The Dark Side to Australia's Equity Revolution: Credit Crunch, Creditor Protection and Corporate Law

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Introduction

"It's my goal," declared former Australian Prime Minister John Howard, "to make Australia the greatest share owning democracy in the world. . . ." (Howard 1998, cited in Donoghue et al 2003, p. 62) Many would say he has achieved this ambition. Certainly, during Howard's eleven-year term of office from 1996 until 2007, there has been a quantum leap in private share ownership in Australia. In 1991, one in seven adult Australians held shares either directly in Australia (Donoghue et al 2003, p. 61). By 1997, however, this had jumped to more than a third and, between 1999 and 2004, to more than half of the adult population (Australian Stock Exchange 2006, p. 6). Among modern capitalist economies, Australia boasts one of the highest — and, at least in 1999 and 2004, *the* highest — rates of share ownership per capita in the world (Donoghue et al 2003, p. 61; Australian Stock Exchange 2005).

The timing of this equity revolution could not have been better. Since 1992, Australia has enjoyed an unprecedented 16 successive years of economic growth (Cahill and Stilwell 2008, p. 5). Corporate profits have remained healthy; employment has been stable; China, as the fastest growing economy over the last decade, has underwritten Australia's resources boom; and Australia enjoys favourable terms of trade with its major trading partners, especially Japan. The 'lost decade' of economic slump in Japan for most the 1990s, the Asian financial crisis in 1997 and the September 11 terrorist bombings in the United States in 2001, although keenly felt in Australia, did not deter the upward march of the Australian economy. Driven by neo-liberal policies of privatization, marketization and deregulation, this sustained economic prosperity has even eclipsed the so-called 'golden age' of capitalism in the immediate post-war period (Cahill and Stilwell 2008, p. 5). Share market value has risen in response to good economic fortune. Since June 2004, for example, the All Ordinaries index more than doubled to reach a peak of 6853.3 points on 1 November 2008. With Howard's extension of the Australian dream from owning a home

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to holding shares, a greater proportion of Australians than ever before have been able to reap the benefits of a surging economy (Donoghue et al 2003, p. 58).

But just as quickly, the Australian dream has turned into a nightmare. The credit crunch, precipitated by the sub-prime mortgage crisis in the United States, has punched the air out of the buoyant Australian economy and pummelled the value out of equity investments. By 19 November 2008, the All Ordinaries index has tumbled to 3483.2, wiping off a massive 49% of its value since the 1 November 2007 peak and marking the third deepest bear market in Australian share market history (Jackson 2008). Indirect investors were also hurt. Superannuation funds, for example, announced their worst ever yearly performance in late 2008 since compulsory superannuation was introduced in 1992 (Yeates 2008, p. 17). Investment advisors were left scratching their heads at the extent of the losses. Caton's (2008b) reaction is typical:

> What an awful week What a shocking month. What a terrible year it has been for [Australian] investors. I don't anticipate a worse one in the rest of my working life !

Such has been the dark side to Australia's equity revolution.

Many have speculated about the causes of the global credit crunch (eg, Cary et al 2008; Gallagher 2008). Others have examined its specific impact on the Australian financial system and economy (Austin & Bilski 2008; Edwards 2008, Reserve Bank of Australia 2008). Some scholars are even beginning to consider the legal ramifications of the credit crunch (eg, Keel et al 2008; Sheahan 2008). One line of analysis is that corporate directors are exposed to legal action due to the impact of excessive debt on the company's ability to trade profitably or their involvement with structured finance products (eg, Keel et al 2008). For example, Australian investors have brought a class-action against Centro Properties Group for misleading and deceptive conduct and failure to make adequate disclosure about their exposure to, and ability to refinance, short-term debt. Similar cases are pending against MFS/Octavier and Allco (Keel et al 2008).

This paper, however, turns the issues on their head. Rather than interrogating the *legal consequences* or implications of the credit crisis, this paper asks instead whether or not — and, if so, to what extent — law has *caused* or *compounded* its effects. And rather than focusing on *financial* services and regulatory institutions, this paper focuses on corporate law and regulation. The question posed in this paper, in short, is: to what extent is Australian corporate law responsible for the pain of the credit crisis on ordinary Australian investors ?

