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INTERNATIONAL INSOLVENCY: GROUP INSOLVENCY AND DIRECTORS' DUTIES

Group insolvency, consolidation of debt and directors' duties and liabilities in the United Kingdom

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GENERAL OVERVIEW OF INSOLVENCY PROCEEDINGS

1. What are the available out-of-court and court-sanctioned insolvency proceedings?

Out-of-court proceedings

Company voluntary arrangement (CVA). Under the Insolvency Act 1986 (IA 1986), a CVA is a contractual agreement between a company and its creditors for a composition in satisfaction of the company's debts. The aim of a CVA is often to avoid administration or liquidation (*see below*).

The proposed CVA must be approved by the company's members and creditors. The directors draft proposals of the compromise they wish to reach with members or creditors and appoint an insolvency practitioner as "nominee" to oversee the proposals' implementation. To be binding on all creditors and members, the proposals must be approved by both:

- 75% in value of all creditors present and voting (including at least 50% of creditors unconnected to the company present and voting).
- A simple majority of voting members.

Once approved, the CVA is reported to the court and the nominee becomes the supervisor of the CVA.

A CVA can be challenged by dissenting creditors within 28 days of filing on the grounds of unfair prejudice or material irregularity. A material irregularity is deemed to be a set of circumstances that could have affected the outcome of the meeting. Unfairness has not been clearly defined in English law but can generally be identified by reference to either a:

- **Vertical comparison.** This involves comparing the treatment of the dissenting creditors under the CVA with that under any likely alternative process. The courts are likely to find that a creditor has been unfairly prejudiced if the return to that creditor under a CVA is less than on liquidation.
- **Horizontal comparison.** This involves comparing the treatment of the dissenting creditors with that of the other creditors under the same CVA. The court may infer unfairness from differences in the treatment of creditors under a CVA, although the fact that different creditors are treated in a different way will not automatically mean that the CVA is unfair.

While the supervisor has powers and responsibilities under the CVA (the exact scope of which will depend on the scope of the CVA), the company's directors otherwise remain in control of the company.

Administration. Administration is a process whereby a company is placed under the control of a qualified insolvency practitioner called an administrator. The day-to-day management of the company and its business is assumed by the appointed administrator, who is empowered to continue trading and realise the company's assets, as necessary. The administrator must act in accordance with the following statutory purposes (*paragraph 3, Schedule B1, IA 1986*):

- The rescue of the company as a going concern.
- A better result for the company's creditors than would be the case if the company was to be wound up without first being in administration, if the company cannot be rescued.
- The realisation of property to make a distribution to one or more secured or preferential creditors, if the above purpose cannot be achieved. Preferential creditors are creditors whose claims rank in priority to those of other unsecured creditors and floating charge holders (*IA 1986*).

Administration lasts for 12 months, unless extended with the approval of the company's creditors or the court. The administrator must act in the best interests of the company's creditors at all times.

Administrators can be appointed out-of-court (although certain documents must still be filed with the court office) in one of the following ways:

- A creditor can appoint an administrator if it holds a "qualifying floating charge" (QFC). A QFC is a floating charge, or a floating charge when taken together with a fixed charge, which relates to "the whole or substantially the whole of the company's property" (*paragraph 14, Schedule B1, IA 1986*). A creditor must give advance notice to any creditor holding a prior-ranking QFC.
- A company or its directors can appoint an administrator. They must give advance notice of their intention to do so to any creditor holding a QFC (*paragraph 22, Schedule B1, IA 1986*).

Receivership. Receivership is not strictly a collective insolvency procedure. It is a remedy allowing a secured creditor to appoint a receiver to realise assets that are the subject of the security to repay the secured debts.

The appointed receiver only owes a duty to his appointer, not to all creditors (although the officer has certain common law duties to avoid unnecessarily harming creditors). There are two main types of receivership:

- **Fixed charge receivership.** A fixed charge receiver is appointed to control the secured assets as specified in the appointment document. The receiver has powers (set out in the relevant security document) to deal with these specific assets. Directors

of the company can continue to deal with assets of the company that are not covered by the security.

- **Administrative receivership.** An administrative receiver can only be appointed by the holder of a QFC. Like administrators, administrative receivers can carry out the company's business and realise its assets. However, unlike for an administrator, an administrative receiver's primary duty is to his appointer rather than to all creditors.

