
CREDIT ISSUES

WOODGATE & CO.

Chartered Accountant
SEPTEMBER 2004

INSOLVENT TRADING - GAOL SENTENCE

Section 588G(3) of the *Corporations Act* states that a person commits the criminal offence of insolvent trading if:

- the company incurs a debt;
- at that time, the person is a director of the company;
- the company is insolvent at the time of incurring the debt;
- the person suspected that, at the time the company incurred the debt, the company was insolvent; and,
- the person's failure to prevent the company incurring the debt was dishonest.

There are two major differences between the civil liability contravention noted in Section 588G(1) of the *Corporations Act* and the criminal liability contravention in Section 588G(3).

To satisfy the onus of proof of a criminal offence, additionally, there is the requirement to prove that:

- the director actually suspected the company was insolvent, rather than there being reasonable grounds to suspect that the company was insolvent; and,

- the failure to prevent the debt being incurred must be dishonest.

The difficulty in firstly, proving those two elements and, secondly, the requirement to prove the charges beyond reasonable doubt, meant that for many years following its introduction in 1993 there were no criminal prosecutions pursuant to Section 588G(3). Since 2002 the Australian Securities and Investments Commission has taken a much greater interest in criminal prosecutions.

In particular, in 2002, the former directors of Farmer Furniture Pty Limited (In Liquidation) pleaded guilty in the Supreme Court of Western Australia to insolvent trading charges brought by ASIC. The former directors of Farmer Furniture Pty Limited were each sentenced to provide a \$20,000 good behaviour bond for a period of up to five years. On 30 May 2002 Ms Barrie-Ann Morgan pleaded guilty to 14 insolvent trading charges and was sentenced to a \$20,000 personal good behaviour bond for 3 years. Further, Messrs Charles Farmer and Mark Farmer, two other former directors of the Western Australia based Farmer Furniture Pty Limited pleaded guilty to 14 insolvent trading charges. Mr Charles Farmer also pleaded guilty to 18 charges of improperly using his

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position as a director of Farmer Furniture Pty Limited. Those charges involved allegations that Mr Farmer caused or authorised the sale of assets of Farmer Furniture Pty Limited but retained the proceeds for himself. At the time that Farmer Furniture Pty Limited ceased trading and appointed a Voluntary Administrator in July 1997, the company owed ordinary unsecured creditors approximately \$2.139M.

On 11 November 2002 Mr Peter John Neagoe was sentenced in the Magistrates Court of Victoria. Mr Neagoe was sentenced to two years and nine months gaol, which was suspended upon Mr Neagoe entering a \$2,000 good behaviour bond, for three years. Mr Neagoe was also prohibited from being involved in the management of a company for five years. Mr Neagoe was a director of Twintara Pty Limited, a building company which operated in Melbourne. Twintara Pty Limited was placed into liquidation on 12 July 2002. The company owed its creditors approximately \$2.1M.

It was only a matter of time before ASIC sought a custodial sentence. In June 2004 Justice Evans of the Supreme Court of Tasmania sentenced Mr Timothy Williams, a director of Cotech Pty Limited (In Liquidation), to 15 months imprisonment in respect of 33 charges of insolvent trading pursuant to Section 588G(3) and two charges of a company knowingly being concerned in doing a fraudulent act contrary to Section 592(6) of the *Corporations Act*. This involved Cotech Pty Limited fraudulently obtaining \$37,500 from BRG Capital Facilitation Pty Limited, who provided a debtor financing facility to Cotech Pty Limited. On two occasions Cotech Pty Limited issued fictitious invoices and received

payment from BRG Capital Facilitation Pty Limited in respect of those invoices. Justice Evans Ordered that Mr Williams be released after serving six months of the sentence. He was to provide a \$2,000 good behaviour bond, for a period of two years following his release. His Honour noted that whilst Mr Williams had not been motivated by greed, he had acted dishonestly in an endeavour to stave off Cotech Pty Limited's failure. Justice Evans stated that those involved in the commercial world are expected to comply with demanding standards of honesty and if they engage in commercial crime they must expect punishment. The importance of deterrent was a factor in the Court's verdict.

The company had creditors amounting to \$1,787,000 and a deficiency in assets to meet liabilities of approximately \$1.7M.

Lessons for directors

- ASIC is likely to continue with criminal prosecutions for insolvent trading in order to reinforce its deterrent effect. It is noted that following funding by the Commonwealth Government of the ASIC's National Insolvent Trading Programme, ASIC is much better resourced in order to detect insolvent trading and commence prosecutions. We can undoubtedly expect to see more activity from ASIC.
- ASIC is much more likely to prosecute directors for insolvent trading where other offences involving dishonesty are involved.
- Directors of to medium size enterprises are likely to be the targets of the ASIC's insolvent trading programme.

- Whether criminal prosecutions do reduce the incidence of phoenix companies remains to be seen.
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