

What Directors Need to Know in Difficult Economic Times



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Currently, many businesses are trying to restructure in order to continue trading. Companies may go into Examinership to facilitate the survival of all or part of a company. Examinership is a legal process, through the High Court, whereby a company and its directors can obtain protection against its creditors, for a period of 70-100 days, to see if a scheme of arrangement can be put together to save all or part of the company’s business into the future. Placing a company in Examinership gives the court-appointed examiner the time to implement a scheme of arrangement. However, where a scheme of arrangement is unsuccessful and an order to wind up the company is made, the procedures in the winding up process become biased towards creditors.

Directors need to be aware of legal proceedings that can be taken against them under the Companies Acts. A shadow director (“a person in accordance with whose directions or instructions the directors of a company are accustomed to act”) and a de facto director (“any person occupying the position of director by whatever name called”) can also be held liable in these proceedings which are as follows:

Return of improperly transferred assets

Where company property has been disposed of in a way which defrauded the creditors or shareholders, the court may order the return of the property or its value on the application of a liquidator, creditor or contributory (that is, any person held liable to make a contribution to the company’s debts) of a company.

Fraudulent preference

A fraudulent preference is a payment or disposal of property of a company, which is unable to pay its debts, in favour of any creditor, within six months of a winding up, with a view to giving the creditor a preference over the other creditors. This payment is

invalid and can be recovered by a liquidator. For a transaction to be a fraudulent preference, it must have been the ‘dominant intention’ to prefer the creditor in question. A bona fide belief that the company will be able to pay its debts at some future date does not negate an intention to prefer in circumstances where, at the time of payment, the company was aware of its own insolvency.

Fraudulent trading

Where a person such as a director is knowingly a party to the carrying on of a business with intent to defraud creditors of the company or for any fraudulent purpose, he can be found guilty of fraudulent trading. This can result in personal liability for all or any part of the debts of the company, amongst other penalties.

The test of intent to defraud requires actual knowledge that there was no reasonable chance that the creditors of the company would be paid. Essentially, this means that if company directors continue to incur debts or credit when they know that there is no prospect of the creditors ever receiving payment, this conduct constitutes fraudulent trading.

Reckless trading

A director can be held personally liable for a company’s debts if he is knowingly a party to any business undertaken by the company in a reckless manner. Even if a person is not found to have been knowingly a party to the carrying on of business in a reckless manner, he can be deemed in law to have been reckless in certain circumstances where he:

- Ought to have known that his actions or those of the company would cause loss to the creditors of the company or any of them.
- Did not honestly believe on reasonable grounds that the company would be able to pay its debts as they fell due.

Failure to keep proper books of account

Every company is required to keep proper books of account. Where there has been a failure to keep proper books and records, a liquidator may apply to court for a director to be held liable for the company's debts if he considers that the failure to keep proper books has:

1. Contributed to the company's inability to pay all of its debts;
2. Resulted in substantial uncertainty as to the assets and liabilities of the company; or
3. Substantially impeded the orderly winding-up of the company.

If a director can prove that he took all reasonable steps to ensure the company complied with the relevant legislation or had reasonable grounds for believing that a competent person with responsibility for the company's accounts acting under a director's supervision was in a position to discharge these duties, then he should not be held liable.

Misfeasance

Misfeasance proceedings can be brought against a director by a liquidator, any creditor or contributory or the Director of Corporate Enforcement, if a director has either:

- Misapplied or retained, or become liable or accountable for, any money or property of the company.
- Been found guilty of any misfeasance or other breach of duty or trust in relation to the company.

In these cases the High Court can order a director to repay or restore money or property to the company, or make a contribution to the company.

Restricting directors

A director of a company, at any time, within 12 months prior to the commencement of a winding up, where the company goes into liquidation, can be restricted by a court from acting as a director of another company for five years. The restriction order means that any company to which the director is

subsequently appointed must meet certain capital requirements.

It is important to remember that resident and non-resident directors of Irish registered insolvent companies or foreign insolvent companies which have a place of business in Ireland may be subject to a restriction order. The provisions apply to directors, de facto directors and shadow directors of the company.

The court has a mandatory duty to impose a restriction order on a director of an insolvent company unless it is satisfied that the director:

- (i) Has acted honestly and responsibly in relation to the conduct of the affairs of the company and that there is no other reason why it would be just and equitable that he should be subject to a restriction; or
- (ii) subject to paragraph (i), was a director of the company solely by reason of his nomination by a financial institution in connection with giving credit facilities to the company, provided that the institution in question has not obtained from any director of the company a personal or individual guarantee of repayment to it of the loans or other forms of credit advance to the company; or
- (iii) subject to paragraph (i), was a director of the company solely by reason of his nomination by a venture capital company in connection with the purchase of, or subscription for, shares by it in the first-mentioned company.

