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Directors' Liability in Insolvency: The Position in the United Kingdom

by
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Introduction

The connection of companies and insolvency is well-known. While companies are solvent and prosper, there is little cause for concern apart from ensuring that companies comply with the rules established with respect to corporate operations. In situations of economic downturn, other considerations come into play, including the liability of management for mistakes leading to the companies in their care entering insolvency. This is an important feature of insolvency legislation in most jurisdictions throughout the world. Part of the intention behind these rules is to protect the interests of other participants in the process, including shareholders, creditors and employees, notably through requiring directors to pay contributions, designed to effect reparations to the parties harmed by their actions. Another part is the need to ensure the protection of the public from the consequences of management mistakes, especially where the reputation of business and the integrity of the markets and corporate law are concerned. Here, the response of the law is often to impose civil and/or criminal liability and, latterly in the law, to attempt to avoid repeat offending through the use of disqualification measures.[1] It is debatable, however, just how far these provisions can be effective, especially given the disincentive to risk-taking they may present by directors nervous of the sanctions they could incur. Of recent concern, too, has been how the liability regimes may affect the choices of directors faced with the onset of insolvency and which may condition the use of particular procedures.

1. The Procedures: An Overview

1.1. It should first be noted that corporate insolvency measures are applicable to all of the internal jurisdictions within the United Kingdom: (i) England and Wales, (ii) Scotland and (iii) Northern Ireland.[2] This chapter presents the law in the United Kingdom, as largely experienced in the internal jurisdiction of England and Wales. The law relating to corporate insolvency is currently contained in the Insolvency Act 1986.[3] The 1986 enactment, resulting from

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[1] See the discussion on this two-part strategy in the context of the reform of United Kingdom law in B. Carruthers and T. Halliday, Rescuing Business (1998, Clarendon Press, Oxford) at 269-283.

[2] Via the Insolvency Act 1986 (England and Wales, Scotland) and the Insolvency (Northern Ireland) Order 1989 (SI 1989/2405). Personal insolvency, or bankruptcy, is a devolved matter and the laws in the separate parts of the United Kingdom are divergent with Scotland having a very different regime to the almost identical provisions applicable to Northern Ireland and England and Wales.

[3] References below to sections, schedules and paragraphs are to those of the Insolvency Act 1986, unless otherwise stated.

the Cork Report,[4] appointed to look into the reform of insolvency law, brought together both personal and corporate insolvency in a single statute. It contains the four procedures applicable to corporate bodies (in order of their appearance in the Act): the "corporate voluntary arrangement" ("CVA"), "administration", "receivership" (retitled "administrative receivership") and "winding up" (or "liquidation"). Schemes of arrangement, currently experiencing a renaissance in use in the context of company restructurings, remain in the Companies Act 2006.[5]

1.2. The first two procedures, titled the "corporate voluntary arrangement" and "administration", were introduced in 1986 by the radical reconstruction of the law through the introduction of the concept of rescue. The Cork Report had suggested the United Kingdom had few methods to rescue companies in financial difficulties. Receivership did not guarantee rescue, while liquidation, although the numerical majority of all procedures instituted, just consigned companies to waste. Some companies could be saved under reconstruction procedures available in companies' legislation, but these were costly, time-consuming and tended only to benefit largely solvent companies. A comparative view of the laws in other jurisdictions, for example, Chapter 11 of the United States Bankruptcy Code 1978 and judicial management in France[6] showed that rescue was a viable proposition for quite a few companies. Two types of procedure were instituted as a result and which are conceptually distinct, the CVA, which attempts to provide a framework for the type of debtor-creditor negotiation similar to that in the context of the informal workout, and administration, a more formal process directed by an administrator under the overall supervision of the court.

1.3. In relation to CVAs, the Cork Report stated the intention behind this procedure that it form a cheap, quick and efficient method for dealing with financial difficulties without engaging formal procedures.[7] The idea was that companies deal with creditors and negotiate terms under the aegis of a nominee, who is an insolvency practitioner. The CVA, as introduced, was similar in structure to schemes of arrangements and reconstructions. The directors of a company facing financial difficulties, but which was not obliged to be insolvent at the time,[8] would apply to court for the approval of CVA proposals,[9] Insolvency Act 1986). The object of proposals would be to compromise or settle claims by creditors with the nominee overseeing and, often as the supervisor, implementing the arrangement.[10] The nominee would

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[4] Report of the Review Committee of Insolvency Law and Practice ("Cork Report") Cmnd. 8558 (1982).
[5] Section 899, Companies Act 2006 (formerly section 425, Companies Act 1985). See J. Tribe, Companies Act Schemes of Arrangement and Rescue: The Lost Cousin of Restructuring Practice? (2009) 24(7) JIBFL 386.
[6] Introduced by Law no. 67-563 of 13 July 1967, later re-enacted in Law no. 85-98 of 25 January 1985.
[7] Cork Report, at paragraph 204.
[8] The formal state of insolvency, measured by the contingent liability test, is not a requirement for any "insolvency" procedure except winding up by the court, although, even then, it is only one of a number of entry routes.
[9] Section 1(1), Insolvency Act 1986.
[10] Ibid., section 1(2).

provide a report to court stating whether proposals should be put before shareholders and creditors for consideration[11] and would summon meetings to consider terms of the arrangement.[12] Once the proposal was agreed at both meetings,[13] the arrangement was binding on all[14] and would be implemented by a supervisor.[15]

1.4. In relation to administration, the Cork Report suggested there was a need for a type of rescue procedure that allowed the business to continue, thus preserving employment, trading and the generation of profits and the (eventual) satisfaction of most creditors.[16] Section 8, as first enacted, contained the "purposes of administration": the survival of the company; the approval of a corporate voluntary arrangement; the sanctioning of a scheme of arrangement; or a more advantageous realisation of assets in a winding up. Administration was viewed as leading somewhere, not just to the company being rescued but also, because of the facility offered to manage a company, to some other procedure being successfully implemented. The production of a report was usual to help the court decide whether an administration order should be granted.[17] An administrator, a qualified insolvency practitioner, would be appointed[18] with wide powers[19] and the ability to investigate and ascertain company's affairs.[20] The administrator would normally publish a statement of proposals to be considered at a creditors' meeting.[21] In pursuing the rescue objective, the administrator would usually sell the business as a going concern, whether as a whole or only those units which were viable, with the corporate shell and any remaining assets being subject to winding up.

