Summit
LAW LLP

3 KEY STRATEGIES

FOR AVOIDING PERSONAL CLAIMS AGAINST DIRECTORS

Introduction

The purpose of this article is to assist directors of companies in or approaching liquidation to understand the dangers and personal liabilities they face because of claims that can be brought by a liquidator against them, personally.

Over the years of working as a specialist insolvency solicitor acting for both directors and liquidators, I have seen how company officers have got themselves into a tangle and spent thousands of pounds on trying to defend liquidator claims.

In whose interest is it to make the litigation last longer, the client's interest or the lawyer's interest?

By way of example, one client director of mine received a 10-page letter of claim from a liquidator's solicitor threatening to commence legal proceedings for various alleged breaches of the Insolvency Act including wrongful trading and misfeasance. By working closely with our director client, we were able to analyse the issues, devise a strategy and rebut and defend the allegations.

Outcome

Thankfully for our client director she has not heard any further from the liquidator and no claim has been commenced in court.

This has saved our client: -

01

Money-she has not had to pay the liquidator's solicitor's legal fees or even damages for the allegations. They were seeking in excess of £650,000.

02

Energy-she has been able to focus on her new business and not waste her valuable time embroiled in litigation.

03

Stress-the longer legal actions go on, the psychological stresses cannot be ignored.

We also understand how liquidators fund the claims and the cost of bringing an action with court costs and after-the-event insurance so armed with that **'insider knowledge',** we can judge what buttons to press to get rid of the claim, through mediation or otherwise.

Given our unique approach in dealing with such claims, unlike most solicitors we firmly believe that rather than waiting for the liquidator to put the pressure on our client directors its often best to 'up the ante' by placing pressure on the liquidator, which ultimately can save time and money for clients. This is what makes Summit Law truly different.

Once you read this guide, I invite you to apply for a complimentary no-cost **"Fighting Liquidator Claims 1-on-1 Consultation"** with me or one of my colleagues, to discover how best to avoid the mistakes I've identified over the last 28 years in order to minimise the risk of personal liability.

Jeremy Boyle.
Solicitor and Partner.
Summit Law LLP.

Strategy 1

Do not start transferring company money out to third parties preferring one specific creditor or family relative or friend to repay a loan or otherwise.

We've seen directors panic and use company funds to pay back loans made by friends or members of their family or to one creditor in preference to another, just before the company goes into liquidation.

This could lead to the director being guilty of misfeasance and make the director personally liable for the loss and put the recipient of the company funds in danger of a claim for repayment. This is called a preference claim.

This can have a serious impact on you and your family. By personal liability we are talking about being liable to the extent of your personal wealth. Accordingly, if the liquidator's claim is substantial and successful your family home could be at risk and could be repossessed and sold in order to pay the liquidator.

To make matters worse you could also be pursued by the Insolvency Service (a government department) and disqualified from being a director for up to a maximum of 15 years. In addition, the court can make a Compensation Order if it can be proved that the director caused a quantifiable loss to one or more of the company's creditors.

By taking professional legal expert advice from specialist insolvency solicitors early and certainly before you repay the loans, we can assess the documentation and dates surrounding the loans from friends or relatives. You will then be in a better position to decide whether the loans can be repaid safely.

This can then save you having to deal with the stressful communications from the liquidator's lawyers.

More importantly perhaps it will also save you having to pay the liquidator's legal expenses and not to mention statutory interest at the rate of 8% per annum. This is because the liquidator will seek interest on the damages awarded being the repayment of the loan to friends or relatives.

It is extremely important that the director's decision-making or reasoning in paying one creditor over another is properly documented with detailed attendance or file notes which should be kept safely. This might include notes of conversations with creditors such as your landlord who might have threatened to evict you for the non-payment of rent.

For example we acted for client C, a director of a technology company. The company ran into financial difficulties, and it became apparent that C had made various payments to relatives using company funds to repay various loans. She did not take advice before the liquidation. She was then pursued by the liquidator's solicitors. We analysed the dates of the loans and the repayment dates and unfortunately the repayments of the loans to relatives were caught by insolvency legislation. Had the director C, come to us beforehand we could have analysed the loans and advised what payments could be made.

Unfortunately, because the director did not take legal advice the liquidator decided to commence court proceedings. This had the effect of making it more expensive and more stressful in dealing with the liquidator's solicitors and meant that in addition to repaying the amounts taken, she also had to pay liquidator's legal fees.

In addition to having to deal with the Liquidator, C also had to instruct us to deal with the Insolvency Service who were seeking a Director Disqualification Order against her. Had we been instructed at the outset; we would have never advised her to make the repayments.

