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DIRECTORS LIABILITY

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

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

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

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

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

EXAMPLES OF PERSONAL LIABILITY

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

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

Insolvent Trading:
If a director allows a Company to incur debts which the director suspects, or should have suspected, the Company is unable to pay.

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

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

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

Unreasonable Director Related Transactions:
If a Company enters into a transaction that proves to be detrimental to the Company AND is director related.

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

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

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

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

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

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

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

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

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

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

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

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

INSOLVENT TRADING

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

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If your Company is insolvent, or there is a real risk of insolvency, a director's duties are expanded to include the interests of creditors (including employees and other creditors).

How to know if it's insolvent?

Signs of financial difficulty include:
(i) ongoing losses
(ii) poor cashflow
(iii) problems obtaining finance and
(iv) unpaid creditors outside usual trading terms

If you suspect your company is in financial difficulty get proper accounting and legal advice as early as possible.

It may be possible to refinance or restructure to ensure the Company can survive.

What if it is insolvent?

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

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

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

If you have existing building contracts, and the Company is a contracting party, this will lead to the termination procedures being enacted.

Insolvency

The three most common insolvency procedures are:
(i) voluntary administration
(ii) liquidation
(iii) receivership

A director also had an obligation to cooperate with a liquidator or administrator after they are appointed.

This includes providing documents, records and information to a liquidator or administrator.

An example would be providing the liquidator with a copy of a recent contract for a disposition of assets by the Company.

PITFALLS OF WIND UP NOTICE PROCEDURE

As a debt collection mechanism, it is a flawed concept.

A winding up application is generally used as an enforcement procedure after a judgment has been obtained at court or VCAT.

Once you file a wind up application, and you force liquidation, it is likely the entire "empire" of the debtor will come crashing down.

A "wind up" will crystallise a termination (in most standard building contracts), and the creditor may just become an unsecured creditor in a throng of other creditors.

Once liquidation occurs, there may be no funds to satisfy the debt.

Preferred option for debt recovery

Manage your debtors to ensure they do not owe you too much over too long a period of time before you get paid.

As a Builder, this may mean keeping a tight rein of contract administration.

Be prepared to suspend works under the contract, or issue a notice of default, if payment is outstanding for too long.

Ensure that you have documentation of variations, or seek evidence of an owner's capacity to pay.

Winding Up Orders

An application to "wind a company up in insolvency".

These are filed with an application and affidavit. It comes after a **statutory demand** has not been set aside or otherwise settled within 21 days.

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An application to wind up the company is made. The failure to comply with the statutory demand compels the Court to presume the company is insolvent.

The affidavit must disclose grounds for the winding up order to be made and evidence of the debt. Failure to comply with the statutory demand is good evidence.

A winding up application (with affidavit) and statutory demands are technical documents and you should seek legal assistance in preparing, filing and serving them.

If the statutory demand is flawed, the later wind up application may also be defective.

Procedure

A complaint or application will be filed at a court or at VCAT (domestic building).

Once a judgment is entered, that judgment will be sealed and is an enforceable debt.

However, even with a judgment you are still not a secured creditor (such as the ATO, a mortgagee, or an employee).

The usual procedure is: Judgment – Statutory Demand – Wind Up Application

Statutory Demand

A statutory demand will normally be served at a Company's registered office, and also has an affidavit to support it.

The supporting affidavit must verify that the debt is due and owing as at that time, and state there is no genuine dispute about the debt.

The statutory demand will make demand for payment of the debt (must be over $2,000) within 21 days after the notice is served on the Company.

Alternatively the Company may make arrangement to secure or compound (compromise) the debt within 21 days. An example would be to agree to enter into an instalment arrangement.

The Statutory Demand must notify the Company of:
(i) the consequences of failure to comply with the demand; and
(ii) must advise how the Company can apply to set aside the statutory demand.

Applications to set aside Statutory Demands

If the Statutory Demand is disputed the debtor must make an application to the Supreme Court of Victoria or the Federal Court of Australia seeking to set aside the Statutory Demand.

Such an application must be made within 21 days of receiving the Statutory Demand.

Applications to Wind Up a Company

This may be made after a Statutory Demand has been served and it:
(i) has not been set aside; or
(ii) otherwise settled;
within 21 days after service.

An application may be made to the Supreme Court to wind up the Company, with an application and affidavit.

The affidavit will verify that the debt is due and owing, and the Statutory Demand was served and remains unsatisfied.

The Company's failure to comply with the Statutory Demand forces the Court to presume that the Company is insolvent.

Unless the Company can rebut the presumption of insolvency, a Wind Up order will be made by the Court.

Pitfalls

(i) The Wind Up application should be prepared, filed and served in accordance with all legal requirements and court rules;

(ii) The application should be based on a valid and correct Statutory Demand that has not been complied with or set aside;

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(iii) It may all be too late; it is the ambulance at the bottom of the cliff.

Whether you wish to make an application, **or** on the receiving end of an application, you should seek legal advice promptly if you have not already.

Accounting advice may also be required at the Statutory Demand stage to see whether a compromise can be made, for example payment over time.

ABOUT LORD COMMERCIAL LAWYERS

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