



Claims against Directors

Wrongful trading...or misfeasance?

Wrongful Trading - and other Insolvency Act claims

- Wrongful trading
 - What you need to prove
 - The problems
- Companies Act misfeasance
 - What you need to prove
 - Is this better?
 - (Relevance of s212 IA'86 - summary remedy for misfeasance.)
 - Other uses for misfeasance claims:
 - Undervalue transactions
 - Preferences
- Back to wrongful trading - seeking a DQ order

Wrongful trading

Key elements

- Liquidator must prove
 - The tipping point:
 - That the director should have known - at a point in time - the company couldn't avoid liquidation (or administration).
 - Lack of skill and knowledge:
 - That a reasonable director (with this director's skill, knowledge and experience) should have realised the company was at that point.
 - Financial loss:
 - What a reasonable director would have done differently or sooner.
 - And how that would have softened the damage.
- Director must prove:
 - They did all they could, to minimise the creditors' losses.
(s214 / s246ZB IA'86)

Wrongful trading - temporary relaxation

- Two, disconnected periods:
 - Response to 'lock-down one' in March 2020.
 - Back-dated to 1 March 2020.
 - Ended 30 September 2020.
 - Revived 26 November 2020 ('lock-down three?').
 - Due to end 30 April 2021 (may be extended or curtailed).
- Originally in:
 - s12 CIGA (Corporate Insolvency and Governance Act 2020).
- Now in:
 - r2 CIGACSLWTERPR (Corporate Insolvency and Governance Act 2020 (Coronavirus) (Suspension of Liability for Wrongful Trading and Extension of the Relevant Period) Regulations 2020).

Wrongful trading - temporary relaxation

- ... the court is to assume that the person is not responsible
 - for any worsening of the financial position
 - of the company or its creditors
 - that occurs during the relevant period...
- Does not apply:
 - To any other claims or duties;
 - To financial services businesses (see the lists in schedule ZA1 IA'86).

Wrongful trading - temporary relaxation

- Practical effect?
- Don't use wrongful trading any time soon.
- You might be OK if the 'tipping point' date is clearly later than 30 April 2021 (or whatever earlier or later date may eventually apply).

Wrongful trading - other problems

- Proving the trigger date.
 - Three stages:
 - 1 Proof of the company's financial condition on any given date.
 - 2 Proving that meant insolvency was inevitable.
 - 3 Proving that a particular director should have realised that.
 - With expert forensic evidence - too complicated?
 - Without expert evidence - insufficient evidence?
- Proving loss.
 - With expert forensic evidence - risk of confusion over what is evidence for:
 - Trigger date;
 - Loss.

Misfeasance as an alternative

- Companies Act 2006 ss171-177
- Main duties (on directors):
 - Act constitutionally.
 - Promote the success of the company (for its members / creditors)
 - Use independent judgement.
 - Use reasonable skill, care and diligence.
 - Manage conflicts of interest.
 - Don't be corrupt.
- Applies to shadow directors and *de facto* directors.

Misfeasance as an alternative

s172 Companies Act 2006

- Director's duty is to:
 - Act in good faith
 - As they consider likely to promote the success of the company
 - For its members' benefit
 - (Or, in some cases, for its creditors' benefit)
 - And in doing so, think about:
 - Long term consequences of decisions;
 - Employees, suppliers, customers, the community and environments;
 - Reputation;
 - Treating shareholders fairly.

Misfeasance as an alternative

- Suppose the last accounts showed a negative balance sheet
 - As at 20 months before liquidation.
 - Approved 12 months before liquidation.
- And, suppose the deficiency account shows further trading losses.
- You don't have to prove liquidation was then inevitable.
- But you can ask for the director to say:
 - What decisions they made, in good faith
 - To promote the success of the company
- The duty is the same, owed to the company, whether it's members or creditors who lose their money.

Misfeasance as an alternative

The effect of:

- s12 CIGA (Corporate Insolvency and Governance Act 2020); and
- r2 CIGACSLWTERPR (Corporate Insolvency and Governance Act 2020 (Coronavirus) (Suspension of Liability for Wrongful Trading and Extension of the Relevant Period) Regulations 2020).

(on s172 CA'06 misfeasance)

- None

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Misfeasance - s212 Insolvency Act 1986 (1/2)

- Often misunderstood.
- Procedural only.
- Does not define any form of 'misfeasance'.
- Allows a liquidator (or administrator):
 - To bring a misfeasance claim
 - By using the Insolvency Act summary procedure
 - Satellite proceedings in the insolvency proceedings
 - Rather than
 - Stand-alone proceedings
 - Which - in the right cases - is quicker, and cheaper.