This demonstrates the importance of seeking specialist legal advice at an early stage and not trying to 'go it alone'.

Strategy 2

Do not continue trading if the company is insolvent!

When a company runs into financial difficulties or troubled waters a director's instinct is to do everything they can to try and resuscitate it or to avoid matters from getting worse.

After all you have worked hard, taken the risk, perhaps mortgaging your home, or taken out a loan (backed by a personal guarantee) to make it a success. So frequently they 'soldier on'.

However, we have seen numerous directors who do not realise or appreciate that they are breaching section 214 of the Insolvency Act 1986.

This means that the directors who continue trading the company can become personally liable for the increased debts of the company. This is called 'wrongful trading'. As we saw in strategy 1 above it means that the directors are liable for the debts of the company, to the extent of their personal wealth for the period when the company wrongfully traded.

Similarly, the Insolvency Service and can and often does pursue directors seeking a Disqualification Order for a maximum of 15 years.

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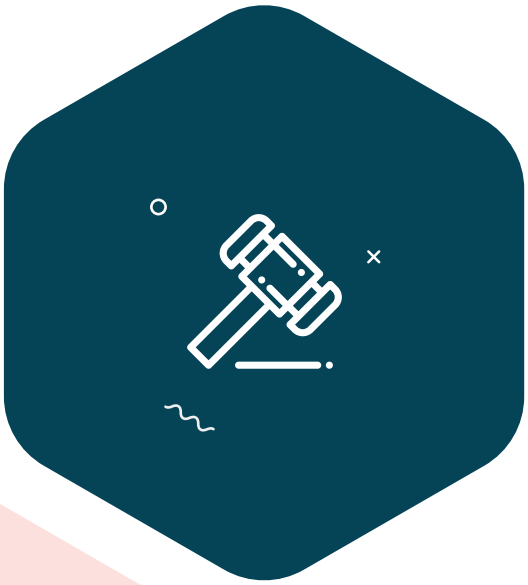
It is extremely important that the director's decision-making or reasoning for continuing to trade is properly documented with detailed attendance or file notes which should be kept safely. This might include notes of conversations with your bank manager, the company's accountant, or creditors such as HMRC.

To illustrate the point Company X Ltd had 2 directors, a father and son. Company X Ltd owned and managed a nightclub. When the company went into liquidation, the liquidators analysed the demands for payment from creditors.

These included HMCE, business rates, County Court judgements and other demands from creditors.

The liquidators were able to prove that the company should have been placed into liquidation much earlier. The father and son were held liable for wrongful trading. The liquidator argued that the directors knew, or ought to have known, that there was no reasonable prospect of avoiding an insolvent liquidation. **The court found in the liquidator's favour and damages were calculated in excess of £1 million.** The father and son could not repay the damages and declared themselves bankrupt. In that particular case Summit Law acted for the liquidator.



This is an extremely complex area of law so it is very important to instruct specialist insolvency solicitors who understand the Insolvency Act and associated legislation. In addition to analysing the documentation there is a lot of case law that needs interpreting so that directors can be properly advised. This Summit Law can assist you to analyse the problem and devise a strategy.

Strategy 3

Make sure you do not pay an Illegal Dividend!

What happens if you declare an illegal dividend?

Where the recipient shareholder knows or (simply put) should have known that a dividend (or part thereof) is illegal, that shareholder is liable to repay the dividend (or the proportion that exceeds available reserves) back to the company (CA 2006, s 847).

It is unfortunately not uncommon for director-shareholders of owner-managed companies to be **unaware of this fact** and declare dividends in excess of distributable reserves. This usually happens when amounts are drawn before financial accounts are prepared and subsequently a sufficient retained earnings balance does not materialise.

As I say above the legal dividends have to be repaid. The impact though can be **quite severe** in cases where the dividends have been paid out routinely over the years and have amassed. Consequently, the liquidator or his solicitors will want the dividends repaid.

If you have paid an illegal dividend, provided it was an interim dividend, then in certain circumstances the easiest way to rectify it is to simply repay the money to the company. If you cannot do so, you can wait to see if future sales will generate enough income to create a profit position again. That of course is not always possible where the company is experiencing financial difficulty or facing insolvency. Before doing so however you should consult with **specialist insolvency solicitors**

In one reported decision unlawful dividends paid to members as 'quasi-salaries' **(on the advice of their accountant to save tax!)** were found on appeal to be repayable by the shareholders. Although shareholders were unaware of their unlawfulness, it was held that a shareholder was liable to return a distribution if they knew or should have been aware that it had been paid in circumstances which amounted to a contravention of the restrictions on distributions (irrespective of whether or not they knew of those restrictions).