The answer to this question requires a mix of empirical and legal analysis. First, the paper needs to test the extent to which there has been an equity revolution in Australia. How many Australians have embraced investing on the Australian share market ? Have Australian companies benefitted from this wider level of equity investment ? In short, how many ordinary Australians have been burnt by steep declines on share market value due to the credit crisis ? Part one of this paper will explore in greater detail what has already been established: private share ownership is at record levels in Australia, exceeding ownership rates in most other advanced capitalist economies. This part will also show that Australia's largest companies seem to be revelling in this equity revolution. A number of empirical studies demonstrate that Australian firms are relying more on equity investors than debt financiers to fund their activities. Internationally, Australia has a relatively low debt-equity ratio, especially compared to its neighbours in the Asia-Pacific region (Cheng and Shiu 2007; Deesomsak et al 2004).

Second, the paper needs to address the extent to which there is an empirical link between corporate regulation and equity participation. Is there an observable relationship between higher levels of equity investment and corporate regulatory style ? And, if so, does Australian corporate law accord with the 'style' of regulation typically associated with higher levels of equity investment ? Previous studies have shown a positive correlation between investor protection laws and capital structure (Cheng and Shiu 2007; Deesomsak et al 2004). Firms in countries with good creditor protection but poor shareholder protection tend to have high leverage (that is, high debt-equity ratio); these firms tend to have a higher supply of debt and use more debt than equity. By contrast, firms in countries with poor creditor protection but good shareholder protection tend to have low leverage; such firms have a higher supply of equity funds and thus use less debt. To determine whether these studies explain the Australian case, Part two will outline the Australian law on creditors' rights, focusing especially on the directors' duty to prevent insolvent trading under section 558G of the Corporations Act 2001.

At first blush, the argument that low leverage among Australian firms is due to poor creditor protection in the law does not seem sustainable. In fact, the law has responded to successive corporate scandals to improve the position of creditor stakeholders. For example, in 1993, the Australian law on insolvent trading was significantly strengthened to impose a positive duty on directors not to continue trading while the company was solvent or on the brink of insolvency. More recently, as a result of high-profile corporate collapses which left employees without their entitlements, the Corporate Law Amendment (Employee Entitlements) Act 2000 was passed to amend the improve the protection of entitlements of employees of failed companies. Reforms in 2003 allowed creditors to void excessive director bonuses and other like transactions which were entered into in the lead-up to a company's financial collapse. On closer inspection, however, as the case study on insolvent trading will reveal, the conditions for engaging these protections for creditors are quite narrow and, therefore, lend some credence to the hypothesis that the quality of creditor protection in the law influences the capital structure of firms — at least in the case of Australia.

Part One: Australia's Equity Revolution

Australia has one of the highest — and, at least in 2004, *the* highest — proportion of its population participating in the share market in the world. Since 1999, total share ownership has hovered at around half the population (Australian Stock Exchange, 2007, p. 6). In 2004, total share ownership reached a peak of 55% of the Australian adult population, or approximately eight million people, owning shares directly or indirectly (via a managed fund or self-managed superannuation fund). This was a significant increase from 51% in 2003 and 50% in 2002. Of the population, 44%, or about 6.4 million, held shares directly, a significant increase from 39% in 2003 and 37% in 2002 (Austalian Stock Exchange, 2007, p. 1).

In its 2006 study of Australian share ownership, the Australian Stock Exchange (2006) reports a slight drop in overall share ownership. In 2006, approximately 7.3 million people or 46% of the Australian population owned shares either directly via shares or indirectly. In terms of direct share ownership, 6 million or 38% of the Australian population were direct investors in the Australian share market. According to the ASX report, those leaving the share market tended to be inactive investors. They acquired their shares passively and had small amounts invested directly or indirectly. They are largely not interested in the share market and found it too daunting. They exited to fund debts, namely mortgages and residential property investments which appeared to be their preferred form of investment.

Even with this recent slide in share ownership, it is clear that Australia has undergone an equity revolution. In a similar Australian Stock Exchange Survey in 1991, equity investment was only 15%. Indeed, 2.9 million Australians — one fifth of the adult population — acquired shares for the first time in the period from 1997. These increases were due to the privatization of wholly government-owned corporations such as Telstra and the Commonwealth Bank and the demutualisation of major insurance provides such as Australian Mutual Provident Society (AMP) and the National Roads and Motorists' Association (NRMA) (Bottomley 2007, p. 183; Harris and Lye 2001). Nearly 2 million Australians purchased shares in Telstra in its initial float in 1997, and 1.8 million in the second Telstra float in 1998 (including 559,000 and 321,000 respectively acquiring shares for the first time) (Harris and Lye 2001, pp. 307, 311-12).