On 15 September 2003, the Enterprise Act 2002 abolished administrative receivership, except in a limited range of circumstances. Administrative receivership is no longer available for most floating charges created on or after 15 September 2003. Although this does not extend to floating charges created before the Act came into force, administrative receivership is now rarely used in practice.

Receivership will not be considered further in this Q&A.

Liquidation. Liquidation involves the realisation of the company's assets for the best price possible in order to distribute proceeds among creditors before winding down the affairs of the company. There are three ways to put a company into liquidation, two of which are out-of-court procedures:

- **Members' voluntary liquidation (MVL).** An MVL is also known as a "solvent" voluntary liquidation. The directors of the company must make a statutory declaration of solvency stating that they are satisfied that the company will be able to pay all of its debts in the 12-month period following the appointment of the liquidator. The members of the company then pass a special resolution (that is, a resolution voted by 75% of the company's members) to appoint a liquidator.
- **Creditors' voluntary liquidation (CVL).** If the directors are unwilling or unable to make the above declaration, the liquidation will be a CVL, also known as "insolvent" voluntary liquidation. A company's members will pass a special resolution to wind up the company and then nominate a liquidator. Once the special resolution is passed, the company must hold a meeting of creditors at which they will vote by majority on the choice of a liquidator (section 98 meeting) (*section 98, IA 1986*).

Court-sanctioned proceedings

Scheme of arrangement. A scheme of arrangement is a compromise between a company and its members or creditors governed by the Companies Act 2006 (CA 2006). Due to its flexible nature (that is, there is nothing in the CA 2006 that prescribes the subject matter of a scheme), a scheme of arrangement is typically used to either:

- Reorganise solvent companies or groups.
- Carry out restructurings of insolvent companies or groups through strategies such as debt write-offs or debt for equity swaps.

To initiate a scheme, a specified party (including a creditor and the company) must apply to the court for an order summoning two hearing dates:

- A first hearing to give directions on how meetings of creditors must be held to vote on the scheme.
- A second hearing to sanction the scheme.

After the first hearing, the company will call the first meeting of creditors and members to vote on the scheme in accordance with the court's directions. If the scheme is approved at the meeting by a majority in number representing 75% in value of the creditors or class of creditors or members or class of members (as the case may be) present and voting, the court will decide at a further hearing whether to enforce the scheme. Once it is sanctioned by the court, the scheme is binding on all relevant classes of members and creditors and on the company.

A scheme of arrangement does not involve the appointment of an insolvency practitioner. The company's directors remain in control of the company.

Administration. The company, its directors or its creditors can also apply to the court for an order appointing an administrator (*paragraph 12, Schedule B1, IA 1986*). Following an application, the court can order the appointment of an administrator, dismiss the application or make any other order it deems fit. Certain parties have the right to attend the hearing and make representations (*see Question 8*).

Liquidation. A company can also be placed into liquidation by court order. This process is most frequently commenced by an unpaid creditor filing a winding-up petition at court. The court will then decide whether a winding-up order is appropriate.

2. What are the proceedings for a liquidation of assets and those allowing for a restructuring of the debtor's operations and debts?

Liquidation of assets

Liquidation or winding-up proceedings are used for the liquidation of a company's assets (*see Question 1 Out-of-court proceedings: Liquidation* and *Court-sanctioned proceedings: Liquidation*).

Restructuring

The proceedings allowing for a restructuring of a company's operations and debts are:

- Company voluntary arrangement (CVA) (*see Question 1, Out-of-court proceedings: Company voluntary arrangement (CVA)*).
- Administration (*see Question 1, Out-of-court proceedings: Administration and Court-sanctioned proceedings: Administration*).
- Scheme of arrangement (*see Question 1, Court-sanctioned proceedings: Scheme of arrangement*).
- Receivership (*see Question 1, Out-of-court proceedings: Receivership*).

3. What are the general requirements for commencing insolvency proceedings?

A company must be insolvent within the meaning of the Insolvency Act 1986, which uses the terms "unable to pay its debts". A company is deemed to be unable to pay its debts if one of the following applies (*section 123, IA 1986*):

- After receiving a creditor's demand for payment of a debt of GB£750 or more (statutory demand), it fails to pay that debt within three weeks.
- The court is satisfied that the value of the company's liabilities is greater than that of its assets (balance sheet test).
- It fails to satisfy a judgment debt.
- It is otherwise proved to the court that the company is unable to pay its debts as they fall due.