Misfeasance - s212 Insolvency Act 1986 (2/2)

- Often misunderstood.
- Procedural only.
- Does not define any form of 'misfeasance'.
- 'Misfeasance'
 - = wrongdoing (< malfeasance = evildoing)
 - Statutory examples in ss171-177 Companies Act 2006.
 - Replace - without much changing - old rules based on case law.
 - Loose, flexible rules (to catch slippery rogues).
 - As always, you need to prove the breaches
 - (It's not enough just to shout 'misfeasance'.)

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 - Other uses for misfeasance claims:
 - **Undervalue transactions**
 - Preferences
- Back to wrongful trading - seeking a DQ order

Undervalue transactions

Key elements to prove the claim (s238 IA'86):

- Financially disadvantageous transaction
- The company was then technically insolvent:
 - (cash-flow or balance sheet)
 - (connected-party presumption, but you're at risk without evidence)
- As insolvency approached:
 - (in the last 2 years before appointment)

Misfeasance as an alternative

s172 Companies Act 2006

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 - Act in good faith
 - As they consider likely to promote the success of the company
 - For its members' benefit
 - (Or, in some cases, for its creditors' benefit)
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 - Long term consequences of decisions;
 - Employees, suppliers, customers, the community and environments;
 - Reputation;
 - Treating shareholders fairly.

Undervalue transactions as misfeasance

The elements under s172 CA'06:

- Financially disadvantageous transaction?
 - Unlikely to promote the success of the company.
- Solvency of the company?
 - Irrelevant. It's misfeasant - and the company entitled to be compensated - whether it's the shareholders or creditors who suffer.
 - (I'll look at s1157 CA'06 later.)
- Last two years?
 - Irrelevant if longer ago (but watch for the limitation period)
- And the director can be personally liable
 - Even if somebody else took the asset.

Wrongful Trading - and other Insolvency Act claims

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 - What you need to prove
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 - (Relevance of s212 IA'86 - summary remedy for misfeasance.)
 - Other uses for misfeasance claims:
 - Undervalue transactions
 - **Preferences**
- Back to wrongful trading - seeking a DQ order

Preferences

Key elements to prove the claim (s239 IA'86):

- Queue-jumping. Letting a mate in, while everyone else waits.
 - They end up suffering less when the company eventually goes bust.
- Bad faith.
 - ‘... influenced by a desire [to prefer] ...’
 - And they have to prove good faith, when the person who benefitted is obviously a mate (connected).
 - (You don't have to prove the bad faith)
- The company was then technically insolvent:
 - (cash-flow or balance sheet)
 - (connected-party presumption, but you're at risk without evidence)
- As insolvency approached:
 - (in the last 2 years / 6 months before appointment)

Misfeasance as an alternative

s172 Companies Act 2006

- Director's duty is to:
 - Act in good faith
 - As they consider likely to promote the success of the company
 - For its members' benefit
 - (Or, in some cases, for its creditors' benefit)
 - And in doing so, think about:
 - Long term consequences of decisions;
 - Employees, suppliers, customers, the community and environments;
 - Reputation;
 - Treating shareholders fairly.

Preferences as misfeasance

The elements under s172 CA'06:

- Helping a mate jump the queue - for no good reason?
 - Unlikely to promote the success of the company in good faith.
 - But, there's no presumption of bad faith to help flush out the truth.
- Solvency of the company?
 - Not directly relevant. But, if the company is solvent, there's no queue to jump. Conversely, if it's insolvent, paying a mate - when others suffer - looks like bad faith.
 - (I'll look at s1157 CA'06 later.)
- Last six months / two years?
 - Irrelevant if longer ago (but watch for the limitation period)
- And the director can be personally liable
 - Even if somebody else took the asset.

Relief - s1157 CA'06

The court can reduce the amount the director has to pay (to nil?) if:

- They were honest; and
- They acted reasonably; and
- It's fair to let them off.

But:

- The director has to prove they were:
 - Honest.
 - Reasonable.

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Wrongful trading - seeking a DQ order

Company Directors Disqualification Act 1986, s10:

- Where the court makes a declaration
 - Under s(213 or) 214 IA'86 (but not s246ZA)
 - For a contribution to BustCo's assets
 - It may also DQ the director
 - For up to 15 years
 - Even if you didn't ask for it.
- So why not ask for it?

The summary slide!

So:

- Should it be:

Insolvency Act 1986

Wrongful trading - s214 / s246ZB

Undervalue transactions - s238

Preferences - s239

Companies Act 2006

Misfeasance - s172

- Why not both?

Any questions?



Our next coffee break briefing ...

Monday 8 March 2021 at 10.30am

on

Insolvent Charities

(including - how to wind up a cathedral!)

If you'd like to contact us...

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