

ASIC releases draft guidance on the duty to prevent insolvent trading

On 24 November 2009, ASIC released Consultation Paper 124 on its *Draft Regulatory Guide – Duty to prevent insolvent trading: Guide for directors*.

The Consultation Paper has been issued in response to ASIC's view that the market would benefit from clarification about the factors it considers when deciding whether to commence any investigation in relation to potential insolvent trading. That view has apparently been formed in light of an anticipated increase in the number of corporate insolvencies as a result of the current economic conditions.

The Consultation Paper aims to give guidance to directors to assist them to understand and comply with their duty to prevent insolvent trading under section 588G of the *Corporations Act 2001*.

The Draft Regulatory Guide:

1. sets out the key principles that ASIC considers directors need to take into account in order to comply with their duty to prevent insolvent trading; and
2. provides guidance on how ASIC will assess whether a director has breached that duty.

Key principles

The key principles are common sense and reflect those considerations taken into account by the courts over the years when determining whether a director has breached his or her duty to prevent insolvent trading:

1. **Directors must inform themselves** – under this principle, directors must keep themselves informed about the company's financial affairs and regularly assess the company's solvency. This requires directors to ensure that proper books and records are kept by the company and to actively monitor those and take steps to satisfy themselves that the company is in a position to pay its debts as they fall due.
2. **Directors should investigate financial difficulties** – directors should take immediate steps to investigate the company's financial position immediately they identify any concerns regarding the company's viability. Directors must assess options available to deal with the company's financial difficulties and carefully consider the company's solvency before the company incurs each new debt.
3. **Directors should seek professional advice** – immediately a director identifies solvency concerns regarding the company, the director should seek appropriate advice from a suitably qualified, competent and reliable person in relation to the solvency of the company, the alternatives available to the company and whether it is realistically possible for the company to continue to trade out of financial difficulties.

4. **Directors should act in a timely manner** – directors should consider and act appropriately on the advice received and in a timely manner.

ASIC's approach to assessment of breach of duty

The Draft Regulatory Guide contains a useful table showing the factors ASIC will take into account in assessing whether a director has breached their duty to prevent insolvent trading. In addition to setting out those factors, the table sets out the type of evidence ASIC will use to make that assessment.

The Draft Regulatory Guide also sets out indicators of potential insolvency which should act as a red flag to any director that the company may be in financial difficulties including:

1. the company has a history of continuing trading losses;
2. the company is not paying its taxes when due;
3. the company's cheques are dishonoured or post dated; and
4. other company directors have resigned citing concerns regarding the company's financial position.

Whilst these indicators are fairly obvious, on finalization of the Draft, any director who ignores these indicators will do so at the risk of being found in breach of their duty to prevent insolvent trading.

Submissions

A copy of the Consultation Paper can be found by clicking [here](#).

ASIC is calling for submissions in relation to the Consultation Paper by 22 January 2010. Submissions can be made on:

- the likely compliance costs;
- the likely effect on competition; and
- other impacts, costs and benefits;

of the Draft Regulatory Guide.

Please do not hesitate to contact Fox and Thomas should you require our assistance in making any submissions to ASIC in relation to the Consultation Paper or if you have any questions in relation to insolvent trading.

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