DentonWildeSapte...

SAVING THE GOING CONCERN – MUST THE CREW ABANDON SHIP?

MARK ANDREWS
DENTON WILDE SAPTE

DentonWildeSapte...

THE POSITION OF THE DIRECTOR

- The law must do a balancing act. It must:-
  a) discourage inappropriate conduct by management and punish the guilty but
  b) avoid destabilising honest and conscientious management during the re-structuring process.
- Due to an uncomfortable combination of intentions and consequences, we do not currently get the balance right in the UK.

1986 AND ALL THAT

- Before the reforming insolvency legislation of 1986 there was widespread concern about the activities of rogue directors.
- The existing remedies (fraudulent trading proceedings and misfeasance proceedings together with occasional criminal prosecutions) were considered to be inadequate.
- Particular concerns were current about
  - Asset stripping
  - Serial failures (ie directors who repeatedly ran companies into insolvency)
  - The common practice of starting up in business again under the same or a similar name.

DentonWildeSapte...

1986 and all that

- The new legislation tilted the balance against delinquent directors by:-
  - creating the new remedy of wrongful trading - Insolvency Act 1986 s.214
  - dramatically curtailing (with criminal sanctions) the ability of directors to trade in the name of a company which had previously gone into liquidation or a similar name – Insolvency Act 1986 s.216
  - creating a disqualification regime to protect the public by disqualifying for a fixed period of up to 15 years directors whose conduct had demonstrated their unfitness for office – Company Directors Disqualification Act 1986.
- Of these, only s.216 can be looked upon as an unqualified success.

WRONGFUL TRADING

- In essence, wrongful trading is continuing to trade otherwise than in the best interests of creditors after the point at which the directors knew or ought to have known that insolvent liquidation was inevitable.
- The remedy is largely ineffective. There have been no more than a handful of successful claims.
- Known inevitability of liquidation is hard to prove.
- It is often in the best interests of creditors to trade on for a while to preserve going concern values even though liquidation may be inevitable.

DISQUALIFICATION

- All insolvency practitioners have a duty to file reports with the DTI on any directors whose conduct has shown them to be unfit to hold office.
- Disqualification proceedings are handled by the DTI.
- In recent years the annual numbers of disqualification orders or undertakings (voluntary disqualification avoiding the need for proceedings) have risen steadily.
- Complex proceedings are often poorly prepared and presented.
- Many orders and undertakings are obtained in relatively minor cases where the individuals cannot afford to fight.

DentonWildeSapte...

THE ENTERPRISE ACT 2002

- The Enterprise Act created a new ground for disqualification which had nothing to do with insolvency or the propriety of a director's conduct.
- A director can now be disqualified from office for breaches of competition law without any need to demonstrate unfitness for office.

DentonWildeSapte...

THE PROBLEM

- Our law talks tough about delinquent directors but the reality is rather softer.
- A director of a company in crisis will be completely safe if he takes expert advice during the crisis period and conducts himself in accordance with it.
- In most cases, directors can be given robust and reassuring advice.
- Unfortunately, they are often given advice, particularly about wrongful trading, which invites them to panic at the moment when they most need to keep their collective nerve.
- The result can be unnecessary insolvency filings and/or inappropriate resignations.

DentonWildeSapte...

THE WORST OF ALL POSSIBLE WORLDS

- Our combination of law and practice fails on both sides of the balance.
- Our law is not used effectively against real delinquents.
- Our disqualification system is not respected.
- The real delinquents pay little heed to the remedies provided by our law.
- But we talk tough enough to frighten the honest and conscientious directors who are not at risk anyway.

DentonWildeSapte...

THE SOLUTION

- We do not need any further legislation.
- Our disqualification process needs careful and critical re-evaluation.
- We need to ensure that, in crisis situations, directors are advised by specialists who can talk knowledgeably and authoritatively about the potential dangers and how to avoid them.
- The lawyers must concentrate on reassuring directors and telling them how to be safe, rather than cataloguing the reasons for them to be very, very frightened.