4. Are there any restrictions on who, or what type of entity, can commence insolvency proceedings?

There are no restrictions on who, or what type of entity, can commence insolvency proceedings. However, entities with different types and degrees of security have different rights in respect of the

type of proceedings they can bring and whether or not such proceedings can be out-of-court.

DOMESTIC FAMILY OF COMPANIES

5. Are joint proceedings available in insolvency or bankruptcy proceedings that are commenced for the family of companies?

Procedure

Group insolvencies are not provided for in English law and there are no procedures relating to corporate groups under Regulation (EC) 1346/2000 on insolvency proceedings (Insolvency Regulation). Each company is treated as a separate legal entity (doctrine of separate legal personality). Insolvency proceedings must therefore be brought separately for each company of a group.

However, in the case of multinational groups, the concept of centre of main interest (COMI) can be used to ensure that all proceedings relating to companies of the same group are brought in a single jurisdiction, provided that the COMI of each company is located in that jurisdiction. Further, the Council of the European Union has endorsed the appointment of a single person to administer multiple proceedings in cases where proceedings have been commenced against a single debtor across multiple jurisdictions.

Location

There are no specific requirements regarding the location of proceedings. The only requirement is that proceedings are brought before a court with jurisdiction to hear insolvency matters. It is possible therefore to bring proceedings either in the High Court in London or in one of its district registries in various other locations across the country, regardless of where a company or its affiliates are located.

6. Must all members of the corporate family proceed under the same type of bankruptcy or insolvency proceeding?

Each company of the group is treated as a separate legal entity for the purposes of insolvency, there is therefore no requirement that affiliate companies proceed under the same type of insolvency proceeding. However, it may often be preferable in practice to use the same type of proceeding for each company.

7. Can a single administrator/trustee/receiver administer the assets and the liabilities of the entire corporate family?

In practice, a single practitioner is often appointed to manage the insolvency proceedings of an entire group, although this is not a legal requirement. Each company will be subject to separate insolvency proceedings.

8. Is a court hearing required to determine whether administration by a single party is appropriate and, if so, must notice be given to creditors?

While group insolvencies are not provided for in English law, a single officer can in practice administer all of the assets and liabilities of a group of companies. There is no requirement for a specific court hearing to determine whether a single officer or multiple officers are appropriate in a given context.

In the case of an administration, the person making the application (or the holder of any prior ranking qualifying floating charge (QFC)) decides of the person appointed as administrator.

In the case of a creditors' voluntary liquidation (CVL), the shareholders passing the resolutions to place the company into liquidation or the creditors decide of the person appointed as liquidator.

All the parties above can attend the hearing regarding the appointment of an administrator (*see Question 1, Court-sanctioned proceedings: Administration*). Only QFC holders are entitled to receive advance notice of such hearing. The holder of a QFC (but not other secured or unsecured creditors) must also be given advance notice if the directors or shareholders wish to appoint an administrator or liquidator out-of-court.

9. Can other professionals work for the entire corporate family?

Law, accounting or auditing firms can work for more than one company in the group. This does not constitute a conflict of interest in itself. However, if a conflict of interest arises between different companies in the group, such professionals would usually be prevented from acting for the entire corporate family.

10. If the law does not permit a single administrator/trustee/receiver, are there provisions allowing different administrators to co-ordinate with each other so that values of assets can be maximised?

There are no specific provisions allowing different administrators to co-ordinate with each other so that values of assets can be maximised. Administrators or liquidators can co-ordinate with each other if they consider that doing so is in the best interests of the creditors of the company they have been appointed to, rather than the interests of the group's creditors as a whole.

11. Does your jurisdiction encourage or discourage overlapping boards or management teams for separate members of a corporate family?

Each group company has its own independent board of directors. Boards often overlap wholly or partially.

12. How are directors of a parent company treated if they are not directors of the subsidiary but manage the affairs of the subsidiary?

The term director includes "any person occupying the position of director, by whatever name called" (*section 251, Insolvency Act 1986 (IA 1986)*). Any person who is not a director of the subsidiary, but who makes decisions in respect of the subsidiary's affairs which are of a type that the subsidiary's directors would be expected to make may therefore be considered a "de facto" director of the subsidiary. Generally, de facto directors are liable in the same way as registered directors.

There is also a concept of "shadow" director in English law. A shadow director is a person in accordance with whose directions or instructions the directors of the company are accustomed to act (*section 251, Companies Act 2006 (CA 2006)*). Depending on the involvement of the directors of the parent company in the management of the subsidiary, they (or the parent company itself) may be considered as shadow directors. Shadow directors are liable in many of the same ways as registered directors, although there are some differences.