Directors may become **personally liable** if they authorise an unlawful distribution which cannot be recovered. The repayment should be made as soon as the error is discovered, and not only in the event of liquidation. If the error is not corrected, the director may be held liable for any unlawful distributions due to a breach of their fiduciary and statutory duties relating to the protection of company's assets.

Remember: get advice first before you declare a dividend or decide to make any payment.

It's Time to Take Action!

If you have received correspondence from a liquidator, then call us urgently to find out what are the key issues you need to address and what your next step should be. Telephone (020) 7467 3980 or complete a contact sheet by clicking this link contact sheet.

We offer any director who wants to find out how to avoid the pitfalls of being sued by a liquidator a no-cost 20 minute **"Fighting Liquidator Claims 1-on-1 Consultation"**. We will cover and discuss common liquidator claims and how to avoid them.

To book your free one-on-one consultation **email** cw@summitlawllp.co.uk or call us on 0207 467 3980 and quote 'free director consultation' which will entitle you to speak to one of our specialist insolvency lawyers.

About the author (Poacher turned gamekeeper)

Jeremy Boyle L.L.B (Hons) is a solicitor and partner and an expert in insolvency law who specialises in insolvency litigation. Jeremy has acted for and advised the UK's most experienced and largest firms of insolvency practitioners when they pursue directors. Jeremy is regularly asked to write articles for leading publications and to provide talks on insolvency related matters.

Accordingly, he is well versed in assisting directors to defend personal claims and describes himself as a 'poacher turned gamekeeper'.Because Jeremy advises liquidators who pursue directors, he is often a few steps ahead and will know what tools in the liquidator's armoury they are likely to use.

So why should I instruct you and not another solicitor? What's in it for me if we hire you?

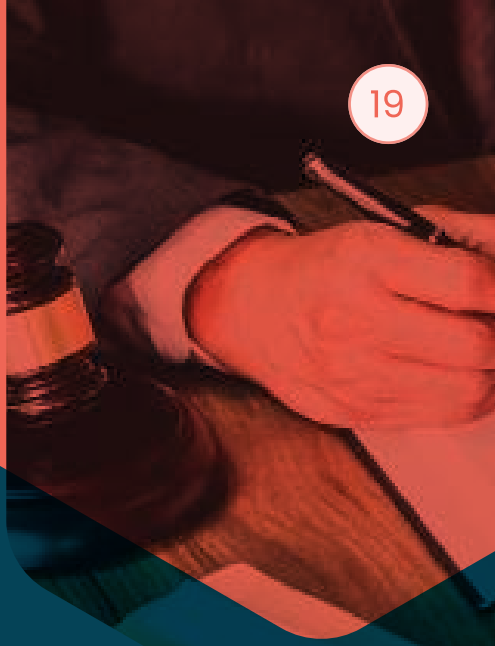
Summit Law is committed to fighting our clients' corner and because we are specialists, we have a wealth of experience and knowledge to draw on.

We are also committed to resolving claims without going to court, wherever possible, to save you money in legal fees and stress but also to give you certainty of outcome.

By instructing Summit Law at the outset, you are investing in specialist lawyers who might well be able to stop a claim being pursued by the liquidator. This will potentially save you huge legal bills and save you a great deal of stress. We can also help to ensure that you do not take the wrong steps or make an admission when you are not required to do so.

