Restructuring & Insolvency

DIRECTORS: ARE YOU AWARE OF YOUR DUTIES AND RESPONSIBILITIES?

Company directors are subject to many duties and responsibilities. Awareness of this is a necessity, especially at a time when a company is experiencing difficult financial circumstances.

WHAT ARE A DIRECTORS' STATUTORY DUTIES?

The duties of a director are detailed in the Companies Act 2006 and include:

- a duty to promote the success of the company;
- to act within the powers conferred by its memorandum and articles of association;
- to avoid conflicts of interest; and
- to exercise reasonable care, skill and diligence.

WHO HAS DIRECTORS' RESPONSIBILITIES?

De jure director

- formally and validly appointed;
- on record as such at the Registrar of Companies; and
- bear the same level of responsibility, whether an executive or non-executive director.

De facto director

- acts as a director but lacks formal appointment.

Shadow director

- a person who effectively gives instructions to a company's board of directors; and
- not formally appointed but has an influential role in the conduct of a company's affairs.

THE 'TWILIGHT ZONE'

Directors of companies operating in the 'twilight zone', where there is risk of insolvency or the company is insolvent, but prior to it entering into a formal process, do not always give priority to their statutory duties. Once a company is insolvent, the directors must act in the interest of the company's creditors and ensure the loss to those creditors is minimised. Therefore, from this time until the company enters a formal insolvency process, directors must be aware of the risks in acting contrary to their duties.

Acts of wrongdoing that can lead to directors incurring personal liability include:

Antecedent transactions

Any transaction entered into in this twilight period that neglects or even abuses the responsibility of the directors may be challengeable by any subsequently appointed office holder and could result in action being brought against the directors personally for breaching their fiduciary duties. Such transactions include:

Preferences – This is where one creditor is given priority over others. This would include repaying a director in relation to any outstanding director's loan account. The relevant time period for challenging such transactions is 6 months before the insolvency event, or 2 years before the insolvency event if the recipient party is connected, which would include a director.

Transactions at an undervalue – This is where an asset is transferred for little (in comparison to its true value) or no consideration. The relevant time period for such transactions to be challengeable is up to two years before the insolvency event.

Unlawful distributions

Any dividends paid by the company, in circumstances where there are insufficient distributable reserves, could be pursued by any subsequently appointed office holder. This may result in the recipients being required to repay any sums received. This is especially relevant in owner managed businesses, where the directors are likely to also be the shareholders.

Floating charge security

Where a company has outstanding borrowing, a director might be tempted to give the lender security, especially if there is a personal guarantee in place. Unless the security is given for new lending, it may be challenged and proven invalid if the company was insolvent at the time. The relevant time period covered by this is up to 12 months before the commencement of a formal insolvency process, and this extends to two years if the lender is a connected person.

Wrongful trading

Directors can be made liable personally to compensate the company for any loss caused to creditors by their failure to take every step to minimise loss, once they were aware, or ought to have been aware, that the company could not avoid insolvent liquidation. Directors should be urged to seek appropriate professional advice early and document their decisions to avoid irreversible deterioration of the position, eventual liquidation of the company, and the risk of personal liability arising from wrongful trading.

Misfeasance

Where a director has breached their fiduciary duties, an office holder can pursue them directly in relation to the loss caused. A director can be required to:

- repay, restore or account for the money or property or any part of it, with interest at such rate as the court thinks just, or
- to contribute such sum to the company's assets by way of compensation in respect of the misfeasance or breach of fiduciary or other duty as the court thinks just.

HOW WE CAN HELP

Directors should always be aware of their duties and, in the event of financial difficulty, professional advice should be sought. Our specialist teams are experienced in providing an analysis of the options available in order to provide the best outcome for the company, its creditors and the directors.

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