DIRECTORS DUTIES - INSOLVENT COMPANIES & WINDING UP

Fergal McManus, Partner in Morgan McManus Solicitors, outlines the dangers for Company Directors in continuing to trade while their Company is insolvent, gives some suggestions as to how personal liability may be avoided and examines issues relating to the subsequent winding up where there are not sufficient assets within the Company to discharge the Liquidator's costs.

Overview

When a company encounters financial difficulty, the directors are under significant legal obligations including personal liability of the Company's debts, if the Company continues to trade while insolvent. Generally speaking a Company is insolvent when its liabilities are greater than its assets or when it can no longer pay its debts as they fall due.

How to Avoid Personal Liability

In a nutshell, the Directors need to act responsibly in respect of the Company's debts. There are a number of measures which the directors of an insolvent or potentially insolvent company should take with a view to properly discharging their duties and avoiding personal liability.

(a) Do not assume that the safest course is to stop trading. You have to take very step which can be properly expected of you to minimise loss to creditors. You can be faulted just as much for a premature cessation of trading as for continuing to trade while insolvent. This makes it essential to obtain competent outside advice as to whether to stop trading or to continue.

(b) Consider carefully with your fellow directors whether the business is viable. If it is, insist on the preparation of:

- a business review; and
- a sensible and constructive programme to reduce expenditure, increase income, ensure on adequate cash flow and restore the company to profitable trading, disposing of unprofitable or marginal parts of the business and dismissing staff who are surplus to the company's needs or who are not doing their job.

(c) Insist on frequent board meetings and minute them properly.

(d) Make sure that there is a proper distribution of responsibility within the company.

(e) Ensure that that accounts are being properly kept and up to date or if not, that steps are taken to do so, with outside help being brought in when necessary.

(f) See that the board regularly receives an updated budged and a full, accurate and up to date picture of the company's trading and financial position.

(g) Get the company to take appropriate outside professional advice on suitable remedial measures.

(h) Keep major creditors regularly informed and enlist their support for the continued operation of the company where this is likely to be of benefit to the general body of creditors. In this connection, it is just as important to have the support of major unsecured creditors as of secured creditors, for it is the former who are most likely to suffer loss and whose support makes it easy for you to show subsequently that you took every step available to you to minimise loss to creditors.

(i) Ensure that you are kept fully in the picture and, so far as possible, that all directors agree on what needs to be done.

(j) Consider the advisability of petitioning for the appointment of an examiner or alternatively of inviting a secured creditor to appoint a receiver to manage the company. Such appointment has the further advantage of ending your management responsibilities though you still have a duty to co-operate with the office holder.

(k) Insist that all recommendations for remedial action made by the directors (and particularly by you) together with your dissent from any unwise actions or inactivity advocated by your fellow directors are fully minuted or otherwise placed on the record, e.g. by the circulation of a memorandum to other directors.

(l) If you are in the minority and your recommendations are repeatedly rejected, so that the company is getting deeper into the mire, resign and record your reasons for doing so in a letter. Resignation is very much the last resort. A director who simply resigns without having taken every step he should have done to minimise loss to creditors will not escape liability. So do not resign before you have gone as far as you can in getting things put right and take advice before doing so.

(m) In the final analysis, having taken appropriate professional advice, the only prudent course of action may be to cease trading and commence the winding up of the Company. The process by which an insolvent Company instigations its own winding up is called a "Creditors Voluntary Winding Up".

Creditors Voluntary Winding Up

The Directors of the Company initiate this process by calling a creditors meeting resulting in the appointment of a Liquidator. The job of the Liquidator is to gather in the assets of the Company and pay out the proceeds in the manner set out in the Companies Acts. As the Company is insolvent,

creditors will not get paid all of the monies owed to them. Indeed, it frequently arises that unsecured creditors obtain no payment from the Liquidator as the remaining assets of the Company are usually swallowed up by preferential creditors such the Revenue Commissioners, Secured Lenders and the Liquidators fees.

How will the Liquidator be paid if the Company is grossly insolvent?

The Liquidator is a preferential creditors and is ordinarily paid out of the assets of the company that are gathered in e.g. sale of land, building or stock, collection of debtors etc.

An increasing number of companies are grossly insolvent in that there may be little or no assets to be gathered in by the Liquidator. In those circumstances, no Liquidator would accept an appointment to act unless they are assured payment of their fees. In those circumstances, directors and shareholders often agree to pay liquidators out of their own personal assets to undertake the liquidation process.

Why do Directors of Insolvent Companies pay Liquidators out of their personal resources?

Office of Director of Corporate Enforcement

The answer lies in the fact that the Office of the Director of Corporate Enforcement (ODCE) take the view that it is the Directors' responsibility to wind up the company, even if they are obliged to pay (indemnify) a Liquidator to do so. It is arguable whether the ODCE have a statutory basis for compelling a Director to wind up insolvent companies but regardless of whether they have such power, a failure to wind up can have serious consequences for the Directors.

Restriction or Disqualification

One consequence that arises is that a failure to wind up the Company in a timely manner is more likely to lead to the ODCE requiring a Liquidator to seek a Disqualification Order against such Director, rather than merely an Order to "Restrict" a Director. Directors clearly need to weigh up the personal consequences of a Disqualification Order made against them in respect of their existing or future business activities. To briefly clarify, a person who has a "Restriction Order" made against them can only be involved as a Director or Secretary of a company, if such company has issued and paid up share capital of at least €63,486.90. A Disqualification Order, on the other hand, is more serious in that the person disqualified may not act as a Director of a company for a fixed period of time (usually 5 years), regardless of how well the company is capitalised.

Personal Liability for Company Debts

The effect of Section 251 of the Companies Act 1990 is that the powers ordinarily vested in a Liquidator to examine company officers, recover company assets and swell the resources available to creditors of the company, can be exercised by, for example, a Creditor or the Director of Corporate Enforcement. The significance of this for Directors is that the legal provisions exist to allow a Creditor to make Directors personally liable for Company debts in certain circumstances. It would be a more difficult prospect for directors to defend such proceedings for imposition of personal liability initiated by a Creditor, Director of Corporate Enforcement or the Liquidator if they neglected their obligations to seek an orderly wind up of the Company.

Seek Professional Advice

As can be seen, the prudent first step for Directors of Companies in financial distress is to seek good advice from their own accountant, a solicitor with experience in this area of the law and if considered necessary an experienced insolvency expert.

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