

Directors' Personal Liability At Greater Risk under New Companies Act ?



The veil of incorporation protecting directors and shareholders of a company from personal liability is one of the fundamental principles of English law. However, under the Insolvency Act 1986 there are a number of instances after a company has entered into liquidation when directors can be held personally liable. The impact of the Companies Act 2006 means new measures may reduce the protection of directors if it can be proven that they were at fault.

On insolvency an important question the liquidator must ask is "is the insolvency the fault of the directors?" Disgruntled creditors are likely to want someone to blame and increasing pressure may be put on liquidators of insolvent companies to seek redress from the directors.

If the liquidator believes the directors are at fault then the Insolvency Act 1986 provides a number of grounds on which he may pursue the directors

personally to force them to contribute towards the company's debts. These include instances where the liquidator can satisfy the Court that the director is guilty of fraudulent trading, wrongful trading or transactions in fraud of creditors.

- **Fraudulent trading**

If in the course of the winding up of a company it appears that any business of the company has been carried on with the intent to defraud creditors of the company or creditors of any other person, or for a fraudulent purpose: the Court on the application of the liquidator may declare anyone knowingly party to carrying on business in this way is liable to make contributions to the company's assets.

- **Wrongful trading**

The liquidator may seek a declaration from the Court that a director is liable to make a contribution to the company's assets if the company has gone into liquidation, and some time before the commencement of the winding up of the company, that person knew, or ought to have concluded, that there was no reasonable prospect that the company would avoid going into insolvent liquidation and that person was a director of the company at the time.

- **Transactions in fraud of creditors**

When a company is ordered to be wound up by the court or passes a resolution for voluntary winding up, an offence is committed if an officer of the company: has made or caused to be made any gift or transfer of, or charge on, or has caused or connived at the levying of an execution against, the company's property or has concealed or removed any part of the company's property since, or within two months before, the date of any unsatisfied judgment or order for the payment of money obtained against the company.

Traditionally, the most onerous example of a possible action a liquidator may take against a director is for wrongful trading, as there is no need to prove any element of intent or fraudulent purpose. It only needs to be shown that the directors continued to trade beyond a point at which they ought to have known there was no reasonable prospect of the company avoiding an insolvent liquidation. As it is unnecessary to prove fraudulent intent, this option is used most frequently by liquidators to pursue directors of insolvent companies.

However, under the Companies Act 2006 which received Royal Assent on 8th November 2006, life could become much more difficult for directors.

Companies Act 2006

Under the Companies Act 2006 the directors of a company have a duty to:

- exercise independent judgment
- exercise reasonable care, skill and diligence
- avoid conflicts of interest
- not accept benefits from third parties
- declare an interest in proposed transaction or arrangement.

In addition directors must promote the success of the company having regard to:

- long term consequences of any decision
- the interest of company employees
- the need to foster relationships with suppliers and customers
- the impact on the community and the environment
- the desirability of the company maintaining a reputation for a high standard of business and conduct
- the need to act fairly between the members of the company.

Directors should be vigilant that creditors will try to use the new legislation to pierce the veil of incorporation and sue directors for company debts, which otherwise may be unpaid by a company in liquidation.

Creditors might try to pursue not only people with the job title director but also "shadow directors" or "de facto directors". A shadow director is someone who may not hold the title director but on whose directions or instructions the other directors are accustomed to act. A de facto director is a person who acts like a director and may assume the functions of a director without a formal appointment.

It remains to be seen how the Court will interpret these duties and the extent to which it will allow creditors to enforce and require settlement of company debts against directors personally.

How can directors protect their position?

Many parts of the Companies Act 2006 do not come into effect until 2008. However, directors and management boards should be preparing for it now.

If directors believe that there is a significant risk that creditors may not be paid and the company continues to trade, any debts incurred during this period and subsequently not paid by the company may be held to be the personal responsibility of the directors. Directors should take early professional advice as to whether trading should continue and whether their proposals are likely to be achieved.

Taking advice from a solicitor, or insolvency practitioner, will help directors to protect their personal position and may result in proposals or a rescue plan being put to the company's creditors.

If a decision is made that a company should continue to trade the directors will be able to point to evidence of professional advice and a detailed record of the decision-making process which may protect them from any future litigation by disgruntled creditors or a liquidator of an insolvent company of which they are a director.

Beswicks insolvency team has extensive experience of advising directors on how to protect their position and reduce the likelihood of incurring personal liability. Beswicks also act for insolvency practitioners and commercial creditors to advise on the merits of pursuing a company's debts against its directors personally.

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