

23 JUNE 2010

Case Note: *The Stake Man Pty Ltd v Carroll [2009] FCA 1415*

Overview

The Federal Court has recently excused a director from breaching insolvent trading laws. This case is the first decision in which the court has exercised its discretion and completely relieved a director from civil penalties where it has been established that the director allowed the company to trade while insolvent.

Facts

The Stake Man Pty Ltd (**Company**) had operated a profitable business of processing and wholesaling raw timber up until 2004, when the decision to acquire new machinery to expand production caused financial problems for the Company, resulting in significant cash-flow issues.

The sole director, Mr Carroll, sought the advice of an accountant – and later an insolvency practitioner – regarding the Company's financial health. Mr Carroll was advised that the Company was nearing insolvency. On this advice and with the aid of an investor, Mr Carroll subsequently advanced further funds to the Company. He also engaged a consultant to help him find an investor and sought further avenues of finance for the Company's business.

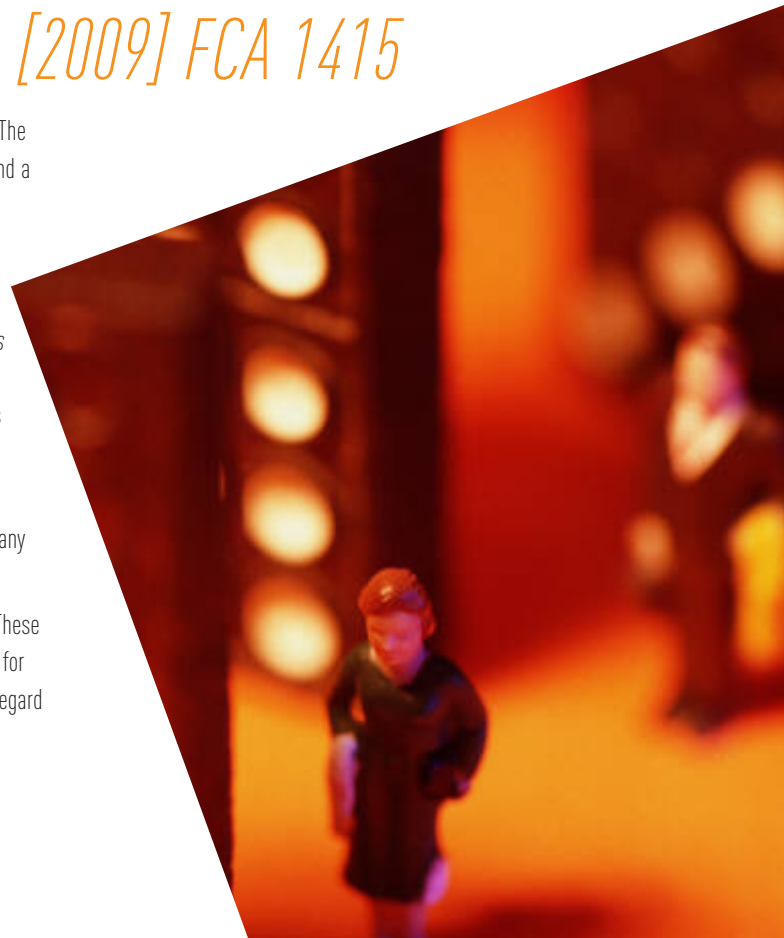
In May 2006, the Company was placed into voluntary administration. The following month, creditors resolved that the Company be wound up and a liquidator was appointed.

The liquidator alleged that, between 31 December 2005 and 10 May 2006, the Company traded while insolvent.

In his defence, Mr Carroll relied on section 588H(2) of the *Corporations Act 2001 (Act)*, contending he had reasonable grounds to expect the Company was solvent during the relevant period, given the Company's stock inventory and ability to realise and sell that stock.

Mr Carroll also relied on s588H(3) and stated that, based on the information conveyed to him by the Company's accountant, the Company was and would remain solvent, even if it incurred further debts.

In the alternative, Mr Carroll relied on s1317S and s1318 of the Act. These sections give the court a discretion to excuse a director from liability for insolvent trading, where the director has acted honestly and, having regard to all the circumstances of the case, he ought fairly to be excused.



Decision

Justice Goldberg in the Federal Court held that the liquidator had established all the elements in s588G and rejected the defence advanced by Mr Carroll under s588H(2), stating that in the circumstances and given the financial difficulties experienced by the Company, it was not reasonable for Mr Carroll to expect the Company's stock could be sold in a timeframe to effect the payment of all the Company's debts as and when they fell due.

Justice Goldberg also rejected the defence relied on by Mr Carroll under s588H(3), stating that although the accountant had given advice regarding whether the company was solvent, the evidence before his Honour did not demonstrate that the accountant was specifically given the role of providing Mr Carroll with such advice. Rather, the accountant's advice was given as part of the general accountancy and advisory work he

was providing to the Company.

His Honour stated: *"when considering whether a person has acted honestly for the purposes of a defence under ss 1317S(2)(b)(i) or 1318 of the Act, the court should be concerned only with the question whether the person has acted honestly in the ordinary meaning of that term, that is, whether the person has acted without deceit or conscious impropriety, without intent to gain improper benefit or advantage for himself, herself or for another, and without carelessness or imprudence to such a degree as to demonstrate that no genuine attempt at all has been to carry out the duties and obligations of his or her office imposed by the Corporations Act or the general law. A failure to consider the interests of the company as a whole, or more particularly the interests of creditors, may be of such a high degree as to demonstrate failure to act honestly in this sense. However, if failure to consider the interests of the company as a whole, including the interests of its creditors, does not rise to such a high degree but is the result of error of judgment, no finding of failure to act honestly should be made, but the failure must be taken into account as one of the circumstances of the case to which the court must have regard under ss 1317S(2)(b)(ii) and 1318 of the Act"*.

Applying these criteria to the case before him, Justice Goldberg found that Mr Carroll acted honestly and, in light of all the circumstances, considered that he ought to be fairly excused for contravention of the insolvent trading provisions under s1317S.

His Honour reasoned that:

- although the accountant did not formally satisfy the criteria to meet the defence available to Mr Carroll in s588H(3)(a)(i) of the Act, the accountant was nevertheless providing advice to Mr Carroll throughout the relevant period and it was reasonable for Mr

Carroll to rely on this advice, despite Mr Carroll's own suspicions and knowledge as to the Company's solvency. During the relevant period, the accountant had told Mr Carroll on several occasions that he did not believe the Company was insolvent;

- Mr Carroll had taken action to increase sales and make the business successful;
- Mr Carroll sought investors to provide further capital and monitored the assets of the Company;
- Mr Carroll requested the advice of an insolvency practitioner and then acted on that advice during the relevant period; and
- upon receiving a bill from the Australian Taxation Office for \$110,000, Mr Carroll immediately sought advice from the accountant, who then put him in contact with the liquidator and the Company was subsequently wound up.

Although Mr Carroll allowed the Company to incur debts while it was insolvent in breach of s588G, in light of the surrounding circumstances and the fact that Mr Carroll neither gained personally from the breach nor acted against professional advice, His Honour considered it appropriate that he be wholly excused from liability for contravention of the insolvent trading provisions.

Comment

This case is the first decision where the court has exercised its discretion and completely relieved a director from civil penalties where it has been established that the director allowed the company to trade while insolvent.



The decision highlights the significance that a court will place on evidence that a director has relied on expert or professional advice, as well as evidence that a director has taken pro-active steps to address any financial issues their company is experiencing.

This decision reinforces the need for directors to actively seek out professional advice and monitor the affairs of their company if they suspect the company may be, or is close to being, insolvent.

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