13. To whom do directors or officers owe duties while the company is solvent? What is the nature of the duties?

The general duties of directors are set out in the Companies Act 2006 (CA 2006) (*sections 171 to 177*). These include a duty to:

- Act within the constitution of the company.
- Promote the success of the company.
- Exercise independent judgment.
- Exercise reasonable care, skill and diligence.
- Avoid conflicts of interest.
- Not accept benefits from third parties.
- Declare an interest in proposed transactions or arrangements.

Directors only owe duties to the relevant company, and not to the corporate group as a whole. However, group companies usually have the same directors, who owe duties to each company.

Creditors

When a company is solvent, directors do not have a duty to consider the interests of creditors beyond the company's contractual obligations to those creditors.

Shareholders

Directors owe duties to the company, rather than to the company's shareholders. There is no duty owed to individual shareholders. However, shareholders can bring actions against directors in a few limited circumstances.

Government authorities

Government and taxing authorities are treated as any other creditor. However, the Companies Act 2006 (CA 2006) sets out some specific duties which, although not owed directly to the government and taxing authorities, are of particular relevance to them. These include duties of the company to:

- Keep accounting records (*section 386, CA 2006*).
- Keep a register of directors and secretaries (*section 275, CA 2006*).
- Keep and maintain a register of members (*section 113, CA 2006*).
- Make annual returns (*section 854, CA 2006*).
- Register charges created by the company (*section 860, CA 2006*).
- Prepare annual accounts (*section 393, CA 2006*).

Employees

Directors have a statutory duty to consider the interests of employees. However, this duty, like duties to shareholders, is owed to the company and cannot be enforced by individual employees.

14. Do the duties or responsibilities of the officers or directors of a family of companies change when the companies become insolvent?

The duty to promote the success of the company (*see Question 13*) is subject to "any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company" *(section 172(3), Companies Act 2006 (CA 2006)*). When a company becomes insolvent, the directors' duty to promote the success of the company is replaced by a duty to act in the best interests of the company's creditors (*paragraph 331, CA 2006 Explanatory Notes*). This means that directors must protect the value of assets and minimise losses to creditors as far as possible.

If only one of the family's companies is insolvent, the directors of that company will owe a duty to that company's creditors. The directors of the companies that remain solvent can still place the interests of their shareholders above those of the insolvent company's creditors.

15. How are competing fiduciary duties addressed where officers and directors of various company family members overlap and conflicts of interest between the family members exist?

Directors must declare any conflict of interest that may arise in the management of the company's affairs (*Companies Act 2006 (CA 2006)*). Unless this requirement is modified by the company's constitution, or through a shareholders' resolution that ratifies the conflict, directors cannot act in transactions where they are conflicted. In extreme cases, directors may have to resign for certain of their directorships.

16. Are the rules regarding members of the corporate family transferring assets to one another different when the members are insolvent?

Companies, whether solvent or insolvent, are prohibited from distributing share capital to shareholders, unless there are sufficient distributable profits (*section 830(1), Companies Act (CA 2006)*). Subsidiaries cannot therefore return share capital to their parent where there are insufficient reserves to do so. These rules have also been held to limit a company's ability to transfer assets to other group companies at less than full value.

In addition, where a company transfers assets to another company of the group for an amount which is substantially less than its market value at a time when it is insolvent (or if it becomes insolvent as a result of the transfer), such transaction can be challenged by an administrator or liquidator if the transferring company enters into administration or liquidation in the following two years (*section 238, Insolvency Act (IA 1986)*). This can be the case for a number of transactions including:

- Asset sales.
- Loans.
- Intra-company guarantees.

If a transaction is deemed to be at an undervalue, the court can make a range of orders to restore the position. Under section 238 of the IA 1986, the court has wide powers regarding the type of order it can make. Most typically, the court will either seek:

- To undo the transaction (that is, restore the asset to the company to make it available to the liquidator, and therefore to creditors).
- A monetary contribution from the directors, for the loss suffered by the relevant company.

17. How are claims of one member of a corporate family against other members of the corporate family treated?

Nothing prevents members of a corporate group from claiming against one another under English law.

Unsecured claims rank *pari passu* with those of third party creditors. In the case of secured claims, the company's priority varies depending on the type of security. No claim can be

subordinated (or prioritised) on the basis of being a claim from a member of the group.

