CLAIMS AGAINST DIRECTORS: A ROADMAP

Louis Doyle

CLAIMS AGAINST DIRECTORS: A ROADMAP

Louis Doyle, Barrister, Kings Chambers

JMW Solicitors, Manchester Wednesday 20 June 2018

1. The statutory duties of directors (see Sections 171-175 of the Companies Act 2006) are to act:

   1.1. in accordance with the company's constitution and only exercise powers for the purposes for which they are conferred (s.171);

   1.2. in the way that the directors consider, in good faith, would be most likely to promote the success of the company for the benefit of the members as a whole (s.172);

   1.3. in exercising reasonable skill, care and diligence (s.174);

   1.4. in avoiding conflicts of interest (s.175).

2. The fiduciary duties owed by the directors to the company, as developed by the common law, are to:

   2.1. deal with the company with loyalty and in good faith, and not to prefer their own personal interests to those of the company;

   2.2. avoid a conflict between the interests of the company and their own interests;

   2.3. not obtain any secret profit from their office.

3. In ***Hall and PV Solar Solutions v. Hughes and Ware [2017]*** **EWHC 3228 (Ch) at [64] and [73]** Registrar Barber identified the following as to the impact of insolvency on the way the court approaches the way in which directors have conducted themselves in discharging their duties under s.172 (above):

   > *"where the company is <u>insolvent or of dubious solvency</u>, the duty to act in the best interests of the Company [under s.172 CA 2006] is regarded as a duty to act in the interests of its creditors as a whole. At this stage, <u>the interests of the company are regarded as the interests of the creditors alone; their interests become paramount</u> ...*
   >
   > *References in certain formulations of the test to be applied under s172 to a company being of 'dubious' or 'doubtful' solvency must be seen in the context of the underlying principle. The 'doubt' in this context is not whether, arithmetically, the numbers add up on a given day. it*
   >
   > *is not a snapshot analysis. The test is wider than that; <u>the court must ask itself, in the context of a given company, whether, at the time of (or as a result of) the director's</u>*

actions, there is a real risk of the company's creditors being left unpaid." *(Emphasis added)*

4. Whether a director has acted bona fide in the interests of the company under Section 172 requires consideration of the director's subjective state of mind, subject to three limitations which trigger an objective approach (see ***Re HLC Environmental Projects Limited [2013]*** **EWHC 2876 Ch at [92]** (Mr John Randall QC):

 4.1. In cases of dubious solvency, the interests of creditors must be considered paramount;

 4.2. The subjective test only applies where there is evidence of actual consideration of the best interests of the company. Absent such evidence, the question is objective: would an intelligent and honest man in the position of the director of the company have reasonably believed that the transaction was for the benefit of the company?

 4.3. Where there is a very material interest (such as a large creditor) which was without objective justification overlooked or ignored, the objective test must also be applied.

5. A payment which might be said to be a normal commercial payment outside insolvency can therefore become a payment made in breach of duty once the company is insolvent or of dubious solvency. By way of example:

 5.1. In ***E-Clear (UK) Plc v. Elia [2013]*** **2 BCLC 455**, the Court of Appeal allowed an appeal against a summary judgment decision upholding a breach of fiduciary duty claim based on the discharge of pre-existing debts, but only on the basis that the company's insolvency was not beyond reasonable doubt and would need to be determined at trial. Patten LJ commented at **[24]:**

 "The question whether Mr Elia committed a breach of fiduciary duty against the company by causing it to re-pay its debts to him in February and March 2009 is inextricably linked to the solvency or otherwise of the company and his knowledge of the financial position. Absent actual or imminent insolvency, the repayment of the debts would be unobjectionable."

 5.2. In ***Vivendi SA v. Richards [2013]*** **BCC 771 at [152]** Newey J found a breach of fiduciary duty to have occurred in circumstances where the directors were aware of the company's financial vulnerability (or dubious solvency) and had made a series of payments pursuant to purported commercial transactions.

6. As a fiduciary, there is an evidential burden on a director to explain the transactions in question once the fact of the payment by the company is established. As observed in ***Re Idessa (UK) Ltd [2012]*** **1 BCLC 80 at [28]:**

 "I am satisfied that whether it is to be viewed strictly as a shifting of the evidential burden or simply an example of the well-settled principle that a fiduciary is obliged to

account for his dealings with the trust estate that [counsel for the liquidator] is correct to say that once the liquidator proves the relevant payment has been made the evidential burden is on the Respondents to explain the transactions in question. Depending on the other evidence, it may be that the absence of a satisfactory explanation drives the Court to conclude that there was no proper justification for the payment. However, it seems to me to be a step too far for [counsel for the directors] to say that absent such an explanation, in all cases the default position is liability for the Respondent directors. In some cases, despite the absence of any adequate explanation, it may be clear from the other evidence that the payment was one which was made in good faith and for proper company purposes."

7. Claims for breach of trust are subject to a limitation period of 6 years, generally speaking. However, by Section 21(1)(b) of the Limitation Act 1980:

   "No period of limitation ... shall apply to an action ... to recover from the trustee trust property or the proceeds of trust property in the possession of the trustee, or previously received by the trustee and converted to his use."

   Directors are to be regarded for all purposes connected with Section 21 of the 1980 Act as trustees. This is because they are entrusted with the stewardship of the company's property and owe fiduciary duties to the company in respect of that stewardship: see ***Paragon Finance plc v. DB Thakerar & Co*** **[1999] 1 All ER 400;** ***JJ Harrison (Properties) Ltd v. Harrison*** **[2002] 1 BCLC 162**, in particular per Chadwick LJ at **[25]-[29];** ***Williams v, Central Bank of Nigeria*** **[2014] AC 1189,** per Lord Sumption at **[28]** and, most recently, ***First Subsea Ltd (formerly BSW Ltd) v. Balltec Ltd*** **[2018[Ch 25,** per Patten LJ at **[50]**. By the same token, the company is the beneficiary of the trust for all purposes connected with Section 21. Complications have arisen where, although a director, the defendant's breach of duty did not involve the misapplication of company property: see for example ***Gwembe Valley Development Co Ltd v. Koshy (No.3)*** **[2004] 1 BCLC 13**. In ***Burnden Holdings v. Fielding*** **[2018] UKSC 14** the Supreme Court confirmed that where a director wrongfully transfers assets away from a company to another company of which he is owner or director, there is no time limit applicable to a claim to recover those asserts so misappropriated.

LOUIS DOYLE

Kings Chambers

www.kingschambers.com

ldoyle@kingschambers.com

20 June 2018