



HEIDTMAN & CO.

LAWYERS

## DIRECTORS' LIABILITIES

Being a company director can be a risky business these days. Increasingly, directors are finding themselves liable for actions of their company even if they were not directly involved.

Most directors have an understanding of their duties as a director. However, it appears many are still unaware of the full extent of their potential liability.

Directors of companies which become insolvent, or which incur large and unexpected liabilities, are often left regretting that they did not keep themselves better informed of their company's dealings.

The past few years have seen many changes to directors' duties and liabilities, making it difficult to keep up-to-date with the full extent of current liabilities under the Corporations Act 2001 (Cth) (the "Act").

### **Can Insolvent Trading Put Me At Risk?**

Recent media coverage of the HIH, One. Tel and Ansett collapses - and the focus of that coverage on the potential liability of the executive and non-executive directors of those companies - has alerted many directors to their own potential exposure to creditors.

All company directors have a duty to prevent insolvent trading by their company. It is important all directors are aware of these obligations and

also that they may be personally liable for insolvent trading.

As a general rule, anyone who is a director at the time a company incurs a debt whilst insolvent is potentially liable for that debt.



The situation is particularly risky for non-executive directors, who are not involved in the day to day management of the company, as it usually takes longer for these directors to obtain relevant financial information.

In the past decade, non-executive directors have faced ever-increasing liability as courts have taken the approach that failure to make enquiries as to the company's solvency is not excusable.

### **What About Other Liabilities?**

Insolvent trading is not the only exposure for company directors. Many statutes which impose requirements or prohibitions on companies also impose obligations on company directors to ensure that their companies do not contravene those laws.

Directors will be liable to pay fines or give compensation if, for example, their company's name and A.C.N. does not appear on necessary company documents, their company pays a dividend in excess of profits, or their company breaches certain trade practices, environmental protection, occupational health and

safety or equal opportunity legislation.

These liabilities are mainly independent of whether the director actually knew about their company's behaviour. The result is an extremely onerous regime for non-executive directors who are not involved in the day to day operations of their companies but still (along with executive directors) find themselves personally liable under the relevant statutes for any unlawful acts of their company, regardless of personal fault.

### **Are There Any Recent Amendments Of Which I Should Be Aware?**



One of the more controversial recent amendments has been the introduction of the statutory business judgment rule.

The purpose of this rule is to clarify the authority of directors when carrying out their duties. The rule, however, does not insulate directors from all liability.

The effect of the rule is that directors will be presumed to have satisfied their duty of care and diligence if they:

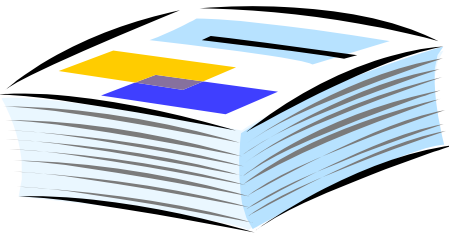
- \* made a judgment in good faith and for a proper purpose; and
- \* did not have a material personal interest in the subject matter of the judgment.

LEVEL 29, BT TOWER, 1 MARKET STREET, SYDNEY NSW 2000 TEL: (02) 9267 3388 FAX: (02) 9267 3688  
E-MAIL: mailbox@heidtmans.com.au WEBSITE: www.heidtmans.com.au ADDRESS: PO Box Q77 QVB Post Shop NSW 1230

**PARTNERS:** DAVID HEIDTMAN, PETER CARKAGIS, ALAN McMURRAN, PENELOPE CABLE, MANUEL THEOS  
**CONSULTANT:** WILLIAM MALOS **SENIOR ASSOCIATE:** MICHAEL TZIRTZILAKIS  
**ASSOCIATES:** ANNE McDONALD, VANESSA MARQUEZ-VALLEJO, ADAM MAZZAFERRO

It is important for directors to bear these points in mind when making material business decisions.

Whilst the business judgment rule will sometimes assist in limiting liability for directors who have made decisions carefully, it will not limit liability under certain specific provisions such as those regarding insolvent trading and misleading statements in prospectuses and takeover documents.



### **How Can I Limit My Liability As A Director?**

To minimize your liability, you should ensure that:

- \* You are adequately informed about the day to day operations of your company and make proper enquiries whenever you feel you do not have all relevant information;
- \* Your company takes out appropriate directors and officers ("D&O") liability insurance to cover you to the full extent permitted by law;



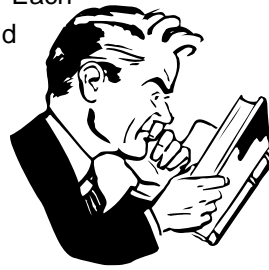
- \* You have a properly drafted Deed of Indemnity, Access and Insurance in place with your company to both indemnify you to the full extent permitted by law and to give you access to relevant company documents you may need to defend yourself against a claim - including after you retire as a director; and

- \* Your own assets are adequately protected from claims against you as a director.

### **How Involved Do I Need To Be In My Company?**

The law requires directors to keep themselves continuously informed of the performance and activities of their company and, before making a decision, to review all relevant information. Each

director should keep extensive personal records of activity reports, board minutes, correspondence and discussions with other officers of the company. Also, regular reports on the financial status and material undertakings of the company should be sought by each director.



### **Will Deed Of Indemnity And Access Protect Me Against Everything?**

No - the Act prohibits a company from indemnifying its directors for liability:

- \* owed by the director to the company or a related company;
- \* arising out of conduct in bad faith; or
- \* in regard to certain more serious matters such as share capital, transactions, requirements for financial reports and insolvent trading.

In other respects, however, a Deed of Indemnity can be entered into with your company to oblige it to reimburse you if you become liable to pay damages or a fine in connection with your role as a director.

### **What Insurance Can My Company Effect?**

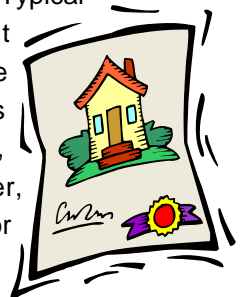
Many major insurers have reasonably standard D&O policies,

providing companies with cover for claims made against their directors. However, a company is not permitted to cover a director for liabilities arising out of conduct involving a wilful breach of duty in relation to the company or improper use of the director's position or company information. Also, most D&O policies contain their own additional exclusions, including claims by major shareholders or other directors - and these should be checked carefully.

### **What If None Of These Work?**

There is always the chance that liabilities will arise which cannot be covered by indemnities or insurance, particularly in the area of insolvent trading.

To guard against these situations, you should put in place appropriate arrangements to protect your personal assets. Typical steps might involve the holding of assets by a spouse, family member, close friend, or family trust.



### **What Advice Should I Get?**

Proper advice should be sought from experts in relation to:

- \* minimising risks;
- \* checking the adequacy of any existing arrangements, and rectifying any deficiencies; and
- \* maximising asset protection arrangements to ensure that you have as little personal exposure as possible to creditors of your company and damages and fines imposed under statute.

We can help.

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