup>112</sup> In this case Robert Walker J. refused to permit the purported assignment of a share of the recoveries in a wrongful trading action on the basis that the action did not belong to the company (it was not company property and was not, therefore, within the liquidator's power to sell company property<sup>113</sup>), but to the liquidator. As a consequence an action under section 214 is incapable of outright assignment.<sup>114</sup> Robert Walker J. took this view notwithstanding the fact that there was not a purported assignment of the claim but only an assignment of a portion of the fruits of the action. It made no difference to his Lordship whether the assignment was of the bare cause of action or a share in the fruits of the action. His Lordship's decision was upheld by the Court of Appeal.<sup>115</sup> In sum, an assignment of a bare cause of action is unquestionably possible<sup>116</sup> and falls within the insolvency exception, but not where the action could not be considered to be part of the property of the company, but was given to the liquidator by legislation, such as under section 214.

Contrast the position in Australia. In the case of *Re Movitor Pty Ltd*<sup>117</sup> the liquidator wished to commence proceedings against the company's directors and the company's holding company for a breach of the insolvent trading provisions, and it was argued that the proceedings fell foul of the rule against champerty. The

106. *British Cash and Parcel Conveyors Ltd v. Lamson Store Service Co Ltd* [1908] 1 KB 1006.

107. See the comments of L. J. Oliver in *Trendtex Trading v. Credit Suisse* [1980] QB 629 at 674 (CA).

108. *Seear v. Lawson* (1880) 15 Ch D 426; *Re Park Gate Waggon Works Co* (1881) 17 Ch D 234 (CA); *Ramsey v. Hartley* [1977] 1 WLR 686 (CA); *Bang & Olufsen UK Ltd v. Ton Systeme Ltd* (unrep, 16 July 1993 (CA)); *Stein v. Blake* [1996] 2 AC 243 (HL); *Norglen Ltd v. Reeds Rains Prudential* [1998] 1 All ER 218 at 232 (HL).

109. Recognised by J. Lightman in *Groveview Holdings Plc v. James Capel & Co Ltd* [1995] BCC 760

at 764.

110. [1998] BCC 44.

111. For instance, *Re Movitor* (1996) 14 ACLC 587.

112. [1995] BCC 911.

113. See, Schedules 4 and 5; section 436.

114. *Re Movitor* (1996) 14 ACLC 587 at 919.

115. *Re Oasis Merchandising Services Ltd* [1998] Ch 170; [1997] 1 All ER 1009; [1997] BCC 282; [1997] 1 BCLC 689 (CA).

116. For a recent case holding so, see *Empire Resolution Ltd v. MPW Insurance Brokers Ltd* [1999] BPIR 486.

117. (1996) 14 ACLC 587.

accounting firm of which the liquidator was a partner had some litigation insurance with an insurance company (known as a “Debt Retrieval Agreement”) and this permitted the firm to propose to the insurance company an arrangement in relation to the provision of support for litigation. Under this arrangement the liquidator entered into an agreement with the insurance company whereby the latter agreed to cover 50% of the liquidator’s costs of the proceedings and 50% of the costs of the defendants if the proceedings failed, in exchange, if the proceedings succeeded, for a premium of 12% of the amount recovered. The liquidator sought the opinion of the court as to whether the agreement was void as constituting champerty or maintenance. Drummond J. of the Federal Court of Australia said that while the overall arrangement was champertous and was void as against public policy,<sup>118</sup> he said that there was no reason why the insolvency exception should not apply to an agreement to sell a share of the proceeds of an action owned by the company in liquidation.<sup>119</sup>

Interestingly, Drummond J. distinguished the insolvent trading provisions from section 214.<sup>120</sup> The former enables a recovery from a director of an amount equal to the loss or damage suffered as a result of the insolvent trading ‘as a debt due to the company’. The debt obviously arose once the insolvent trading occurred and this happened before winding up commenced. So, while a liquidator may, in Australia, agree to share the fruits of an action with an underwriter, no matter what the basis for the action, and can assign an action to which the company is entitled, a liquidator in the UK is not permitted to assign an action, such as one for wrongful trading, as it is granted to him or her personally by legislation.