1.5. The Insolvency Act 1986 also partially codified the law relating to receivership, renamed administrative receivership, which was an institution created at common law to enable the recovery by secured creditors of debts owed them through the imposition of a receiver to collect and realise company property. Receivers are usually appointed under a floating charge covering all or most of the company's assets given as security by the debtor to the creditor under an instrument known as a debenture. The debenture will contain certain clauses providing that, when the debtor defaults on repayment or other obligations, the "crystallisation" of the floating charge will occur and will entitle the secured creditor to appoint a person known as the receiver and who will usually be an insolvency practitioner. Receivers may also be appointed by the court, if the powers of the court are required to compel the debtor, as may be the case where the security is in jeopardy, where the debt requires to be

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[11] Ibid., section 2(2).
[12] Ibid., section 3. Proposals affecting preferential/secured creditors could not be considered without their consent.
[13] Ibid., section 4.
[14] Ibid., section 5, subject to the possibility of a challenge under section 6.
[15] Ibid., section 7.
[16] Cork Report, Chapter 9.
[17] Rule 2.2, Insolvency Rules 1986 (SI 1986/1925).
[18] Old section 13, Insolvency Act 1986. References to "old" sections are to those in Part II as enacted in 1986.
[19] Ibid., old sections 14-17 and Schedule 1.
[20] Ibid., old sections 21-22.
[21] Ibid., old sections 23-24.

repaid or where interest is in arrears.[22] The receiver principally acts on behalf of the secured creditor. However, to minimise liability on the part of the creditor, the clause appointing the receiver usually deems him to be an agent of the debtor company, so that he can do all the things the directors may do, especially gather in and deal with the assets. The position of other creditors, especially unsecured ones, is particularly acute in receivership. The receiver's duty is principally to the floating charge holder and fulfilling this duty is paramount, even though it may cause the demise of the company, for example by selling off the machinery and factory premises in the case of a manufacturing company or the business itself. After the secured creditor has been satisfied, the receiver returns the company to its directors. The company, if viable, may then continue to trade. This may be rare, especially where the business of the company has been sold as a "going concern". Usually, the company goes into winding up.

1.6. Lastly, winding up, or liquidation, as the oldest of the statutory procedures instituted in the United Kingdom,[23] has changed in detail, but not in its substance. Its function is to effect an organised and equitable method for distributing funds to those entitled to them. Liquidation exists in a number of varieties: members' voluntary winding up, creditors' voluntary winding up and winding up by the court. Except in a voluntary liquidation (usually in a members' voluntary winding up), there are never enough realisable assets to settle all claims and, therefore, the distribution of proceeds is undertaken by means of a list of priorities established by statute. After payment is made in full or when moneys are exhausted, the liquidator applies to the Registrar of Companies for the company to be dissolved and struck off. This is the moment when its separate legal existence comes to an end.

1.7. There were few occasions for reforms over the years, although two statutes, the Insolvency (Amendment) Act 1994 and Insolvency (Amendment) (No. 2) Act 1994, were passed effecting minor changes in that year.[24] Major changes were, however, introduced by the combined impact of the Insolvency Act 2000 and the Enterprise Act 2002. The former introduced a new framework for the CVA, to allow for a 28-day moratorium,[25] although enforcement of its provisions was delayed till the adoption and enforcement of the Enterprise Act 2002, which looked at administration. As the changes only apply to certain companies, those eligible being small companies as defined by section 382(3) of the Companies Act 1986,[26] there exist two parallel CVA procedures, that introduced in 1986 ("old-style CVA") and the same, as introduced by the 2000 legislation ("new-style CVA").

1.8. The reforms to administration reflected concerns about the position of unsecured creditors, the need to streamline administration as a rescue tool

[22] H. Rajak, Company Liquidations (2nd ed) (2006, Thomson, London) at paragraph 3-011.
[23] Via the Joint Stock Companies Act 1848.
[24] Rules on adoption of contracts of employment by administrators and receivers and the adjustment of transactions in winding up respectively.
[25] Section 1A, Insolvency Act 1986 (introducing the procedure in Schedule A1).
[26] Ibid., paragraphs 2(2), 4 and 4A-4C, Schedule A1, excluding certain small companies from the benefit of the moratorium.

and the importance of collective insolvency procedures (as opposed to private recovery methods like receivership). Despite great opposition from financial lenders, the Government saw it as being desirable to promote administration and restrict receivership.[27] However, the holder of a floating charge would be given a part to play in the administration proceedings through powers to appoint the administrator and a new purpose for administration beneficial to secured creditors being included.[28] A rewritten section 8 acted as an enabling provision, repealing Part II of the Insolvency Act 1986 (containing the administration provisions) and providing that a new Schedule B1 would have effect. However, and potentially confusingly, Part II is still preserved for special administration regimes for, *inter alia*, water and sewage companies, railway companies, air traffic service companies, public-private partnership companies and building societies. As a result, there exist two parallel administration procedures, that introduced in 1986 ("old-style administration"), which has been preserved for certain companies, and that introduced by the 2002 legislation ("new-style administration"), which is applicable to all other companies.