Based on this evidence, some proclaim Australia to be one of the greatest share-owning "democracies" in the world (Howard 1998, cited in Donoghue et al 2003, p. 62). Certainly, in terms of percentage figures, Australia has one of the highest per-capita participation in the equity market than anywhere else (see Table 1 below). However, to the extent that 'democracy' implies equality of participation, Australian share-ownership data do not reveal an equal spread of share-ownership across all sectors of the population.

For example, men are still more likely than women to own shares, and ownership is concentrated more heavily among Australians aged 55 years and over. However, the 2004 Australian Stock Exchange report (2005) does show that these gaps are narrowing. Thus:

- 2004 witnessed an increase in direct share ownership among both men and women. One in two (50%) men and two in five (40%) women were direct investors in 2004.
- Share ownership increased in all age brackets, with the 55 years and older group showing a significant increase from 48% in 2003 to 56% in 2004.
- In the previous two years, 5% of direct investors were new to the share market. New investors were likely to be men (55%), aged less than 35 years (53%), tertiary educated (39%) and with a household income of $ 70,000 to $ 100,000 (31%).
- Share ownership is increasingly being found among middle Australians — shares are no longer just the terrain of the high income earner and tertiary qualified.
- While the incidence of direct share ownership continues to increase with higher levels of education, household income and assets, healthy increases were reported across the board. 2004 saw significant inroads among those with a trade certificate (from 36% in 2003 to 45% in 2004) or degree (47% to 53%), and among those with household incomes of $ 30,000-$ 40,000 (28% to 39%) or $ 40,000-$ 50,000 (33% to 44%).
- Those living in regional Australia are just as likely as residents of the major cities to hold shares directly. In 2004, direct share ownership was equally likely in regional and metropolitan Australia. Almost one in two metropolitan (44%) and regional (45%) dwellers were share owners, with the latter showing a significant increase from 37% in 2003.

Table 1: International comparison of total share ownership

	00	01	02	03	04	05	06
Australia-Direct Direct/Indirect	40% 52%	N/a	37% 51%	39% 51%	44% 55%	N/a	39% 48%
Hong Kong — Shares	22%	20%	20%	18%	24%	29%	N/a
Korea — Stocks	7%	8%	8%	8%	8%	7%	N/a
Germany — Shares Shares/funds	10% 19%	9% 20%	8% 18%	8% 17%	7% 16%	7% 17%	N/a N/a
Switzerland — Shares Shares/Funds	32% 34%	N/a	24% 25%	N/a	20% 21%	N/a	20% 21%
UK — Stocks/shares	25%	24%	22%	N/a	N/a	21%	N/a
Canada — Shares/Funds	49%	N/a	46%	N/a	49%	N/a	N/a
USA — Direct/Indirect	N/a	52%	50%	N/a	49%	50%	N/a
New Zealand — Direct	21%	N/a	N/a	N/a	N/a	23%	N/a

(Source: Australian Stock Exchange 2005, p. 41)

■ All states across Australia enjoyed an increase in share ownership, especially Western Australia. One in two investors in Western Australian (48%) and New South Wales (46%) held shares directly, as did two in five of those in Victoria (43%), Queensland (42%) and South Australia (41%).

Not only are Australians enjoying a greater taste for equity investments, but Australian firms are also hungry for equity funding. In fact, empirical studies show that Australian firms largely prefer equity over debt financing, with a comparatively low level of leverage compared to firms in other economies. This trend is particularly pronounced when Australian firms are compared with those in the Asia-Pacific region. So much is clear in Tables 2 and 3 below. Table 2 considers the equity-debt ratio of Australian firms compared to over forty other countries in North America, South America, Europe and Asia, whereas Table 3 compares debt-leverage in firms in Australia and select Asia-Pacific nations.