The upshot is that in the UK it is likely that many liquidators are going to refrain from taking proceedings for wrongful trading because it is uncertain as to whether they will be liable for an adverse costs order and they might not be able to secure some sort of financial cover.

## XI. Burden of Proof

One of the benefits of wrongful trading and insolvent trading in the respective jurisdictions providing for civil liability is that the claimant is only required to establish his or her case on the balance of probabilities. This is to be contrasted with the criminal offence of fraudulent trading under section 458 of the Companies Act 1985 in the UK, and the offence of insolvent trading provided for in Australia under section 588G(3) of the Corporations Act where the defendant is alleged to have acted dishonestly. In these latter cases, the criminal standard of proof has to be discharged.

If a claimant in the UK is able to establish, on the balance of probabilities, that the director, at some time prior to the commencement of winding up, knew or

118. *Ibid.* at 593.

119. *Ibid.* at 595, 596. In this respect his Honour was declining to follow the English decision in *Grovewood Holdings Plc v. James Capel & Co Ltd* [1995] 2 WLR 70; [1995] BCC 760. See *UTSA Pty Ltd (in liq) v. UltraTune*

*Australia Pty Ltd* (1996) 14 ACLC 1262 at 1285–1286; (1996) 21 ACSR 251 at 279–280 and *Re Tosich Construction Pty Ltd* (1997) 23 ACSR 126 at 141 where the same view as in *Re Movitor* was expressed.

120. *Ibid.* at 595–596.

ought to have concluded that there was no reasonable prospect of the company avoiding going into insolvent liquidation, then the burden of proof shifts to the director who has the onus of establishing that he or she took every step with a view to minimising the potential loss to the company's creditors as ought to have been taken.

In Australia, the same applies to the extent that once the liquidator proves the necessary elements of section 588G, the onus falls upon the director to make good one of the defences under section 588H. But one difference in Australia is that if civil penalty proceedings are brought by the corporate regulator, although the elements of section 588G need only be proved on the balance of probabilities, the courts have imposed a slightly higher standard of proof in such cases as a civil penalty is in issue.<sup>121</sup>

## XII. The Public Element

While the provisions under consideration have, provided as their main thrust, for compensation to creditors of companies in insolvent liquidation, they also play a public role. First, section 588G can be used as the basis for criminal liability, where a director has engaged in insolvent trading dishonestly, as well as a basis for civil penalty liability. Section 214 does not provide for criminal liability. If it is thought that criminal proceedings are warranted they have to be initiated on the basis of fraudulent trading under section 458 of the Companies Act 1985 which retains criminal liability, for fraudulent trading.<sup>122</sup>

The fact that wrongful trading does not lead to criminal liability should not be seen as an indication that section 214 has no public role to play. On the contrary, it is intended to play a public as well as a private role. In *Re Oasis Merchandising Services Ltd*<sup>123</sup> Robert Walker J. adverted to the public element in section 214 proceedings, which involves an attempt to prescribe a minimum standard of conduct of directors in managing the affairs of companies. The public function is marked by the fact that it is linked to directors' disqualification, and is a process intended to protect the public from reckless and/or dishonest directors. If a court hearing a wrongful trading claim decides that the case is proven, it may, of its own volition, disqualify the respondent from acting as a director<sup>124</sup> for a period of up to 15 years.<sup>125</sup> Further, even if the court does not decide to make a disqualification order after finding wrongful trading established, the Secretary of State for Trade and Industry may base an application under section 6 of the Company Directors' Disqualification Act 1986 for a disqualification order on the finding.

121. See *Briginshaw v. Briginshaw* (1938) 60 CLR 336 on the standard of proof required where civil penalties can be ordered.