1.9. The liability of directors is discussed below in the proper sequence of the procedures contained in the Insolvency Act 1986.[29] A couple of preliminary points may, however, be made. It should first be noted that, despite the onset of insolvency, the directors remain subject to the duties imposed on them in the statutory statement contained in the Companies Act 2006 and may be pursued for breaches of these.[30] Although ratification of certain breaches of these duties is normally available,[31] subject to full disclosure to the company of actions that engender breach, thus enabling the company to give retrospective approval to the directors' actions, this is not available if the creditors are likely to be prejudiced because the company is insolvent. The onset of insolvency also has an impact on the focus of directors' duties. While the company is solvent, there is no general duty to creditors as they can investigate documents on public record.[32] However, where a company is solvent, but a failure to attend to management duties by the directors causes losses to a creditor, the courts have held that there is a duty of care to creditors.[33] Section 172(3) of the Companies Act 2006 also subjects the duty to promote the success of the company to the general law governing specific duties owed, for example, to creditors on insolvency. Examples may include where the directors have engaged in transactions harming the general interest of creditors, such as in the case of an unfair preference to one creditor.[34]

[27] Ibid., sections 72A-H, which bring in a general prohibition on administrative receiverships, subject to some clearly defined exceptions for large scale projects.
[28] Ibid., paragraph 3, Schedule B1, which states that the new purpose are: (a) rescue of company as a going concern; (b) achieving a better result than liquidation; (c) realising property to make a distribution to secured/preferential creditors (the receiver function).
[29] For the purposes of this discussion, "director" is as defined in section 250, Companies Act 2006. Many of the liability regimes also extend to persons in the position of a "shadow director" as defined in section 251.
[30] Sections 170-177, Companies Act 2006.
[31] Ibid., section 180 (applying to sections 175-177).
[32] *Multinational Gas and Petrochemical Co Ltd* [1983] 1 Ch 258.
[33] *Winkworth v Edward Baron* [1987] 1 All ER 114.
[34] *West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250.

Lastly, in most of the procedures, unless released by law, the directors will also be subject to any specific obligations imposed on them by statute and remain liable for compliance.

2. CVA

2.1. The liability of directors depends on whether the CVA is one under the law as originally enacted (old-style CVA), which survives for companies excluded from the benefit of the amendments brought in by the Insolvency Act 2000, or the new-style CVA with moratorium implemented by that reform. The assumption behind both types of CVA is that it is the directors who make the proposal to the members and creditors and who are, therefore, in charge of the process. This would normally exclude the issue of liability, given that the CVA should result in the rescue of the company and, thus, the effective immunity of the directors to claims of mismanagement which led to the company experiencing financial difficulties necessitating resort to negotiations with the creditors under the ambit of a CVA.[35] However, statute does impose certain liabilities, some of which are common to both types of CVA. For example, section 6A makes it an offence to make false representations or to perform or omit to perform any act with view to obtaining the approval of members or creditors to a proposal for a CVA. Furthermore, section 7A allows for the prosecution of delinquent directors where an offence has been committed in relation to the obtaining of a new-style CVA with moratorium or where approval has been sought from the members or creditors.[36] The nominee or supervisor is required under section 7A(2) to report the matter to the Secretary of State, who may launch an investigation under Part XIV of the Companies Act 1985.[37] In the case of the new-style CVA, it is clear that this provision guards against the possibility of directors using the benefit of a 28-day grace period under the moratorium without there being good cause.

2.2. Where only the new-style CVA is concerned, the effect of the moratorium on creditors is of particular importance. Directors are personally liable, if without reasonable excuse, where the nominee is not informed of a moratorium coming into force so as to allow the nominee to advertise that fact, *inter alia*, to the creditors[38] and also if the company documents do not denote that a moratorium is in force in respect of the company.[39] The rules also provide that a director who permits or authorises certain transactions to take place will be liable, for instance, where credit of more than £250 is obtained,[40] company property is disposed of,[41] a payment in respect of company debts

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[35] One exception to this would be where it is an administrator or liquidator applying for an old-style CVA and who would have available to him/her the full panoply of actions under those two procedures (for which see below).
[36] Section 4A (old-style CVA) or paragraph 42 of Schedule A1 (new-style CVA), Insolvency Act 1986.
[37] Incidentally, the only part of the Companies Act 1985 that has survived the enactment of the Companies Act 2006, on grounds that investigations potentially apply to bodies other than companies.
[38] Paragraph 9, Schedule A1, Insolvency Act 1986.
[39] Ibid., paragraph 16.
[40] Ibid., paragraph 17.
[41] Ibid., paragraph 18.

and liabilities is made,[42] a failure to inform the Registrar of Companies when charged property is disposed of,[43] disposal of the charged property itself[44] and entering into market contracts in relation to settlement on the financial markets.[45] The directors are also liable for certain offences in connection with company property for the 12 months prior to the moratorium coming into effect or during the time it is in force. These include concealing or fraudulently removing company property, concealing, destroying or falsifying company documents, including by making false entries, fraudulently disposing of or altering company documents as well as pawning or pledging company property.[46]

2.3. A particular form of civil liability also exists in connection with acts or omissions perpetuated by the directors during a moratorium, enabling the members or creditors of the company to apply to court by petition for an order on the ground that the company's affairs are being or have been conducted in a manner which is unfairly prejudicial to the interests of its creditors or members generally or of some part of these groups. A claim may also be brought on the ground that any actual or proposed act or omission of the company is or would be so prejudicial. The remedies available include regulating management of the company by the directors, requiring the directors to do or refrain from doing something, requiring meetings of creditors or members to be summoned and bringing the moratorium itself to an end.[47]