Table 2: International Comparison of Total Debt Ratio

	Number of firms (1998-2001)	Total debt ratio (%)	
		Mean	Median
Argentina	210	47.72	48.80
Australia	1,365	42.15	45.41
Austria	292	61.01	60.67
Belgium	359	59.93	63.16
Brazil	786	57.60	56.61
Canada	1,573	46.39	48.84
Chile	419	39.53	40.25
Colombia	69	33.27	28.79
Denmark	482	55.06	57.02
Egypt	18	50.63	50.09
Finland	371	51.60	53.78
France	2,123	61.50	62.54
Germany	2,301	60.48	64.31
Greece	607	46.91	46.69
Hong Kong	1,160	42.15	39.35
India	1,015	56.87	58.01
Indonesia	503	66.85	70.21
Ireland	219	47.43	49.95
Israel	170	46.13	48.85
Italy	621	58.59	60.40
Japan	8,253	58.58	59.56
Jordan	6	33.94	32.51
Malaysia	1,215	51.87	49.52
Mexico	378	47.33	46.86
Netherlands	663	60.55	64.12
New Zealand	189	48.43	49.37

Norway	499	55.62	58.22
Pakistan	227	62.91	63.93
Peru	128	44.82	42.86
Philippines	288	46.34	46.34
Portugal	253	56.52	59.97
Singapore	768	46.56	46.53
South Africa	1,096	48.40	47.91
South Korea	1,539	66.20	67.85
Spain	461	53.56	53.22
Sri Lanka	31	46.13	47.94
Sweden	794	52.08	54.56
Switzerland	575	55.42	56.99
Taiwan	850	41.88	42.32
Thailand	762	61.97	64.25
Turkey	289	52.37	52.08
United Kingdom	4,953	51.60	52.03
United States	1,286	58.34	60.68
Venezuela	70	31.80	29.88
Zimbabwe	21	49.94	50.86
TOTAL SAMPLE	40,257	54.44	55.35

Source: Chen and Shiu 2007, p. 33

Table 3: Leverage in the Asia-Pacific

	Leverage		Leverage		Leverage		Leverage
Thailand		Malaysia		Singapore		Australia	
Mean	0.4136	Mean	0.2697	Mean	0.2401	Mean	0.1856
SD	0.3098	SD	0.2608	SD	0.1245	SD	0.1871
Minimum	0.0000	Minimum	0.0000	Minimum	0.0000	Minimum	0.0000
Maximum	0.9979	Maximum	0.9734	Maximum	0.9187	Maximum	0.9638

Source: Deesomsak et al 2004, p. 397.

Part Two: Creditor Rights under Australian Corporate Law

The question that arises from this statistical portrait illustrating the Australian preference for equity over debt is whether this is explicable on the basis of Australian corporate law. Specifically, can low leverage in Australia be explained on the basis of weak creditor protection laws in the Australian Corporations Act 2001 ?[1] This part attempts to answer this question by exploring one of the key legal protections for creditors under the corporate law statute: the duty to prevent insolvent trading under section 588G.

In general, the Corporations Act provides a number of protections to creditors. These

1) For creditor protections available under the general law of contract, tort and trust and under legislation other than the Corporations Act 2001, see Pascoe and Anderson (2003).

include:

- prioritising the claims of creditors over shareholder-members in the distribution of capital when a company is wound up;
- deferring any claims by shareholders to dividends or other entitlements until the creditors are paid in full when a company goes into liquidation;
- affording standing to an unsecured creditor to prevent potential breaches of the Corporations Act that might result in loss to the creditor;
- imposing personal liability on the company's directors for incurring debts when the company is insolvent or on the brink of insolvency;
- imposing personal liability on directors for failing to protect the entitlements of employees;
- imposing liability on a holding company when a subsidiary company goes into liquidation for debts incurred by the subsidiary in the course of insolvent trading;
- imposing personal liability for a company's debts on a person who manages it while he or she is under a disqualification imposed under the Corporations Act;
- restricting company transactions that reduce the share capital to the prejudice of creditors (such as share buybacks or redeeming preference shares) and imposing personal liability on the company's directors for any such transactions that cause loss to the creditors should the company go into liquidation; and
- voiding transactions entered prior to the company going into liquidation — such as unfair preferences, uncommercial transactions, unfair loans, and excessive director bonuses and other director-related transactions — to protect the amount of capital available to satisfy creditors' claims against the company.