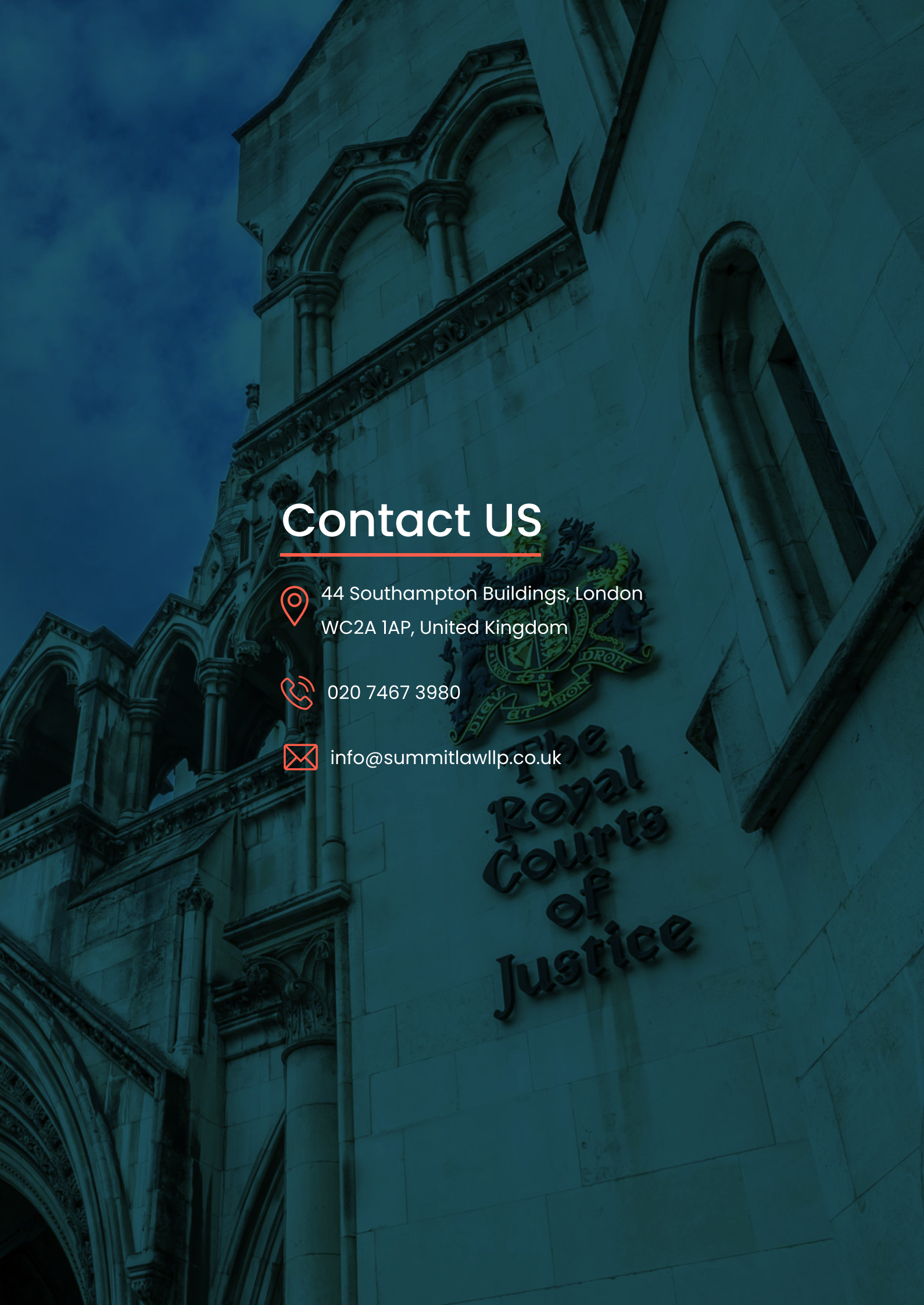
Because we are specialists working day in and day out on insolvency cases, unlike other solicitors, we do not have to research the law, we know the relevant provisions so it can save time which brings in huge cost savings for our clients whereas other lawyers who might claim to be experts will waste time having to research this specialist area of law.

What others say about us



*"**Jeremy Boyle** and the team at Summit Law has been completely supportive and helped us to navigate a very negative 9-month legal problem. Their attention to detail and common-sense approach to tackling heated legal questions with a cool perspective, ultimately saved us 100,000's! They cared enough when our chips were down to help us get out of a bad deal...thank you Summit Law!" (a director and Summit Law client)*

*"I first contacted Summit Law LLP late on a Friday morning. At the start of a bank holiday weekend. I had received by email that morning an instruction that a court hearing had been made related to an issue that I was involved with. After preliminary discussions with **Jeremy Boyle** (Senior Partner) about the case I decided to instruct Summit Law to represent my interests at the court hearing. In effect this only gave us 1 full working day to prepare our submissions, appoint council and be prepared. The Summit team were super-efficient and kept me up to speed on all aspects of the case. The barrister selected was professional and efficient. Our challenge to the hearing was successful and we were awarded costs. This was an important decision that we were obliged to fight at very short notice. Without the commitment of the whole team at Summit Law LLP I am sure the outcome of the copyist proceeding would have been vastly different. Their attention to detail, professionalism, speed of action and importantly communication was exemplary. Thanks to all concerned". (A Summit Law client).*



Contact US

44 Southampton Buildings, London
WC2A 1AP, United Kingdom

020 7467 3980

info@summitlawllp.co.uk