2.4. Where the CVA proposal has been adopted, the supervisor does have some powers, chiefly to petition the court for directions[48] and to petition for the administration or liquidation of the company,[49] in which case the liability regimes available in those procedures would apply to the directors.[50] The supervisor also has the power to apply under section 423, which states that a transaction at an undervalue occurs where the company enters into a transaction with a person (including, in many instances, a director) by which it makes a gift to that person or enters into a transaction with that person on terms for which there is no consideration or for a consideration the value of which is significantly less than the value of the consideration provided by the company. This facility is also available to the "victim" of the transaction, a term which would include the creditor bound by the CVA. The transaction can only be impugned, however, if the court is satisfied it was entered into for the purpose of putting assets beyond the reach of a potential claim or to prejudice the interests of a person who has made or may make a claim.[51] However,

[42] Ibid., paragraph 19.
[43] Ibid., paragraph 20.
[44] Ibid., paragraph 22.
[45] Ibid., paragraph 23.
[46] Ibid., paragraph 41.
[47] Ibid., paragraph 40, which is modelled on what is often called the "unfair prejudice" action available to members under section 994, Companies Act 2006.
[48] Ibid., section 7(4)(a) or paragraph 39(5)(a), applicable to old-style and new-style CVAs respectively.
[49] Ibid., section 7(4)(b) or paragraph 39(5)(b).
[50] The same would be true if a CVA failed and the company went into liquidation.
[51] G. Weisgard, M. Griffiths and L. Doyle, Company Voluntary Arrangements and Administrations (2nd ed) (2010, Jordans, Bristol) at paragraph 8.64., citing *National Westminster Bank v Jones* [2001] 1 BCLC 98.

neither the nominee nor the supervisor has a reporting obligation under the Company Directors Disqualification Act to enable an investigation into the conduct of directors and/or ultimately disqualification proceedings to be undertaken, unless the company subsequently goes into administration or liquidation.

3. Administration

3.1. The liability of directors falls to be discussed in much the same way as for the CVA by reference to old-style administration and new-style administration, the second being introduced by the Enterprise Act 2002, although the differences between the liability regimes appears in fact to be minimal. Of note, firstly, is the presumption that, because the directors are involved in the process of rescue, the issue of liability is normally excluded or minimised by a successful rescue, which invites the same immunity as in the case of a successful CVA. Nonetheless, as stated earlier, the directors are subject to the general duties in companies' legislation and to any specific obligations imposed on them by statute. That said, however, the directors may not exercise any management powers without the administrator's consent, the words being defined to include any power which could be exercised so as to interfere with the administrator's powers, whether that power is conferred by the Articles of the company or a statute.[52]

3.2. Statute does, however, impose certain liabilities. In relation to both types of administrations, for example, a duty is imposed on directors to submit a statement of the company's affairs to the administrator.[53] Furthermore, the administrator, as an office-holder, enjoys certain extensive rights under sections 234-7. Under section 234, a person having company books or property, including an officer of the company, is required to surrender or transfer the property to the receiver. Section 235 imposes a duty to co-operate, while section 236 enforces assistance in any enquiries undertaken into the company's dealings, also on the officers. The court may also, under section 237, enforce the duty to co-operate against directors and seize documents. Directors are also personally liable where company documents do not denote that the company is subject to administration.[54]

3.3. The rules relating to prior adjustment of transactions apply in the case of administrations. The general impact of these sections is to restore to the company assets removed or given away by the directors, often to benefit themselves or related parties. Thus, in relation to transactions at an undervalue, the administrator is authorised to make an application to the court for an order restoring the position to what it would have been if the company had not entered into the transaction, which order the court may make as it thinks fit. A transaction at an undervalue is defined as including the situation where the company enters into a transaction with a person by which it makes a gift to that person or enters into a transaction with that person on terms for

[52] Old section 14(4) and paragraph 64, Schedule B1, Insolvency Act 1986, applicable to old-style and new-style administrations respectively.
[53] Ibid., old section 22 and paragraph 47.
[54] Ibid., old section 12 and paragraph 45.

which there is no consideration or for a consideration the value of which is significantly less than the value of the consideration provided by the company. If the court is satisfied that the company entered into the transaction in good faith for the purpose of carrying on its business and that there were reasonable grounds for believing that the transaction would be of benefit to the company at the time the transaction was entered into, the court will not make the order sought.[55]

3.4. Similarly, preferences may also be impugned. Where a company has given a preference to a person, the administrator is authorised to make an application to the court for an order restoring the position to what it would have been if the company had not given the preference, which order the court may make as it thinks fit. A company is defined to give a preference to a person if that person is a creditor of the company or a surety or guarantor for a debt or other liability of the company and the company either does anything or suffers anything to be done that has the effect of putting the person into a position, in the event of the winding up of the company, which is better than the position he or she would have been in if the preference had not been given. A court may not make an order impugning the preference unless the company was influenced in deciding to give the preference by a desire to put the person into a position, in the event of the winding up of the company, which would be better than the position in which the person would be if the preference had not been given. If at the time the preference was given, the person to whom it was given was an associate of or connected with the company (otherwise than by reason only of being the company's employee), the presumption will be made that the company was influenced in deciding to give the preference by the desire to better that person's position in the event of a winding up, unless proof to the contrary is brought.[56]

3.5. Extortionate credit transactions or unfair security may also be undermined. Where a company is or has been a party to a transaction for or involving the provision of credit to the company, the administrator may apply to the court for an order impugning the credit transaction if it is or was extortionate and it was entered into in the period of 3 years ending with the commencement of the administration. A transaction will be deemed extortionate if, having regard to the risk accepted by the person providing the credit, the terms of the credit transaction are or were such as to require grossly exorbitant payments to be made in respect of the provision of the credit, whether these payments are made unconditionally or in certain contingent circumstances, or the credit transaction otherwise grossly contravened ordinary principles of fair dealing.[57] A floating charge may also be rendered invalid where it is connected to the lending of money or the supply of goods or services to the company or the diminution or discharge of the company's debts, where the charge is created in favour of a connected person within 2 years of the administration being opened or while the administration petition or notice of intention to appoint is pending.[58]

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[55] Ibid., section 238.
[56] Ibid., section 239.
[57] Ibid., section 244.
[58] Ibid., section 245.

