Directors Duties to Creditors: Can a creditor claim against a director for breach of director's duties?

There are two mechanisms by which a creditor can claim against directors for breach of director's duties, the first is under a Section 1324 application for an injunction to restrain such breaches, the second is a claim under Section 588G for breach of the duty not to trade while insolvent.

Director's duties are owed to a company, there is no duty owed in law by directors to creditors (see Spies v R (2000) 18 ACLC 727). There is no provision in the Corporations Act 2001 (Cth) ("the Corporations Act") for creditors to bring a derivative action on behalf of a solvent company against the directors (shareholders do have this ability pursuant to Section 236).

The agreement giving rise to the creditor-debtor relationship may be breached by director's conduct, but the creditor will not have a direct cause of action against the directors under the agreement unless the director has given a personal undertaking or guarantee.

Section 1324 of the Corporations Act 2001 (Cth)

As "a person whose interests are affected" by the director's conduct, a creditor is empowered to seek an injunction to stop breaches of director's duties pursuant to Section 1324(1). Subsection 1324(10) allows an award of damages where the court has the power to grant an injunction.

Pleadings by creditors to the effect that Subsection 1324(10) only requires that an injunction be possible at law, not that it be practical or even actually granted, have been consistently rejected by superior courts, which have held that the subsection cannot be read in isolation and contrary to the relationship between directors and creditors otherwise established by the Corporations Act.

In McCracken v Phoenix Constructions (Qld) Pty Ltd [2012] QCA 129, the Queensland Court of Appeal cited with approval Perry J in Executor Trustee Australia Ltd & Anor v Deloitte Haskins & Sells (1996) 22 ACSR 270 that the purpose of Section 1324 is the granting of an injunction, and that damages are merely a substitute or supplementary remedy not intended to grant a creditor or other interested person a general right to damages.

However, Subsection 1324(10) can still be utilised by creditors to claim damages to supplement an injunction to stop a breach of directors duties, where such an injunction does not adequately remedy the effects of the breach.

Relief in Insolvency

Creditors may find some relief once a company is insolvent, ie unable to pay its debts as and when they fall due (Section 95A). The purpose of a solvent company is to maximise the return to shareholders. The purpose of an insolvent company is to maximise the return to creditors, with shareholders only entitled to any assets that remain after all creditors have been fully paid.

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Once a company is in liquidation, Section 588R allows a creditor to directly bring a damages action for breach of the Section 588G duty not to trade while insolvent, with the written consent of the liquidator. Sections 588S and 588T allow a creditor to directly bring an action if the liquidator has not commenced an action within 6 months of receiving notice from the creditor. Pursuant to Section 588M, any such damages are "a debt due to the creditor", not the company.

There are no equivalent provisions for other director's duties, and any creditor seeking to recover damages for breach must do so through the liquidator.

It is open to a creditor to fund the liquidator to pursue the former directors for damages for breach of director's duties with such an action being brought by the liquidator in the name of the company. A creditor can seek an agreement from the other creditors in the liquidation to the effect that the funding creditor will receive their costs of funding the action in priority, as well as some degree of priority or higher proportion in the division of any assets so recovered.

**Conclusion**

Where a creditor is concerned about breaches of director's duties in a solvent company they may seek an injunction and damages pursuant to Section 1324, but otherwise have little recourse other than to call the debt and seek enforcement. The law considers the creditor is an external party with only contractual interests in the company.

However, if a company is wound up in liquidation, in essence the assets of the company become the assets of any creditors which are retained by the company pending distribution. A creditor is able to bring an action for breach of the duty not to trade while insolvent, but is unable to bring an action in respect of breaches of other director's duties.

Creditors do have the option to fund the liquidator in actions against the directors personally for recovery of damages for breach of director's duties.

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