Julian Dobson SOLICITORS

Insolvency Lawyers

Directors – Personal liability unlimited ?

Introduction

A lawyer's answer to the above question is – "well that depends". The practical answer for some directors is that the extent of their personal liability may as well be unlimited. The push towards directors being made personally liable in relation to limited companies continues to gather momentum. In this article we look at the different types of personal attacks being made on directors.

The role of a director

A company may only act through human beings. The general meeting (shareholders) of a company is sometimes referred to as an "organ" of the company. The board of directors being regarded as the second corporate organ of a company. Use of the term organ is indicative of a vital role in a company. The insistence on a director being human is to make sure that there are individuals responsible in law for the observance of the numerous statutory and other duties imposed upon them. Nevertheless attempts have been made to avoid the need to have an identifiable human as a director by the use of false names and addresses such as 1 rue de Plage, Nice, South of France. Fortunately most directors provide accurate details to allow their identification at Companies House.

The move to make directors more accountable

Prior to the **Company Directors Disqualification Act 1986 (CDDA86)** the conduct of some directors called for legislative change. In particular the practice of phoenixism and the re-use of company names led to the introduction of the CDDA86. This enabled the Secretary of State to apply for directors to be disqualified for a period of between 2-15 years in circumstances where their conduct rendered them unfit to be concerned in or involved in the management of a company.

Whilst disqualification prevented a director from plying his trade through a limited company following disqualification, it did not result in any personal financial liability. That was until recently when compensation orders have begun to be used.

Compensation Orders

With effect from 01 October 2015 new provisions were inserted into the CDDA86 enabling the court to order a director to pay compensation to creditors for conduct for which a director has been disqualified and which has caused loss to creditors. It wasn't until 01 November 2019 in the case of **Re Nobel Vintners Limited** that the first compensation order was made against a director. In that case the director was found to have misappropriated monies and was ordered to pay the sum of £559,484 for the benefit of specified creditors and as a contribution to the assets of the company in liquidation. The courts ability to make a compensation order against a director ranks alongside the existing provisions contained in the Insolvency Act 1986. Following the making of the first compensation order, it is likely to be used more frequently in the future.

Wrongful trading – COVID-19 suspension

The wrongful trading provisions were brought in under the **Insolvency Act 1986**. It enables the court to make an order against a director of a company which has gone into insolvent liquidation where the director knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation. The court may order a director to personally contribute to the company's assets for the loss incurred by the company from the date on which the director

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either knew or should have concluded that there was no reasonable prospect that the company would avoid insolvent liquidation. Whilst the number of cases that have resulted in orders being made for wrongful trading are relatively modest, nevertheless the threat of personal liability for directors exists. The outbreak of the COVID-19 epidemic saw the government recognizing the risk to directors resulting in the government announcing a suspension of the wrongful trading provisions for a period of 3 months from the beginning of March 2020. Whilst this will give some reassurance to directors, it is not a total exoneration from such claims. The perpetuation of an earlier period of wrongful trading through the COVID-19 suspension will not avoid a subsequent claim for wrongful trading. Similarly, directors will need to be well prepared for the removal of any suspension period to ensure that they do not expose themselves to liability for wrongful trading post-pandemic. This should be a key element of a company's COVID 19 exit strategy.

Misfeasance

Liquidators have increasingly utilised the provisions of **s212** of the **Insolvency Act 1986** which provides a "summary remedy against delinquent directors". Such claims rely on breaches of other provisions of the **Companies Act 2006** and the **Insolvency Act 1986** as the basis for a misfeasance claim. This can be for either illegal dividends, a director's loan account, preferences or transactions at an undervalue. It also captures claims for breach of a director's fiduciary duties. Where a misfeasance claim is made out the court may order the director to personally contribute to the company's assets by way of compensation.

HMRC – directors personal liability

Directors of a limited company already have personal liability in respect of some HMRC liabilities. HMRC can issue a Personal Liability Notice against a director who they consider is responsible for non-payment of National Insurance Contributions (NIC) due to fraud or neglect. Directors may also become personally liable as part of a requirement to provide a Vat Security Bond. Of greater concern to directors is the announcement by HMRC of future proposed changes to legislation to make directors personally liable for corporate tax debts in situations where they are suspected of abusing the insolvency framework in order to avoid paying taxes. Details of the legislation are yet to be published. Industry concerns have been raised about yet another challenge to the concept of limited liability.

Zombie MkII

Since the banking crisis and recession of 2008 reference has been made to so called Zombie companies which survived the earlier recession. Typically they have few unencumbered assets and significant debts. In addition to the Zombie MkI companies that continue to exist, there is likely to be a new breed of Zombie MkII, being companies that have survived the COVID-19 pandemic with the aid of government assistance and loans which have little prospect of returning to profitability and repaying their debts. Both types of Zombie companies will potentially lead to insolvent liquidations where there are little assets available for recovery for the benefit of creditors. Inevitably the focus will shift to the directors and particularly those directors that have personal assets. Notwithstanding the governments suspension of the wrongful trading provisions, directors will be at greater risk of attack personally than ever before.

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What to do ?

The lament of insolvency practitioners that “you should have come to see me earlier” has never been more true. Now is the time that directors should be consulting with both insolvency practitioners and insolvency lawyers to obtain advice as to what is in the best interests of their companies, creditors and themselves personally.

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