3.6. The administrator may also bring a section 423 claim in relation to a transaction defrauding creditors in much the same circumstances as the supervisor of a CVA.[59] In relation to new-style administrations only, the directors are made liable to indemnify any person against liability that might arise under a defective appointment of an administrator.[60]

3.7. Of note here too is the fact that the administrator is under an obligation to report to the Secretary of State if the conduct of the directors is such as would render them unfit within the meaning of section 6(1) of the Company Directors Disqualification Act 1986 to be concerned in the management of a company, with view to disqualification proceedings being taken against them.[61]

4. Receivership

4.1. The position of the directors appears to be dependent on whether the appointment of a receiver by the court or by the secured lender. Where the court makes the appointment using its powers under section 32, which it may on the application of the secured creditor, the receiver is appointed as an officer of the court to carry out functions given to him under the order. As such, he supersedes the company and the company's powers are in abeyance, including the ability of the directors to act.[62] This is not to say that the directors are *functus officio* or that they are exempt from performance of duties specifically laid on them by companies and insolvency legislation, such as the general duties and specific compliance obligations, examples of the latter being the requirement to prepare accounts and file statutory returns.[63]

4.2. Nevertheless, the powers that the directors can exercise are seen as "residual" and are viewed as "subsidiary" to those enjoyed by the receiver. The most important of these appears to be the power to deal with assets, including choses in action falling outside the scope of the receivership or in relation to which the receiver wishes to avoid acting. However, the directors will need to ascertain the position of the receiver *vis-à-vis* these assets under penalty of being deemed in trespass for wrongly interfering with those assets.[64] As examples of the use of these powers, the directors can raise an action to sue the secured creditor where the receiver refuses to proceed with a claim for breach of contract.[65] Similarly, the directors may challenge the validity of the debenture itself. Needless, to say, liability may accrue for the use of these powers, albeit "residual" in nature.

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[59] See 2.4. above.
[60] Paragraphs 22 and 34, Schedule B1, Insolvency Act 1986.
[61] Section 7(3)(c), Company Directors Disqualification Act 1986.
[62] Rajak, note 22 above, at paragraph 3-016.
[63] In so doing, they will require the assistance of the receiver, who may be exposed to misfeasance proceedings under section 212, Insolvency Act 1986, if failing to assist or impeding their function.
[64] L. Doyle, Administrative Receivership: Law and Practice (1995, FT Law and Tax, London) at paragraph 2.4.1.
[65] *Newhart Developments Ltd v Co-Op Bank* [1978] 1 QB 814.

4.3. Where the receiver is appointed out of court under the terms of any debenture giving rise to this right on the part of the secured lender, the receiver is normally deemed to be the agent of the company.[66] This is a useful device in that, although the receiver has imposed a personal liability under statute, he is entitled to an indemnity out of the assets of the company.[67] In this way, liability accrues to the company and, possibly, the directors for any breaches of contract. However, the same observations in relation to "residual" powers and the ability of directors to act may be made here. Furthermore, irrespective of mode of appointment, under sections 234-7, the receiver, as an office-holder, enjoys certain extensive rights. Under section 234, a person having company books or property, including an officer of the company, is required to surrender or transfer the property to the receiver. Section 235 imposes a duty to co-operate, while section 236 enforces assistance in any enquiries undertaken into the company's dealings, also on the officers. The court may also, under section 237, enforce the duty to co-operate against directors and seize documents. A further example of enforced co-operation is section 47, which imposes a duty by directors to submit a statement of the company's affairs to the receiver. Lastly, directors are also personally liable where company documents do not denote that the company is subject to receivership.[68]

4.4. Of note here too is the fact that the receiver is under an obligation to report to the Secretary of State if the conduct of the directors is such as would render them unfit within the meaning of section 6(1) of the Company Directors Disqualification Act 1986 to be concerned in the management of a company, with view to disqualification proceedings being taken against them.[69]

5. Liquidation

5.1. As noted above, the idea is that rescue absolves the directors of liability for management mistakes, subject to the policing powers that are available to the insolvency practitioners involved in the processes, which mostly serve to compel co-operation by the directors, negate the effect of certain transactions and, in all cases except CVAs, report the conduct of directors with view to investigations and proceedings for disqualification. However, within the context of liquidation, in addition to the above, a full panoply of measures is available to sanction the directors and require contributions to be made. This is perhaps a reflection of both the antiquity of winding up as a statutory procedure (and possibly its enactment against the background of Victorian distaste for insolvency and desire to punish) as well as the need to ensure the recovery of funds to enable as many of the creditors' claims as possible to be settled.

5.2. In the case of both members' and creditors' voluntary winding up, unlike in the situations of rescue and receivership above, directors cease to perform their duties on the appointment of a liquidator, unless the liquidation

[66] Section 44(1), Insolvency Act 1986.
[67] Ibid., sections 37(1) and 44(1).
[68] Ibid., section 39.
[69] Section 7(3)(d), Company Directors Disqualification Act 1986.

committee provides authority to do so.[70] The position in winding up by the court has similarly been settled as a result of "judicial activism" and the pronouncement that the directors "become *functus officio* and [their] powers are assumed by the liquidator".[71] In both these instances, the release of the directors from their positions does not, however, absolve them from liability for past conduct or any other liability imposed by statute.