Of these, the duty of directors to prevent insolvent trading under section 588G is particularly important. This is for two reasons. First, the threat of personal liability is a very real risk to directors of companies in trading difficulties (Pascoe and Anderson, 2003, p. 16). Although media coverage has focused on the failures of insurance and hi-tech giants such as HIH and One. Tel respectively, the empirical evidence shows that the bulk of insolvent trading cases are brought against firms in such mainstream industries as construction and the retail trade and manufacturing sector (James et al 2004, p. 229-230; Goldman 2005, p. 216). Second, although the legislated duty has been in effect for over 40 years, there has been a noticeable rise in insolvent trading cases since the 1990s, especially following some high profile collapses of major Australian companies (James et al 2004; cf Herzberg 1998).

Section 588G holds a person personally liable for the debts of the company if:

- the person is a director of the company when the company incurs a debt;
- the company is insolvent when it incurs the debt or becomes insolvent because it incurs the debt;
- when it incurs the debt there are reasonable grounds for suspecting that the

company is insolvent or would become insolvent because it incurs the debt; and
- the director is aware at the time the debt is incurred that there are reasonable grounds for suspecting the company is insolvent or a reasonable person in a similar position in a company in the company.

(a) Strong ?

On an initial reading, section 588G communicates a strong policy that directors should take into account the interests of creditors during times of trading difficulties. So much is clear from the significant penalties imposed on those who breach the provision. In addition to this personal liability, for example, directors who plunge their companies into insolvency may be ordered to pay a civil penalty of up to $ 220,000 if the company's ability to pay creditors has been compromised (section 1317G (1)). The court may additionally order their disqualification from ever managing a corporation again (sections 206C, 206D). If the failure to prevent the debt was dishonest, directors face criminal sanctions of a fine of up to $ 220,000, imprisonment for up to five years, or both (section 1311 and Schedule 3). The consequences for breach of section 558G, therefore, can be very serious. As Barrett J observed in *Woodgate v Davis* (2002) 55 NSWLR 222; 42 ACSR 286; 20 ACLS 1314:

> Section 588G and related provisions serve an important social purpose. They are intended to engender in directors of companies experiencing financial stress a proper sense of attentiveness and responsible conduct directed towards the avoidance of any increase in the company's debt burden. The provisions are based on a concern for the welfare of creditors exposed to the operation of the principle of limited liability at a time when the prospect of that principle resulting in loss to creditors has become real.

Furthermore, the definitions of such key words as "director", "debt" and "insolvency" indicates a legislative intention that section 588G have a broad application. For example, the definition of "director" in section 9 of the Corporations Act extends to persons other than formally appointed directors. This may include persons who are not formally appointed to the board but act as if they had that authority ("de facto directors") and those for whom other directors are accustomed to accepting their wishes or instructions ("shadow directors"). According to *DCT v Solomon* (2003) 52 ATR 729; 199 ALR 325, section 588G will extend to persons who might have:

- daily contact with the officially appointed directors;
- the right to approve asset sales;
- active involvement in the preparation of cash flow statements;
- authorisation to enter into negotiations with directors and third parties for capital injections; and
- the power to seek professional advice on behalf of the company.

The definition of "debt" is similarly widely cast. A "debt" is any liability to pay a liquidated amount, that is, an amount that is fixed or can be calculated: *Cmr for Corpoate*

Affairs v Abbott (1980) CLC 40-667.[2] Further, the definition of "debt" is extended by subsection 588G (1A) which deems certain transactions to constitute incurring of a debt. The transactions include: paying a dividend; making a reduction of share capital; buying back shares; issuing and redeeming redeemable preference shares in certain circumstances; financially assisting a person to acquire shares in the company or its holding company; and entering into uncommercial transactions.

Finally, the definition of "insolvency" is based on standards of commercial common sense rather than technical balance-sheet tests: *White Constructions (ACT) Pty Ltd (in liq) v White* (2004) 49 ACSR 220. By section 95A, a company is "insolvent" if it is unable to pay all its debts as and when they become due and payable. This definition will be triggered when the company incurs a series of debts which, although alone are insufficient to cause illiquidity, but in totality have that effect. This test, in short, is concerned with the viability of the company as a business rather than whether there is an excess of liabilities over assets. If a company has a deficiency of net assets but is in a position to pay all its debts as and when they become due and payable, because of a very strong profit-making business, it is solvent: *Quick v Stoland Pty Ltd* (1998) 157 ALR 615; 29 ACSR 130 at 139. Further, a temporary lack of liquidity is insufficient to establish insolvency (*Bank of Australasia v Hall* (1907) 4 CLR 1514; *Sandell v Porter* (1966) 115 CLR 666 at 670); there must be an "endemic shortage of working capital": *Hymix Concrete Pty Ltd v Garritty* (1977) 13 ALR 321'at 328; 2 ACLR 559; CLC 40-312. *White Constructions (ACT) Pty Ltd (in liq) v White* (2004) 49 ACSR 220 at [289] encapsulates the meaning of insolvency into the following five propositions:

1. Whether or not a company is insolvent for the purposes of s95A or s588G is a question of fact to be ascertained from a consideration of the company's financial position taken as a whole;
2. In considering the company's financial position as a whole, the court must have regard to commercial realities. Commercial realities will be relevant in considering what resources are available to the company to meet its liabilities as they fall due, whether resources other than cash are realisable by sale or borrowing upon security, and when such realisations are achievable;
3. In assessing whether a company's position as a whole reveals surmountable temporary illiquidity or insurmountable endemic illiquidity resulting in insolvency, it is proper to have regard to the commercial reality that, in normal circumstances, creditors will not always insist on payment strictly in accordance with their terms of trade by does not result in the company thereby having a cash or credit resource, which can be taken into account in determining solvency;
4. The commercial reality that creditors will normally allow some latitude in time for payment of their debts does not, in itself, warrant a conclusion that the debts are not payable at the times contractually stipulated and have become debts payable only upon demand.
5. In assessing solvency, the Court acts upon the basis that a contract debt is payable at the time stipulated for payment in the contract unless there is evidence, proving to the court's satisfaction, that

2) This is distinguishable from a liability to pay unliquidated or equitable damages.

a. there has been an express or implied agreement between the company and the creditor for an extension of time;
b. there is a course of conduct between the company and the creditor sufficient to give rise to an estoppel;
c. there has been a well-established and recognised course of conduct in the industry where debts are payable on a different basis

Section 588E assists in determining insolvency by allowing claimants to "presume" insolvency in certain circumstances. (Such presumptions, however, are rebuttable.) For example, a presumption of insolvency may be made where the company fails to keep proper accounting records or where there were instances of insolvency in the twelve months leading up to an application for a winding up order.

(b) Weak ?

Despite a clear policy against insolvent trading, strong penalties for its contravention and broad definitions of "director", "debt" and "insolvency", the law is seldom invoked (Pascoe and Anderson 2003, p. 16). According to a recent empirical study of insolvent trading cases (James et al 2004), only 103 cases have been heard by federal and state courts since the 1960s. There was a spike of 62 cases during the 1990s, but only 15 cases in the first few years of the 2000s (p. 236). The vast majority of cases are brought against proprietary companies. Indeed, only eight cases have ever involved public companies, of which four cases involved the same sets of facts and an appeals process and one case involved a not-for-profit company limited by guarantee (p. 228). This might explain the relative low levels of compensation awarded in successful cases. In 16.7% of cases, the compensation was less than 20,000 and in 64% of the cases, it was less than 200,000. Compensation only exceeded $ 500,000 in less than 11% of the cases (p. 226).

Why, asks Herzberg (1998), are there so few insolvent trading cases ? Pascoe and Anderson (2003, p. 16) identify procedural and substantive problems. Procedurally, insolvent cases are unusual because directors can avoid liability if they believe the company is encountering trading difficulties by appointing an independent administrator (section 436A (1)). Further, creditors cannot file actions for insolvent trading on their own initiative; they need the consent of the liquidator pursuant to s 588R. Only if the liquidator fails to provide consent within three months may the creditor serve upon the liquidator a notice of intention to commence proceedings and apply to the court for leave to commence action (sections 488S, 588T). "The liquidator is then required to provide reasons for his or her refusal and the creditor must file the statement of reasons with the court when applying for leave to commence action." (Pascoe and Anderson 2003, p. 16)