Substantive consolidation

18. Is pooling of assets and liabilities of some or all members of the corporate family allowed, so that a creditor of one member becomes, in essence, a creditor of all members?

There is no doctrine of substantive consolidation under English law, as this would be contrary to the doctrine of separate legal identity (*see Question 5*).

19. What proceedings are required for the court to order the pooling of assets and liabilities?

Not applicable. See *Question 18*.

20. Is the partial pooling of assets and liabilities allowed? What conditions apply?

Not applicable. See *Question 18*.

21. If the pooling of assets and liabilities is required, are there any protections for certain types of creditors?

Not applicable. See *Question 18*.

Secured creditors

22. How are secured creditors treated in relation to a family of companies?

The claims of secured creditors against each member of a corporate family are treated separately. Any other treatment would go against the doctrine of separate legal identity (*see Question 5*).

INTERNATIONAL FAMILY OF COMPANIES

23. What extra considerations are necessary if one or more members of the corporate family is incorporated under or governed by the laws of another jurisdiction?

There are no extra considerations if one or more members of the corporate family is incorporated under or governed by the laws of another jurisdiction.

24. If insolvency/restructuring proceedings are instituted for corporate family members in different countries, do any international treaties or EU legislation apply to govern this situation?

England applies two main regimes:

- The Cross-Border Insolvency Regulations 2006 (SI 2006/1030) (Cross-Border Regulations) (CBIR) which give effect to the UNCITRAL Model Law on Cross-Border Insolvency 1997.
- Regulation (EC) 1346/2000 on insolvency proceedings (Insolvency Regulation).

The Insolvency Regulation, unlike the UNCITRAL Model Law which is incorporated into local laws on a voluntary basis, applies to all EU member states except Denmark. It provides that the main insolvency proceedings (main proceedings) must be commenced in the state where the debtor has its centre of main interests (COMI). The Regulation also requires that proceedings against the same debtor in other EU countries be treated as ancillary to the main proceedings (secondary proceedings).

25. Do domestic courts typically attempt to exercise jurisdiction over all the assets of the company filing domestically (regardless of where the assets are located) or do they limit their jurisdiction to domestically located assets?

Under the Insolvency Regulation, whether a court attempts to exercise jurisdiction over all the assets of the company filing domestically depends on whether the company's centre of main interest (COMI) is deemed to be in England, and therefore whether the English proceedings are deemed to be main proceedings or secondary proceedings (*see Question 24*). Whether the proceedings are believed to be main or secondary is stated by the petitioner at filing. There is a rebuttable presumption that a company's COMI is the jurisdiction of its registered office. The jurisdiction and legal effects of main proceedings opened in any one member state must be recognised across the EU. An office holder appointed to these proceedings will be able to exercise his powers in any member state without the need for a further court order.

However, if English proceedings are secondary proceedings, they will only have legal effect in relation to assets located in England.

Under the UNCITRAL Model Law on Cross-Border Insolvency 1997, provided that the state in question is a signatory to the Law, English courts have varying rights to apply for recognition of the English proceedings in the relevant state.

26. Do the courts enforce court orders from foreign jurisdictions that attempt to exercise jurisdiction over assets located in your jurisdiction but owned by the company that is subject to the foreign insolvency proceedings?

Under the Insolvency Regulation, English courts must recognise and enforce court orders from other EU member states if the proceedings commenced in such states are deemed to be main proceedings (*see Question 24* and *25*).

Under the Cross-Border Insolvency Regulations 2006 (SI 2006/1030) (Cross-Border Regulations) (CBIR), a foreign party must submit an application for recognition to the English court which, after considering the application, will issue a recognition order if it sees fit.

27. Under what conditions, if any, can the courts communicate and co-ordinate with courts of a foreign jurisdiction in an effort to co-ordinate the administration of assets of family members?

In addition to the relevant provisions in the Insolvency Act 1986, Insolvency Regulation and UNCITRAL Model Law on Cross-Border Insolvency 1997 (*see Questions 24 to 26*), parties can refer to and adopt various non-binding guidelines and principles on a voluntary basis. These include the:

- American Law Institute (ALI) and International Insolvency Institute (III) Guidelines Applicable to Court-to-Court Communications in Cross-Border Cases 2001.