Contributions

5.3. In relation to all types of winding up, where a limited company is wound up under the law, any director past or present whose liability under the Companies Act 2006 is unlimited will be required to make a contribution, in addition to any contribution he may owe under section 74 in his capacity as a member, as if he were a member of an unlimited company. Exemptions are available for those who have ceased to be directors more than a year prior to winding up and for contributions in respect of debts contracted after they cease to hold office. The requirement to contribute is also subordinated to any rules requiring this in the Articles of the company as well as where a court deems it necessary in order to satisfy the company's debts and liabilities as well as the expenses of winding up.[72]

5.4. In relation to all types of winding up, where a company is being wound up and it has within 12 months before the commencement of the winding up made a payment in respect of the redemption or purchase of its own shares and the aggregate realisable value of the company's assets and the amount paid by way of contribution to its assets is not sufficient for the payment of its liabilities and the expenses of the winding up, the court may, on the application of the liquidator, require a contribution to the company's assets so as to enable the insufficiency to be met. An order may be made against a person from whom the shares were redeemed or purchased or a director who signed the statutory declaration for the purposes of the redemption or repurchase. A person from whom any shares were redeemed or purchased may be ordered to contribute an amount not exceeding so much of the payment as was made in respect of his or her shares and the directors will be jointly and severally liable for that amount. Where a contribution is forthcoming, the court may direct any other person who is jointly and severally liable to contribute under this provision to pay to the contributory such amount as the court thinks just and equitable.[73]

Malpractice

5.5. A director will be liable where, within 12 months prior to proceedings taking place or while they are current, he conceals or fraudulently removes company property, conceals, destroys or falsifies company documents, including by making false entries, fraudulently disposes of or alters company

[70] Sections 91 and 103, Insolvency Act 1986.
[71] Rajak, note 22 above, at paragraph 10-012, citing *Re Union Accident Insurance Co Ltd* [1972] 1 WLR 640 at 642 (per Plowman J).
[72] Section 75, Insolvency Act 1986.
[73] Ibid., section 76.

documents as well as pawns or pledges company property.[74] A director who has made a gift or transfer of or charge over company property or who has concealed or removed any company property at the time a judgment or order for execution has been issued against the company is also liable, unless the conduct occurred more than 5 years prior to proceedings taking place or the director shows there was no intent to defraud the company's creditors.[75]

5.6. A director is also liable where he does not assist the liquidator to discover the company's property or reveal the consideration paid for acquisitions or disposals, fails to deliver up all company property, including books and papers, within his control or custody, does not inform the liquidator where he knows that a false debt has been proved or, after the winding up has commenced, prevents the production of any book or paper relating to the company's property or affairs. Furthermore, an offence is committed if the director attempts to file fictitious losses and expenses to account for any property transaction, including where he has done so at any creditors' meeting in the 12 months prior to proceedings. In relation to all offences, exculpation may be made where the director shows there was no intent to do so.[76] Liability also arises where the company's books, papers, registers or securities are mutilated, destroyed, altered or falsified or if any false or fraudulent entry has been made in them with intent to defraud or deceive any person.[77]

5.7. Any material omission from a statement relating to company affairs made during or prior to winding up occurring is also sanctioned, unless the director can show there was no intent to defraud.[78] Similarly, any false representation or other fraud for the purpose of obtaining the consent of the company's creditors to any course of action within winding up is sanctioned, whether the representation occurred before or during proceedings.[79]

Penalisation of Officers: Misfeasance and Fraudulent and Wrongful Trading

5.8. A summary procedure contained in the law is available to compel a director to contribute to the company's assets, where the company is in liquidation and the director has misapplied or retained company money or property or has been guilty of misfeasance or a breach of a fiduciary or other duty. The application may be brought by the liquidator, creditor or, with the leave of the court, any contributory against a director with view to compelling an account for the money or property misapplied, together with any interest, as well as compensation in respect of the misfeasance or breach of duty.[80] Misfeasance has been defined as conduct which falls between the breach of the duty of care and skill, on the one hand, and the fiduciary duty, on the

[74] Ibid., section 206. Aiding and abetting others to conceal, destroy or falsify company documents, including by making false entries, as well as fraudulently disposing of or altering company documents is also an offence.
[75] Ibid., section 207.
[76] Ibid., section 208.
[77] Ibid., section 209.
[78] Ibid., section 210.
[79] Ibid., section 211.
[80] Ibid., section 212.

other.[81] The court does have a discretion to absolve an honest and reasonable director for a breach of duty.[82] This is so even if the breach was negligent in nature.[83] The procedure is termed summary because it does not create any new cause of action which was not already available to the company while it was solvent, although it may not have been interested in pursuing a claim.[84]

5.9. The liquidator is authorised to apply to the court for an order that persons who were knowingly parties to the carrying on of the company's business with intent to defraud creditors of the company or creditors of another person, or for a fraudulent purpose, be liable to make such contributions to the company's assets as the court thinks proper.[85] "Defraud" and "fraudulent purpose" are terms that denote "actual dishonesty involving… real moral blame".[86] There must, however, be conduct that amounts to carrying on the business with intent to defraud.[87] The test of intent does require that there be subjective intent on the part of the director to commit the fraud and this cannot be established by an objective assessment of conduct, as might be in the case of wrongful trading.[88] Because of the association with a parallel penal provision in section 993 of the Companies Act 2006, which applies to similar conduct with the requisite intent, whether or not the company is in liquidation, the subjective intent has to be established on the criminal standard of proof: "beyond reasonable doubt". This makes it very difficult to secure orders and the instances of cases under the provision are few and far between. This was one of the reasons motivating the suggestion that it be replaced with a provision with a civil standard of proof and relying on an objective assessment of conduct. This did result in the wrongful trading provision, but without repealing the fraudulent trading provision. Nonetheless, the section does have two advantages in that, firstly, it is wider and applies not just to directors.[89] Secondly, a punitive element may be added to the contribution over and above any compensatory element.[90]

5.10. In the course of a winding up, the liquidator may apply to court for an order, if the court thinks it proper to do so, in relation to a person who is or has been a director of the company requiring that the person is liable to make a contribution to the company's assets. The court may make an order where the