Substantively, insolvent trading cases are rare because they are difficult to make out (Pascoe and Anderson 2003, p. 16). This is because, under section 588G, creditors need not only prove that the company was insolvent at the time the director incurred the debt;

but that this fact was reasonably apparent to the director. In other words, the director must be "aware" that there were reasonable grounds for "suspecting" that the company was insolvent or would become insolvent upon the debt being incurred. This is tested by reference to whether a director of ordinary competence — one who is expected to be capable of reaching a reasonably informed position about the financial capacity of the company (*Commonwealth Bank of Australia v Friedrich* (1991) 5 ACSR 115; 9 ACLC 946) — had real concerns about the future viability of the company as a going concern: *Kenna & Brown Pty Ltd v Kenna* (1999) 32 ACSR 430. According to Einfeld J in *Metropolitan Fire Systems Pty Ltd v Miller* (1997) 23 ACSR 699 at 703, the court is not concerned with the particular director's *actual* aptitude, education or experience. Nevertheless, given the vagaries of business and the uncertainties of external economic circumstances, it is invariably difficult to establish that a director, without the benefit of hindsight, had grounds for concern that the company would not be able to trade itself out of financial difficulties.

Finally, section 588H provides four defences to proceedings for a contravention of section 588G. First, a director may furnish evidence that when the debt was incurred, the director had reasonable grounds to expect, and did expect, that the company was solvent at that time and would remain solvent even if it incurred the debt and any other debts that it incurred at that time. Second, a director may establish that, at the time when the debt was incurred, that he or she reasonably relied on an advisor or delegate to monitor the solvency of the company. Third, a director may argue that at the time the debt was incurred, he or she did not take part in the management of the company because of illness or for some other good reason. Finally, the director may submit that he or she took reasonable steps not to incur the debt but was over-ruled by the rest of the board.

Conclusion

Australia's equity revolution has revealed its dark side during the global financial crisis. Australian investors — and, to a lesser extent, Australian corporations — have been stung by the fragility of financial institutions in the United States and Europe culminating in some high-profile collapses (such as Lehman Brothers), private buy-outs (such as the purchase of Merrill Lynch by the Bank of America) and some large-scale state-based bailouts (such as Fannie Mae, Freddie Mac and American International Group in the United States and Northern Rock in the United Kingdom). Originating in the United States, the credit crunch was the result of excessive financial risk and poor regulatory oversight by such institutions as credit rating agencies and financial product research houses. With the explosion in sub-prime mortgages in the United States in the early 21st century, the crisis was triggered when the US housing bubble burst despite confident assumptions that property prices would always rise. Losses proliferated throughout the global economy through the securitization of mortgage loans and the sale of other debt-based investment packages (Austin and Bilski 2008; Cary et al 2008; Gallagher 2008).

Although the Australian financial system is strong and well-regulated (Brunton 2008; Reserve Bank of Australia 2008), the Australian economy has been shaken by the global crisis. Ordinary Australian investors, for example, have particularly suffered, enduring average losses of about 50% over the last year to their share portfolios, superannuation funds and managed investments. Corporate Australia, perhaps due to the preference for equity over debt, has been less affected. The major casualties have been those companies that have relied heavily on sub-prime backed securities (such as Basis Capital which has been liquidated and Absolute Capital which has been put into voluntary administration) or are burdened with high levels of short-term debt which they are struggling to service (such as ABC Learning Centres which is currently in voluntary administration and facing almost certain liquidation and MFS/Octavier, RAMS Home Loans and Centro Properties Group which are facing ongoing trading difficulties). Even for the majority of Australian companies with healthier debt-equity ratios, none can escape the prospect of almost-certain world-wide recession due to choked supplies of global finance. America might have caught the cold, writes Gallagher (2008, p. 30), but the whole world — including Australia — is sneezing.

To what extent is Australian corporate law responsible for compounding the pain of the financial crisis by precipitating the revolution in private share ownership? This doctrinal overview of creditor protection law in Australia — focusing especially on the personal liability of directors for insolvent trading — provides mixed support for the proposition that weak creditor protection laws are responsible for corporate Australia's preference for equity. Clearly, creditors have legislated rights which, in certain circumstances, may trump those of shareholders; however, despite broad definitions and stiff penalties, the evidentiary and procedural difficulties render the protections more attractive in theory than in practice. This might explain the relatively few number of cases brought against directors — especially those of public companies — under section 588G and its predecessor provisions. Even so, further empirical research is required to test whether creditor protection laws are weak, both in comparative perspective and in the eyes of Australian creditors, and, if so, whether such laws are linked to the greater taste among Australian public companies for equity over debt. The overview in this paper suggests such a link; but it certainly does not establish it as a certainty.

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