- INSOL International (International Association of Restructuring, Insolvency & Bankruptcy Professionals) Global Principles for Multi-Creditor Workouts 2000.
- ALI Principles for Co-operation in Transnational Insolvency Cases among the members of the North American Free Trade Agreement (NAFTA) 2001 (ALI NAFTA Principles).
- ALI/III Global Principles for Co-operation in International Insolvency Cases.

RESPONSIBILITIES OF OFFICERS AND DIRECTORS

28. What is the specific nature of the duties and responsibilities of officers and directors of a company? How do those duties and responsibilities change when the company becomes financially distressed?

The nature of the duties and responsibilities of officers and directors of a company are discussed in *Question 13*.

When a company becomes insolvent, the directors' duty to promote the success of the company is replaced by a duty to act in the best interests of the company's creditors (*see Question 14*). When a company approaches insolvency, but is not yet insolvent, a director's duty to promote the success of the company is modified to include an obligation to have regard to the interests of creditors, rather than being displaced entirely (*paragraph 332, Companies Act (CA 2006) Explanatory Notes*). When a company becomes financially distressed, duties to creditors therefore come into play, and increase in importance as the company's financial stability worsens, until duties to the company are entirely replaced by duties to the company's creditors on insolvency.

29. What specific types of conduct are in breach of the duties and responsibilities of officers and directors?

Types of breach

Failure to take reasonable steps to minimise losses to creditors. Directors may be liable for wrongful trading if they failed to take every step with a view to minimising potential losses to the company's creditors when they were aware (or should have been aware) of a reasonable prospect that the company would go into insolvent liquidation (*section 214, Insolvency Act 1986 (IA 1986)*).

Misappropriation of corporate assets. A director may be sued by a liquidator for misfeasance if he has misapplied, retained or become accountable for any money or other property of the company (*section 212, IA 1986*).

Undervaluation of corporate assets in a preference or other transaction to the detriment of creditors. A director can be personally sued for misfeasance for transferring a company's assets at an undervalue under section 238 of the IA 1986 (*section 212, IA 1986*).

Failure to inform creditors of insolvency. The insolvency office holder has a duty to inform creditors of his appointment; directors are not obliged to inform creditors of the company's insolvency or an appointment.

Preferring payment to one creditor as opposed to another when insufficient monies are available to pay both. There is a preference if within a six month-period before an administration or liquidation (or a two-year period where creditors are connected to the company), a company does anything which has the effect of putting a creditor into a better position than they would have been in the event of the company going into insolvent liquidation (*section 239, IA 1986*). In addition, the company that gave the preference must have been influenced by a desire to place the creditor in a better position. However, when the company and the creditor are connected, there is a rebuttable presumption that the company was influenced by such a desire.

In addition to remedies available against the creditor who received the preference, a director who caused a company to give a preference may be held personally liable for misfeasance.

Continuing to trade when there is little prospect of being able to pay when due. A director may be liable for wrongful trading when there is no reasonable prospect of the company being able to pay when due (*section 214, IA 1986*). The director need not be guilty of actual dishonesty.

Other breaches

Directors can be liable for fraudulent trading if any business of the company has been carried on with an intent to defraud creditors or for any fraudulent purpose (*section 213, IA 1986*). Such fraudulent activity must be intentional to attract liability.

30. What duties do officers and directors have to key creditor groups before the company becomes financially distressed?

Creditors

See *Question 13, Creditors*.

Shareholders

See *Question 13, Shareholders*.

Government authorities

See *Question 13, Government authorities*.

Employees

See *Question 13, Employees*.

31. How do officers' and directors' duties change after the company becomes financially distressed or insolvent?

Financially distressed

While the directors of a company owe no duty to consider the interests of creditors when the company is solvent, the interests of creditors increase in importance as the company's financial position worsens (*see Question 28*).

Insolvent

The interests of creditors will displace the interests of the company on insolvency (*see Question 14*). When the company is insolvent, the directors must therefore consider creditors in priority to shareholders (*West Mercia Safetywear Ltd [in Liquidation] v Dodd [1988] BCLC 250*) and employees. The government and taxing authorities are treated in the same way as other creditors.

32. What civil and criminal liability exists for the officers and directors if they breach their duties and responsibilities?

Directors may be personally liable in civil proceedings for misfeasance in certain circumstances (*see Question 29, Types of breach*). Directors who are liable for misfeasance can be required to:

- Restore or account for money or property lost.
- Contribute an amount by way of compensation.

