

Australian Corporations and Business Associations Law

—A Critical Analysis of Insolvent Trading

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Abstract: The current state of the trade law in Australia, which has not fully balanced the interests of the creditors, has suggested that the board can perform its duties responsibly. Although the new law has some shortcomings, but safe harbor to the directors provides a new solution to the problem of the bankruptcy also make other creditors paid off during this period. As far as the author's concerned, safe harbor should be supported, but it needs to be improved. Also the government may receive different proposals to reform the insolvency law to encourage directors of insolvency companies.

1. Introduction

The development of insolvent trading law in Australia has become a significant area in recent years. It is noteworthy that the current Australia insolvent trading law has not already adequately balanced the interests of creditors and promoted that director could exercise their responsibility dutifully (Petch 2011, p.2). These limitations of current law are reasons that should consider changing the section 588G. An Act assented at 18 September 2017 from Federal Register of Legislation which named Treasury Laws Amendment Act (2017) aims to solve the pressing problem based on previous law and this Act also provides new contents in order to make more progress on insolvent trading. The motivation to promote insolvent trading reform is encouraging to revive the firms near-bankrupt finance rather than giving up those companies. This expectation is likely to be regarded as a great impetus for the frequent improvement of insolvent trading law. This paper consists of five parts, the presentation of previous law on insolvent trading, and the introduction of the changing in Amendment, also the difference between previous s588G, as well as the effectiveness of the safe harbor, together with the recommendation and conclusion.

2. Organization of the Text

2.1 Previous insolvent trading law

The requirements of directors' personal liability for insolvent trading showed that directors would face serious punishment when companies are insolvent or close to insolvency by incurring the trade debts or statutory debts if directors are relevant responsible (s 588G). As regarding

criminal punishment, offences related to the fraud and dishonesty would face the punishment of imprisonment above five years (s 588G (2)). However, there are four defenses which directors could avoid personal liability by relying on section 588H. Firstly, according to the *Statewide Tobacco Services Ltd v Morley* (1990) 9 ACLC 827, directors had some responsibilities to manage and to operate companies instead of ignoring the companies' affairs and information. Secondly, there is the reasonable reliance that directors could get suggestions from another capable person (s 588H (3)). Thirdly, directors are unfortunately not participating relevant decision-making of companies because of illness (s 588H (4)). Fourthly, section 588H (5) states that directors have to try to follow all rational processes to bolster company's tottering finances by placing it into voluntary administration or stepping down voluntarily. However, there is adequacy which remained in section 588H although these four defenses could positively provide methods to help directors avoid serious punishment when facing insolvency in terms of theory.

2.2 The amendments for insolvent trading

Compared to the highlight of penalizing director personal liability, a safe harbor has been created in the Schedule 1- Amendment as section 588GA in order to give a possible harbor for directors. This inserted content would lead to a great change in insolvent trading law because it will pay more attention to promoting company development and recovering from their financial crisis. (Treasury laws amendment 2017, p.5).

There are three main changes in Amendments compared to s 588G. The most important thing is that directors are not liable for debts due to insolvency if they take actions leading to a better outcome from company. Moreover, s 588G points out that directors will be banned from safe harbor if using books and information without provided before. However, according to the Email to Mr. James Mason (2017, p.2), whether safe harbor could sufficiently provide director certainty to recover good corporate from the wreckage is still an unresolved issue.

2.3 Comparisons of the amendment and current insolvent trading law

Firstly, a significant improvement of a new law is safe harbor provision in order to prevent directors from serious personal liability. This safe harbor aims to protect good directors with the better outcome and survive the more companies from falling into bankruptcy.

Secondly, this safe harbor could be regarded as an effective self-saving method before passively entered into voluntary administration. Actually, few businesses have been successfully saved from this method because it is not a practical way to administrate and control the whole corporation relying on outside people rather than their own directors.

Paying attention to the better outcome test in safe harbor in new law is a point that should focus on. This test provides that directors should consider the consistency of company size with financial records, so that decrease the insolvent trading risks in the future (Treasury laws amendment 2017, p.13).

Moreover, the importance of insolvency safe harbor serving to honest directors in new law shows that information and books provided to administrators and liquidators should follow an appropriate request for evidence (Marsh and Roberts 2017, p.275).

Finally, two-year review relating to safe harbor in the new law is an innovative concept added after section 588H. This means that every two years reviewing update timely information which underlined the importance of evidence (Marsh and Roberts 2017, p.276).

Although the effectiveness shows in many perspectives, the weakness of new content should also not be ignored.

2.4 The effectiveness and weakness of Amendment safe harbor

The advantages of new insolvent trading law main reflect in four features: functional, flexibility, certainty, and community. Firstly, the function of safe harbor helps honest directors have an opportunity to manage insolvent companies better rather than directly giving up into de voluntary administration. The reconstruction of companies by administration sometimes leading to value destructive because it would undercut morale and make employees feel failing. Secondly, the new law has more details aiming at the structures of different companies and sizes between the conglomerates and small business in order to avoid too much unnecessary spending. Thirdly, the certainty is important in new law according to Katie (2017, pp.2) reported that there is a negative trend in current directors because of the serious personal liability. Under this pressure, those dishonest directors may be opportunistic in order to maximize the financial value. Finally, the community of safe harbor reflects that the interests of creditors and employees' benefits have been required.

Although there are many advantages of new insolvent trading law, it also nothing worth but limitations. Boothman (2016, p.18) stated that safe harbor was could also be shipwreck because it was a difficult process to balance the staying on safe harbor and keeping work on own business for directors. This safe harbor actually increases the directors' pressure because they have to take care of other people although directors would accept the serious punishment alone. The importance of restructuring in new law does not consider other potential problems which lead to insolvency such as weak management system and financial difficulties. Another disadvantage about the new law is about two years review reform in section 588HA. For dishonest directors, they would have more reasons to make distortions of financial information with many methods in order to provide company information under frequently review requirement, so that this high stress is difficult to keep working motivation. Therefore, the reviewing needs more improvements in the new insolvent trading law.

3. Recommendation and Conclusion

Although the new law has some limitation, the effectiveness compared section 588G should not be ignored. In my opinion, safe harbor should be supported but also needs some improvements. The government could receive different suggestions to reform insolvent reading law.

In addition to safe harbor, there are two other alternative methods to voluntary administration named "pre-pack transactions" and "license agreement" separately. There is a relevant research from Walton (2017, p.550), when directors sell the business for another new entity, pre-pack transactions as a preparatory step for administrators and liquidators check. The Direct Agreement would be an effective method and protect all parties.

In conclusion, the safe harbor gives directors a new method to solve the insolvency, and also make other creditors receive returns, although there are some disadvantages in the new law. Therefore, there are also many researches that could be focused on in the future.

References

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Cases list

Statewide Tobacco Services Ltd v Morley (1990) 9 ACLC 827

Legislation

Corporations Act 2001 (Cth), s 588G (2), s 588 H (2) (3) (4) (5)