The courts have held that the fact that the company's business failed is not evidence of a lack of responsibility or of dishonesty. There are a number of considerations which should be taken into account in determining whether a director has acted 'responsibly' such as the extent to which:

1. He has complied with his obligations under the Companies Acts.
2. His conduct could be regarded as so incompetent as to amount to irresponsibility.

3. He is responsible for the insolvency itself.
4. He is responsible for the net deficiency in the assets disclosed at the date of the winding up.
5. He has, in his conduct of the affairs of the company, displayed a lack of commercial probity or want of proper standard.

What should directors do?

Trading while insolvent is fraught with difficulties and directors, therefore, need to pay careful attention to their duties and responsibilities, collectively and individually. The safest course of action for directors when a company has become insolvent is to put the company into a creditors' voluntary liquidation or into Examinership. A creditors' voluntary liquidation is where a company goes into liquidation and the liquidator is appointed following a meeting of the company's creditors and where the company is unable to pay its creditors in full. The reckless trading provisions do not apply when a company is under court protection.

Other forms of liquidation:

- Members voluntary liquidation – where a company goes into liquidation but is solvent and able to pay its creditors in full
- Compulsory liquidation – where a liquidation is ordered by the High Court. The parties who may apply to Court for this include creditors or members of the company itself.

Receivership - Receiverships occur where a receiver is appointed usually by a bank or financial institution for the purposes of realising the assets secured in favour of the bank or financial institution.

If the directors do not want to put the company into liquidation or Examinership, the best course of action to adopt is neither to take further credit nor reduce the assets of the company. In order to ensure that no further credit is incurred, suppliers, including utilities, need to be paid in advance.

If the directors decide to continue to trade while insolvent, there is clearly a

serious risk of personal liability, if the company ultimately goes into liquidation. There are a number of steps that they can take to improve their chances of being able to rely on the 'honestly and responsibly' defence, including:

- (a) convening frequent board meetings;
- (b) obtaining financial advice, preferably from an accountant with insolvency experience;
- (c) preparing a budget/business plan;
- (d) keeping creditors informed of the financial state of the company;
- (e) obtaining legal advice on the

insolvency law implications of what they are doing;

- (f) ensuring that there can be no suspicion of fraudulent preference.

As soon as a director is aware that insolvent liquidation is inevitable, he must raise the issue with the board with a view to them taking independent professional advice. Further credit should not be incurred pending this advice and directors must try to minimise the potential loss to creditors. If a director fails to persuade his colleagues to take these actions, one option is to resign in protest but he should seek independent advice to ensure that there are no other steps he

should take to protect creditors. The onus on the rest of the board will then be greater.

This article has been written by John White. John is a partner and head of corporate and commercial at Beauchamps Solicitors. This article is merely intended to highlight issues and is not to be regarded as legal advice on any particular matter. Specialist advice should be sought in all circumstances. If you have any queries or want more detail on directors' duties in the current climate you can contact John at Beauchamps Solicitors, Riverside Two, Sir John Rogerson's Quay, Dublin 2. Tel: 01-4180600 or email j.white@beauchamps.ie

CIARA O'BRIEN MPSI 1982 - 2009

The pharmacy profession is sadly diminished by the tragic death of Ciara O'Brien MPSI, of Fermoy, Co Cork, in a road accident on the 25th April 2009.

"Grieve not that I die young. Is it not well to pass away ere life has lost its' brightness"

Ciara graduated from The School of Pharmacy, Trinity College Dublin, in the class of 2005. Her unassuming and understated persona belied a quiet determination to excel in her chosen career as a pharmacist and she opted for community pharmacy as her choice of practice.

She had a sharp intellect embracing the challenge of her pre-registration year with enthusiasm and, subsequently, having her pre-registration project published in the Irish Pharmacy Journal. In her all too brief (two and a half years) as a qualified professional, she made her mark as a conscientious, caring and brilliant professional.

One of the many tributes paid to Ciara referred to her as a "diamond who cared about everyone".

Firmly rooted in her community, she packed so much into her short life. She was a fanatical sportswoman and an avid supporter of Cork hurling. She was voted player of the year by her colleagues in Fermoy Hockey Club in the 2008/2009 season and played with them in an All Ireland club final. She also won a county camogie medal in 2008.

Ciara will be sadly missed and heartfelt sympathy is extended to her family and Steve.

D. O'D.