122. Section 213 of the Insolvency Act also provides for liability for fraudulent trading, but this liability is only civil.

123. [1995] BCC 911 at 918.

124. Company Directors' Disqualification Act 1986, section 10(2).

125. Company Directors' Disqualification Act 1986, section 10(1).

The position in Australia is different and the policy issues associated with insolvent trading are emphasised by the legislature, the courts and the regulators, both the ASIC<sup>126</sup> and the Commissioner of Taxation. We have explained that insolvent trading is proscribed by section 588G, and that its occurrence is more clearly defined than is wrongful trading under section 214. However, this comparative lack of flexibility in section 588G is countered by a greater accessibility for directors to structured and protective insolvency restructuring arrangements, under Part 5.3A. The tax provisions also induce directors to act. The policy of requiring directors to address the insolvency of their company earlier rather than later, or too late, is evident. The threat of insolvent trading claims is but one element of the implementation of that policy. Australian courts will often make clear statements of the wrong occasioned by insolvent trading and how directors should be attentive to its prevention. In *Woodgate v. Davis*,<sup>127</sup> Barrett J. of the New South Wales Supreme Court said:

“Section 588G and related provisions serve an important social purpose. They are intended to engender in directors of companies experiencing financial stress a proper sense of attentiveness and responsible conduct directed towards the avoidance of any increase in the company’s debt burden. The provisions are based on a concern for the welfare of creditors exposed to the operation of the principle of limited liability at a time when the prospect of that principle resulting in loss to creditors has become real.”

In *Tourprint v. Bott*,<sup>128</sup> Austin J. opened his judgement with these words:

“This case is a cautionary tale for company directors, especially in the small business sector. The defendant, Geoffrey Bott, joined the board of directors of the plaintiff company less than a year before it went into voluntary administration. He received no remuneration as a director. For at least a substantial part of that period, the company was hopelessly insolvent. For the reasons I shall give, the consequence for the defendant is that he is liable to the company’s liquidator under the insolvent trading provisions of the Corporations Law [now the Corporations Act] in a sum in excess of \$500 000, plus interest.”

As well, apart from civil liability for damages, Australian law allows civil penalties to be imposed, for insolvent trading and other such “white collar” corporate misconduct. The purpose behind that policy was to allow corporate regulation to be pursued unconstrained by the real difficulty, indeed near impossibility in many cases, of proving complex commercial claims to the high criminal standard. Whilst the breach of a civil penalty provision is not a criminal breach, and no prison sentence can be ordered, civil penalties can be considerable—over A\$200 000 for each breach—and various banning orders can be made as a consequence of a civil penalty breach being found.<sup>129</sup>

In addition, section 588G(3) defines the additional elements of insolvent trading at a criminal level, that is, that there is a subjective suspicion of insolvency on the

126. Details of ASIC’s insolvent trading enforcement program are to be found at <www.asic.gov.au>

127. (2002) 42 ACSR 286 at 294.

128. (1999) 17 ACLC 1543 at 1545.

129. Corporations Act 2001, Part 2D.6.

part of the director, and that the director's "failure to prevent the company incurring of the debt was dishonest." Whilst there are the inevitable difficulties of proof of such an issue as insolvency to the criminal standard, there have been a number of such prosecutions brought, to which in many cases there have been pleas of guilty.<sup>130</sup>

It is difficult for any provision to fulfil both private and public functions, and it is doubtful whether, in the UK, section 214 comes near to doing so.<sup>131</sup> It may be argued that the inclusion of a public function in section 214 attenuates its potency as a weapon in civil litigation; it is difficult to distinguish the private and public functions and the extent of improper behaviour needed to fulfil the latter function, which would be more stringent than in relation to the former, that could be required before a court would be willing to hold that a civil action should succeed. Also, director disqualification might well depend on whether success can be secured in a wrongful trading action, and it seems anomalous that a public function is dependent on success in a civil case.<sup>132</sup>

In contrast, in Australia, the prohibition against insolvent trading is more readily enforced against directors by liquidators on behalf of creditors, and by ASIC and the Director of Public Prosecutions on behalf of both creditors and the State. That regulation has been supported in the past by the more sympathetic administration regime for dealing with insolvent companies.