Additionally, directors and officers may be criminally liable for fraudulent trading and for concealing or failing to hand over assets under the Insolvency Act 1986 (*see Question 29, Other breaches*).

The offence of fraudulent trading is punishable by imprisonment (*section 993, Companies Act (CA 2006)*).

Breaches of duties such as keeping accounting records are also criminal offences, whether or not the company subsequently enters into administration or liquidation. Breaches are punishable by imprisonment (*section 387, CA 2006*).

When a company has entered into administration or liquidation, disqualification proceedings can be commenced against directors who have acted improperly (*see Question 42*).

33. Are officers and directors exposed to civil claims by creditors, shareholders, government authorities or employees?

See *Question 32*.

34. Is the existence of potential personal civil or criminal liability a factor in officers and directors deciding when and if to put the company into a formal insolvency/reorganisation procedure?

Directors are exposed to potential civil liability for wrongful trading under the Insolvency Act 1986 (IA 1986) if both:

- They unreasonably delay in putting the company into a formal insolvency procedure.
- The company's creditors suffer loss as a result of the delay.

Directors are also exposed to potential civil liability for breaching their general duties if they initiate a procedure prematurely, resulting in losses for creditors, although this may be difficult to establish in practice.

35. Is insurance available to protect officers and directors from claims that arise while operating a financially distressed company?

Companies often take out directors' and officers' (D&O) insurance. D&O policies typically cover directors' liabilities arising out of claims of negligence and breach of duty. They typically exclude fraud, dishonesty or criminal convictions.

36. Can officers and directors resign from their positions once the company becomes financially distressed?

A director who resigns at a time when the company is financially distressed may later be found to have breached his duty to act in the best interests of creditors.

In addition, resignation before a potential liquidation is not in itself a defence to wrongful trading. A director who resigned at a time when the company had no reasonable prospect of avoiding insolvent liquidation may therefore still face liability, although this will depend on the circumstances. For example, a director may be forced to resign as a result of a genuine conflict of interests or may have an irreconcilable difference of views with other directors (although in the latter case, it is wise to ensure that such views have been recorded in board minutes or that the director has otherwise documented his attempts to convince the other directors to take alternative steps to improve the situation).

37. How common is litigation against officers and directors for violation of their duties after the commencement of an insolvency/reorganisation procedure? Is the litigation typically successful?

Statistics from the Insolvency Service indicate that 1208 directors were disqualified following disqualification proceedings in 2013/2014. Successful actions against directors for financial compensation are rarer.

Proceedings are typically not successful if directors can prove that they have been competent in fulfilling their duties. This can be proved through taking and archiving appropriate board minutes that show due consideration of the creditors' best interests when handling the company's business, such as taking advice from lawyers and financial advisers and other steps with a view to protecting creditors.

38. What defences against civil and/or criminal sanctions are available to directors and officers under general corporate law?

A director has a defence to misfeasance if he can prove that he acted honestly and reasonably. For example, this may be the case where a director acted in good faith but relied on the incorrect advice of a third party. A director is not automatically liable if a decision proves to be incorrect, but there must be suitable evidence for the reasonable basis of their decision, such as professional advice (including valuation). This defence is not available for other claims such a wrongful trading (*see Question 40*).

39. If it appears that the "going concern values" will result in a higher return to creditors than a liquidation of the assets, can officers and directors be protected if they decide to continue operations to protect the values for the benefit of all creditors?

Directors and officers who continue to trade to protect the "going concern values" for the benefit of all creditors can be liable for wrongful trading (*see Question 29, Types of breach: Failure to take reasonable steps to minimise losses to creditors*) if the company subsequently enters into liquidation. This will depend on the court's assessment of the directors' reasons for continuing to trade.

The position is the same if the result is an increase of debt owed to creditors, even where the officers and directors were acting in good faith.

40. Are there any other defences available to directors and officers under bankruptcy or insolvency laws?

A director can avoid liability for wrongful trading if he can show that he took every step with a view to minimising the potential loss to the company's creditors (*section 214(3), Insolvency Act (IA 1986)*) (*see Question 29, Types of breach: Failure to take reasonable steps to minimise losses to creditors*).

41. What provisions in your jurisdiction's bankruptcy or insolvency laws are specific to the duties and sanctions for officers and directors?

Directors or officers in breach of their fiduciary duties to the company can be held personally liable under the Insolvency Act 1986 (IA 1986) (*section 212*).