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[81] Rajak, note 22 above, at paragraph 13-010.
[82] Section 1157, Companies Act 2006.
[83] *Re D'Jan of London Ltd* [1993] BCC 646. *Re Produce Marketing Consortium* [1989] BCLC 513 does, however, state that the provision allowing for relief does not apply to actions initiated under section 214, Insolvency Act 1986.
[84] C. Hanson and P. Wilkinson, England and Wales, Chapter 7 in A. Sorensen (ed), Directors' Liabilities in Case of Insolvency (1999, Kluwer Law International, London) at 195.
[85] Section 213, Insolvency Act 1986.
[86] Hanson and Wilkinson, note 84 above, at 192, citing *Re Patrick and Lyon Ltd* [1933] Ch 786.
[87] Rajak, note 22 above, at paragraph 13-004, citing *Re Augustus Barnett and Son Lt*d [1986] BCLC 170.
[88] Idem, citing *Re William C Leitch Bros Ltd* [1932] Ch 71.
[89] Idem, citing *Re Gerald Cooper Chemicals Ltd* [1978] Ch 262 as an example of an action against a creditor.
[90] Hanson and Wilkinson, note 84 above, at 192, citing *Re A Company No. 001418 of 1988* [1990] BCC 526.

company has gone into insolvent liquidation and where a person who was a director at the time knew or should have concluded at some time before the commencement of the winding up that there was no reasonable prospect that the company would avoid a winding up. The court may not make the order where it is satisfied that, after the person knew or ought to have concluded of the risk to the company, that person took every step he ought to have taken with a view to minimising the potential loss to the company's creditors.[91] Insolvent liquidation is defined for these purposes as entry into liquidation at a time when the company's assets were insufficient to meet its liabilities.[92] Conduct by the director is assessed by the standard of the reasonably diligent person, which appears to contain a mix of objective and subjective standards, in that the state of mind of the director is relevant for establishing the state of knowledge, but the adequacy of the knowledge falls to be dissected on an objective assessment.[93]

5.11. As far as wrongful trading is concerned, there are doubts about the utility of the provision, given that there seem to be very few instances on the use of the section to pursue claims and very few reported decisions on the scope of the provisions. One reason may be that the initiative, given to liquidators by the section, may so rarely be seized because liquidators are unwilling to expend assets in the pursuit of litigation unless there is an overwhelming prospect of success. Given that the costs of litigation may not necessarily be met as of right from the insolvency estate, even though courts have the power to accord priority to the litigation costs as a claim against the estate, the uncertainty acts to dissuade liquidators from embarking on litigation under this section. Nevertheless, the *raison d'être* for this section is stated as being that it acts as a counter-incentive for directors to maximise their own position as shareholders by seeking to trade out of insolvency, a course of action that is unlikely to have a great chance of success, because they enjoy the protection of limited liability should they fail. The imposition of liability would tend to make directors consider the interests of the creditors more, given that the creditors' interests are most at stake in situations where shareholders' equity has already been exhausted and the company is in effect trading with the creditors' money, supplies and credit.

Phoenix Companies

5.12. Certain provisions penalise the re-use of company names or the use of names tending to suggest an association with a former business. Where a company has gone into insolvent liquidation and a person has been a director at any time within the 12 months prior to proceedings beginning, that person may not be a director of a company with a prohibited name, take part in the promotion, formation or management, directly or indirectly, of such a company or be involved in the running of a business under a prohibited name, where

[91] Section 214, Insolvency Act 1986.

[92] Rajak, note 22 above, at paragraph 13-006 suggests that nothing turns on the definition of "insolvent liquidation" as applications are only likely to be seen in the context of windings up by the court.

[93] The test in section 214(4), Insolvency Act 1986 is also to be seen in section 174, Companies Act 2006 (part of the statutory statement referred in note 30 above).

that business is not being carried out using a corporate form. A prohibited name is defined as a name by which the liquidated company was known or one that is so similar as to suggest an association with the insolvent company.[94] Personal liability for debts and liabilities of the company is imposed on any person contravening the provisions of section 216.[95]

Adjustment of Prior Transactions

5.13. The rules in relation to transactions at an undervalue (section 238), preferences (section 239), extortionate credit transactions (section 244), avoidance of floating charges (section 245) and transactions defrauding creditors (section 423) are similarly applicable.[96]

General Co-Operation and Particular Liabilities

5.14. The rules on enforced co-operation under sections 234-237 apply in the case of all liquidations.[97] The duty on directors to submit a statement of the company's affairs also applies in certain types of winding up.[98] Directors are also personally liable where company documents do not denote that the company is subject to any type of liquidation.[99] Where the company is being wound up by the court, compliance with the rules relating to the public examination of officers is also required.[100] The liquidator is also under an obligation to report to the Secretary of State if the conduct of the directors is such as would render them unfit within the meaning of section 6(1) of the Company Directors Disqualification Act 1986 to be concerned in the management of a company, with view to disqualification proceedings being taken against them.[101]

6. Miscellaneous Liabilities

6.1. Certain civil liabilities subsist or remain imposed irrespective of the onset of insolvency. For example, directors may be liable, where a public company operates without obtaining a trading certificate, to indemnify any party who has suffered loss or damage by reason of the company failing to adhere to its obligations within any transaction with that party.[102] Similarly, general legal principles would impose liability for a tort that the director procured the company to commit.[103]

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[94] Section 216, Insolvency Act 1986. Leave may be given to re-use a name where the business is in fact taken over under an arrangement supervised by an insolvency practitioner and also on application to court for leave to do so.
[95] Ibid., section 217.
[96] See 3.3.-3.6. above.
[97] See 3.2. and 4.3. above.
[98] Section 99 (creditors' voluntary winding up) and 131 (winding up by the court), Insolvency Act 1986.
[99] Ibid., section 188.
[100] Ibid., sections 133-134.
[101] Section 7(3)(a)-(b), Company Directors Disqualification Act 1986.
[102] Sections 761 and 767, Companies Act 2006.
[103] *C. Evans and Sons Ltd v Spritebrand Ltd* [1985] 1 WLR 317.