### XIII. Assessment

Undoubtedly both provisions have flaws. With the Australian provision a liquidator has to establish insolvency and that debts were incurred when the company was insolvent, and both of these points can be difficult to prove. Arguably the UK provision has more drawbacks. Shortly after the advent of section 214, a number of academics regarded wrongful trading as a significant weapon in the arsenal of liquidators. Academics and practitioners alike saw section 214 as having a bright future in providing much needed protection for creditors.<sup>133</sup> In the early days of the provision Prentice said that it was "unquestionably one of the most important developments in company law this century."<sup>134</sup> Oditah said that section 214 was a "welcome additional weapon in the fight against abuse of the privilege of limited liability by directors of trading companies."<sup>135</sup> Since these statements other commentators have been more circumspect and less optimistic about its potential and impact. It is probably fair to say that section 214 has not lived up to its early promise. There seems to be several shortcomings endemic to the wrongful trading provision, and that might be the reason why courts in recent years in the UK have tended to

130. See <www.asic.gov.au>

131. See the comments in R. Schulte, "Enforcing wrongful trading as a standard of conduct for directors and a remedy for creditors: the special case of corporate insolvency" (1999) 20 *The Company Lawyer* 80.

132. For some very interesting discussion of this issue, see *ibid.*

133. *Ibid.*

134. "Creditor's Interests and Director's Duties" (1990) 10 OJLS 265 at 277.

135. Above n 75 at 222.

place a benevolent interpretation on what directors have done,<sup>136</sup> and why there appear to be relatively few actions brought by liquidators.<sup>137</sup> Hicks found, in conducting empirical research amongst directors, that actions for wrongful trading are rarely brought against directors who are disqualified under section 6 of the Company Directors' Disqualification Act 1986.<sup>138</sup> While it is not possible to gauge the effect of threats to bring wrongful trading actions have on directors, from a consideration of the case law it appears that the provision has been a "paper tiger,"<sup>139</sup> a view reflected in the business community.<sup>140</sup> This is somewhat ironic given that the provision is, *prima facie*, tougher than the Australian provision. The ineffectiveness of section 214 is not due alone to the provision itself. It has probably got as much to do with the fact that the archaic champerty rule still exists and effectively prevents liquidators obtaining appropriate funding for wrongful trading (and other) actions. It might be thought that in tying wrongful trading to director disqualification and even using the word "wrongful" that there must be a degree of blameworthiness required before a person can be held liable for a breach of section 214. Certainly it might be argued that in several cases the courts have seemed to require an element of moral wrongdoing before finding against a director.<sup>141</sup> This is something that was not envisaged by the Cork Committee, which saw wrongful trading as effecting a balance between encouraging the growth of enterprises and discouraging downright irresponsibility.<sup>142</sup>

Besides the fact that section 214 actions appear to be few and far between, it has been asserted,<sup>143</sup> with some justification, that there is no evidence to suggest that directors' conduct has become more responsible in relation to their companies' affairs as a consequence of the advent of the provision.

Other problems encountered with section 214 have surrounded the two main elements of the provision. The problems are: when can it be said that there is no reasonable prospect of the company avoiding insolvent liquidation; and what can constitute "every step" taken to minimise losses to creditors?

Perhaps section 214 would have been more successful if it has been based on insolvency, namely directors would be liable if they traded when the company was insolvent. This is the approach taken in Australia, which has amended its counterpart of section 214 on several occasions. It seems that Australia may have now got it right. The present section, 588G of the Corporations Act, while still producing some debates over interpretation and application, appears to be quite successful. While the definition of insolvency has caused some difficulties in Australia, because it can be seen as somewhat imprecise, it is not as imprecise as the test set out in section 214. Arguably, directors might be able to detect insolvency before they could

136. For example, in *Re Continental Assurance Co Ltd* [2001] BPIR 733 and *The Liquidator of Marini Ltd v. Dickens* [2003] EWHC 334 (Ch); [2004] BCC 172.