SUBSEQUENT RESTRICTIONS ON OFFICERS AND DIRECTORS

42. If a company becomes insolvent, is an officer or director of the insolvent company legally restricted from acting as an officer or director in another company?

A director or officer of the insolvent company is not automatically restricted from acting as officer or director in another company. When the company enters into administration or liquidation, the administrator or liquidator will send the Secretary of State a report on the conduct of all directors in the previous three years. The Secretary of State will then consider if it is in the public interest to seek a disqualification order against any of the directors.

Under the Company Director Disqualification Act 1986, directors can be disqualified if a court finds that they are unfit to be directors of a company (this can include any proof of misfeasance under section 212 of the Insolvency Act 1986 (IA 1986)). The concept of unfitness is not defined and is assessed by the court on a case-by-case basis, having regard to factors including the:

- Type of business concerned.
- Experience or skills that the director holds himself out to have.
- Day-to-day management responsibilities of the director.

If the court makes a disqualification order, the director will be prevented from acting as a director of any company for a specified period between two and 15 years (depending on the extent of the director's unfitness to be a director). In practice, directors often give undertakings not to act as a director for a certain period of time to avoid the cost of proceedings.

43. If an officer or director becomes personally insolvent, is he legally restricted from continuing to act as an officer or director of his current company or another company?

Current company

A person who is bankrupt cannot act as a director of any company.

Another company

See above, *Current company*.

44. If a company becomes insolvent, is an officer or director of the insolvent company legally restricted from obtaining credit as a promoter of a second company?

An officer or director is not legally restricted from obtaining credit as a promoter of a second company, unless he has been disqualified from acting as a director (*see Question 42*).

ONLINE RESOURCES

Legislation.gov

W www.legislation.gov.uk

Description. Website maintained by the UK legislature containing up-to-date copies of statutes referred to in the article.

Insolvency.gov

W www.insolvency.gov.uk

Description. Website maintained by the insolvency service in England and Wales containing up-to-date copies of statutes referred to in the article.

Practical Law **Contributor profiles**

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Recent transactions

- Advising Incisive Media, the leading business-to-business information and events company, on its debt for equity swap.
- Advising Albemarle & Bond, the pawnbroking business, on its debt restructuring and subsequent administration.
- Advising OpCapita on its "loan to own" acquisition of the UK business and assets of GAME Group and on its exit by way of flotation.
- Advising Kew Green Hotels on its lease and subsequent debt restructuring.
- Advising Better Capital in relation to the "loan to own" acquisitions of Jaeger and Calyx.
- Advising ING Bank, Eurohypo, Deutsche Hypothekenbank and Grant Thornton (as administrators) on the restructuring of the Britannica retail property portfolio.

Professional associations/memberships.

- Member of the Institute for Turnaround.
- R3: Association of Business Recovery Professionals.
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Recent transactions

- Advising Kew Green Hotels on its lease and subsequent debt restructuring.
- Advising Incisive Media, the leading business-to-business information and events company, on its debt for equity swap.
- Advising Albemarle & Bond, the pawnbroking business, on its debt restructuring and subsequent administration.
- Advising the administrators of City Link, Hunter Kelly, Charles King and Tom Lukic of EY, on the companies' administration.
- Advising Better Capital in relation to the "loan to own" acquisition of Jaeger.
- Advising ING Bank, Eurohypo and Deutsche Hypothekenbank on the restructuring of GB£330 million retail property investment facilities.

Professional associations/memberships.

- R3: Association of Business Recovery Professionals.
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Professional qualifications. England and Wales, Solicitor, 1998

Areas of practice. Restructuring and insolvency.

Recent transactions

- Advising OpCapita on its purchase of certain of the businesses and assets of the GAME group of companies from their administrators.
- Advising the shareholders of Monarch Airlines on the restructuring of the group and its finances involving the introduction of GB£75 million of new monies.
- Advising Better Capital on its acquisition of secured loans made to the Calyx group of companies, and then on the acquisition of the UK businesses within the group from their administrators.
- Advising the secured lenders on the administration of a major UK retailer involving over 1,600 stores and 7,000 employees.
- Advising Alchemy Partners in relation to the restructuring of the Tattershall Castle Group and related GB£125 million debt facilities.

Professional associations/memberships.

- Member of the Institute for Turnaround.
- R3: Association of Business Recovery Professionals.
- Insolvency Lawyers' Association.

Publications. *Insolvency and Restructuring Manual,* 2nd Edition, Simon Beale (Bloomsbury Professional, 2013).