7. Consequences of Liability and the Disqualification of Directors

7.1. Apart from the imposition of civil and criminal liability under the provisions noted above, directors may also be disqualified on the basis of the same conduct.[104] While disqualified, a person may not be a director of a company or take part in the promotion, formation or management of a company without the leave of the court.[105] Disqualification may be for up to 15 years, although a lower tariff of 5 years is set in certain cases.[106]

7.2. A director may be disqualified by conviction for an indictable offence in connection with the promotion, formation, management or liquidation of a company.[107] Management in this context could also potentially include actions in the context of CVAs and administration. The court may also make a disqualification order where a person has been guilty, while a director of a company now in liquidation, of any fraud in relation to the company or of any breach of his duty as a director. Alternatively, it may be made where that person is guilty of an offence of knowingly being a party to fraudulent trading under section 993 of the Companies Act 2006.[108] Participation in fraudulent or wrongful trading under sections 213-214 may also give rise to disqualification at the same time a contribution order is made.[109]

7.3. Most disqualifications arise from disqualification for unfitness under the law. The court may make a disqualification order where a person is or has been a director or shadow director of a company which has, at any time during or after his directorship, become insolvent and that, furthermore, his conduct as a director or shadow director of that company makes him unfit to be concerned with the management of a company.[110] An application may also be made by the Secretary of State following a report received by an office-holder in insolvency (administrator, receiver or liquidator) or where an inspection of the company has taken place.[111]

7.4. Matters for determining unfitness are set out in section 9, which introduces the schedule to the Act, and states that, where it falls to a court to determine whether a person's conduct as a director of any particular company or companies makes him unfit to be concerned in the management of a company, the court will have regard in particular to the matters mentioned in

[104] These provisions also apply to those acting as de facto directors and shadow directors: *Re Lo-Line Ltd* [1988] 2 All ER 692 and *Re: Hydrodan (Corby) Limited* [1994] 2 BCLC 180 respectively.
[105] Section 1, Company Directors Disqualification Act 1986. See, for an example of where leave was given at the same time as a disqualification order was made: *Re Majestic Recording Studios Ltd* [1989] BCC 1.
[106] Ibid., sections 3 (disqualification for persistent default) and 5 (disqualification on summary conviction). The determination of the appropriate tariff is a matter for the court: *Re Sevenoaks Stationers (Retail) Ltd* [1991] Ch 164.
[107] Ibid., section 2.
[108] Ibid., section 4.
[109] Ibid., section 10.
[110] Ibid., section 6, which singularly imposes a minimum term of disqualification of 2 years.
[111] Ibid., sections 7-8. In the case of these two sections, disqualification undertakings under section 1A may be accepted from the director instead of orders being pursued, the effect being a form of “voluntary” withdrawal from doing the things a section 1 order would prohibit.

Part I of the schedule and, where the company has become insolvent, to the matters, mentioned in Part II.[112] These matters are not exhaustive and a court may take into consideration other aspects of the director's conduct.[113]

7.5. Part I includes:

(a) any misfeasance or breach of any fiduciary or other duty by the director in relation to the company;
(b) any misapplication or retention by the director of, or any conduct by the director giving rise to an obligation to account for, any money or other property of the company;
(c) the extent of the director's responsibility for the company entering into any transaction liable to be set aside under Part XVI of the Insolvency Act 1986 (provisions against debt avoidance);
(d) the extent of the director's responsibility for any failure by the company to comply with some provisions of the Companies Act 2006, including, *inter alia*, records, registers, annual returns as well as registration of charges; and
(e) the extent of the director's responsibility for any failure by the directors of the company to comply with directors' duty to prepare annual accounts or signing of balance sheet and documents to be annexed.

7.6. Part II includes:

(a) the extent of the director's responsibility for the causes of the company becoming insolvent;
(b) the extent of the director's responsibility for any failure by the company to supply any goods or services which have been paid for (in whole or in part);
(c) the extent of the director's responsibility for the company entering into any transaction or giving any preference;
(d) the extent of the director's responsibility for any failure by the directors of the company to comply with the duty to call a creditors' meeting in creditors' voluntary winding up; and
(e) any failure by the director to comply with any obligation imposed on him under certain provisions of the Insolvency Act 1986.

Summary

From the above account, directors are faced with a formidable array of liability, both civil and criminal, in all procedures within insolvency. Although the bulk of the provisions is aimed at directors of companies in liquidation, there are many obligations in the context of CVAs and administration which directors must be aware of when negotiating with creditors and forging a path towards rescue. Only in receivership is the policing role of the insolvency practitioner lighter than in other procedures, although a reporting facility, similar to other procedures, still enables investigations to be initiated and the disqualification regime to be set in motion. Thus, the directors face not just civil and criminal liability, but also the prospects of being disqualified from corporate life for a time to come. With this in mind, practical advice for

[112] Ibid., section 9.
[113] *Re Sevenoaks Stationers (Retail) Ltd* [1991] Ch 164.

directors anticipating or experiencing the onset of insolvency would be to ensure that their compliance obligations under companies and insolvency legislation are up to date and cannot be impugned. They should ensure that their internal information on the company's finances and affairs is complete. They should also seek and follow appropriate advice given by their financial advisers or insolvency practitioners that have been or may be appointed. In this context, knowledge and awareness by the director of what is happening to the company is crucial. Courts will not normally use hindsight to judge the actions of directors, but will form a view of their actions on the basis of the information actually known to them or which a reasonable diligent director would have ascertained at the relevant time. It pays directors in these cases to be proactive and take the lead in the diagnostic and resolution process leading to the possible recovery of the company, rather than reacting to and being led by events.

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