137. Above n 39 at 97.

138. *Disqualification of Directors: No Hiding Place for the Unfit* (Chartered Association of Certified Accountants, Research Report No 59, London, 1998) at 125.

139. C. Cook, "Wrongful Trading—Is it a Real Threat to Directors or a Paper Tiger" [1999] *Insolvency Lawyer* 99 at 100.

140. "Wrongful Trading Laws that Directors Ignore" *Accountancy Age*, 29 October 1992 at 8.

141. Above n 36 at 140.

142. At para 1805.

143. Above n 139 at 104.

be expected to conclude that there was no reasonable prospect of the company avoiding insolvent liquidation.<sup>144</sup>

Nevertheless, a review of the significant insolvent trading decisions in Australia shows that where the action is successful, the directors have invariably blatantly breached the law to a significant financial degree, and for an extended period.<sup>145</sup> The suggestion is made that even though the law may seek to be precise at the point in time at which directors are required to act, the commercial and legal reality is such that only clear cases are pursued, where there is substantial money to be obtained and hence, or invariably, the insolvent trading has continued for some time. A director who, in a vain attempt to trade out of the company's difficulties, continues to incur debts to the value of A\$10 000 will find in reality that such a claim is not pursued. This may be because of the amount of the claim, or that the liquidator or creditors see little blame attaching to such conduct.

The number of insolvent liquidations in Australia have decreased in the past decade, while the number of administrations have increased significantly.<sup>146</sup> This could be due to a number of reasons, one being that directors, cognisant of the prohibition of insolvent trading, have initiated the administration process. Whereas in the UK insolvent liquidations have remained at a relatively high level, with few administrations, and this might be suggestive of the fact that wrongful trading has not induced directors to initiate actions to stop the slide into insolvency.

## XIV. Conclusion

Undoubtedly it is true to say that both provisions discussed here require awareness on the part of directors as to their companies' financial state, something that has not been the norm in company law.<sup>147</sup> Certainly, it is a difficult task to introduce a provision that effectively sets aside the inveterate separate legal entity concept and all that flows from it, and to do so in such a way that ensures that values such as certainty, efficiency and fairness are fostered. There will always be those who would argue that such a provision as those under study here do not enhance efficiency as they are applied *ex post* to contractual dealings and they overly-compensate unsecured creditors. Others will point to the lack of teeth that the provisions have and want to see the provision strengthened in some way.

While the UK and Australia started from virtually the same position in the twentieth century, with very similar fraudulent trading provisions that were relatively impotent, each jurisdiction has gone, certainly since the mid-1980s, its own way. The Australian regime involves several provisions against the UK's one provision, and it might be thought that the former's law is more complex. Yet this is not the case. The Australian provisions seek to define critical elements of its scheme, such as the meaning of "insolvent" and what defences may be relied on. But there

144. But note the criticism of the Australian criteria of insolvency in Morrison, above n 38 at 166–169.

145. For example, *Fryer v. Powell* (2002) 139 FLR

433.

146. See <[www.asic.gov.au](http://www.asic.gov.au)>

147. Whincop, above n 2 at 25.

remains significant unanswered questions concerning aspects of the UK provision, such as what is involved in directors taking “every step” to minimise creditor losses.

Of course, in relation to both wrongful trading and insolvent trading, liquidators will generally refrain from taking any action unless they can be assured to some reasonable degree that respondents are not impecunious. It will often be of little value if a case succeeds but the liquidator only has a claim in a director’s bankruptcy. Hence, no matter how effective an illicit trading provision appears to be, it might not matter if directors have no funds.