



DAVID HARBY

Partner

David is a barrister, litigator and mediator with significant experience of complex international disputes and, in particular, insolvency, trust and fraud litigation and advocacy. David routinely advises and works with insolvency practitioners, offshore law firms, financial institutions and corporate and commercial clients throughout the world.

Beyond the grave: The High Court holds that the duties of directors survive entry into a creditors voluntary liquidation (“CVL”).

Summary: In this article on a recent case concerning insolvent companies, David analyses the importance of directors’ remaining mindful of their fiduciary duties when dealing with assets that could be said to belong to an insolvent company in which they held office. The January judgment concerned transactions at an undervalue, preference payments and fiduciaries being held to account. (*In Re Systems Building Services Group Ltd (“the Company”) [2020] EWHC 54 (Ch) (21 January 2020).*)

The facts

1. The Company was initially placed into administration on 12 July 2013 with Mrs Gagen Sharma appointed as its administrator. That administration was converted into a CVL on 3 July 2013 and the Company later dissolved on 24 February 2016. However, in *Top Brands v Sharma* [2014] EWHC 2753 Mrs Sharma was found liable for misfeasance under s. 212A of the Insolvency Act 1986 (“the IA”) on the grounds that she had negligently and/or in breach of fiduciary duty misapplied monies whilst acting as an office-holder of a company known as Mama Milla Limited. That judgment was upheld by the Court of Appeal on 10 November 2015. Mrs Sharma was adjudged bankrupt and on 30 June 2016 and on 8 August 2017 she gave an eight-year Bankruptcy Restrictions Undertaking to the Secretary of State. Following the conclusion of the *Top Brands* proceedings, Mr Stephen Hunt took over 44 of Mrs Sharma’s appointments under a Block Transfer Order dated 17 June 2016. It was a result of Mr Hunt’s investigations that the instant applications were brought against a former director of the company, Mr Michie, and System Building Services Limited. It should be noted that it was made plain by the Court that it was not alleged that Mr Michie knew of any investigations or complaints regarding Mrs Sharma at the time that he had instructed her.
2. The applications against Mr Michie concerned: (1) the purchase by him of a Property from the Company acting by Mrs Sharma as its then liquidator, at a price which it was alleged Mr Michie knew to be a substantial undervalue; (2) payments paid out of the Company’s bank account to one of the Company’s creditors, shortly after the Company was placed into administration; and (3) payments made by the Company to Michie which it was alleged remained unaccounted for over the period 22 July 2010 to 10 July 2012, prior to the Company entering into administration.



The Central Issue

3. It was common ground between the parties that Mr Michie remained a director of the Company notwithstanding the Company's entry into administration and thereafter voluntary liquidation pursuant to paras 61 and 64 of Schedule B1 to the IA. However, there was considerable debate at trial on whether and, if so, to what extent the "general duties" that apply to a director pursuant to ss. 170 to 177 of the Companies Act 2006 ("CA") survive a company's entry into formal insolvency; in this case administration and thereafter a CVA.
4. The Court noted that "this issue had not been heralded by the pleadings" and that in fact Mr Mitchie, through his counsel, had sought to "row back" from an admission made in his Reply that "Mr Mitchie had the duties set out therein (...)" in the application notice. The Court said that it was "unfortunate that such a significant shift in position should be disclosed so shortly before trial". However whilst the Court was "mindful" that it had "heard limited argument" on the issue, it rejected Mr Michie's final position or argument. This was namely "that once a company enters into administration or CVL, the "general duties" of a director only survive in respect of any *exercise* by that director of *powers, qua director*, preserved by, or permitted in accordance with, the IA 1986."

The Court's findings

5. The Court held against Mr Mitchie on the above issues for the following reasons:
 - (i) it is clear from ss. 170 to 177 of the CA themselves that the "general duties" extend beyond the exercise by a director of any given power. As to this:
 - (ii) Section 175(1), for example, provides that "a director of a company must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company". The Court found that the application of that section is not dependent on the exercise of a given power by a director acting as such;
 - (iii) the above distinction is also exemplified in s.176(1) which provides that "a director of a company must not accept a benefit from a third party conferred by reason of (a) *his* being a director; or (b) his doing (or not doing) anything as director". Simply being a director is sufficient to trigger this duty; it is not dependent upon the exercise of a power by a director acting as such; and
 - (iv) the Court found that s.170(2) was also relevant: This provides (amongst other matters) that "a person who ceases to be a director continues to be subject to the duty in s.175 (duty to avoid conflicts of interests) as regards the exploitation of any property, information or opportunity of which he became aware at a time when he was director". This was held to be a clear example of the "reach" of these provisions, namely that the duties imposed by s. 175 continue to apply to a person even after that person ceases to be a director and consequently beyond the point when an individual is "*exercising*" any powers as a director;
 - (v) the Court also held that it is clear that the CA expressly states when its provisions are not to apply to an administration, compulsory liquidation or CVL. The Court cited s.193, which expressly provides that members' approval is not required in respect of substantial property transactions (as defined in s.190) between a company and its directors where the company is being wound up or is in administration;
 - (vi) as is made clear by s.170(3) and (4), the duties of a director in ss. 171 to 177 "are based on certain common law rules and equitable principles as they apply in relation to directors and, whilst they "have effect in place of those rules and principles" are to be interpreted and applied in the same way". The Court held that these underlying "principles were plainly of sufficient



flexibility to extend beyond the company's entry into a formal insolvency process such as administration or voluntary liquidation";

(vii) s.172(3) expressly preserves the duties of a director in certain circumstances "to consider or act in the interests of creditors of the company"; and

(viii) the IA provides that a company's entry into administration or voluntary liquidation does not, of itself, result in the removal of directors from office.

6. The Court accepted that there is little case law and textbook commentary in the area. However, "this does not lead inexorably to the conclusion that the general duties of a director set out in ss. 171 to 177 cease to exist on a company's entry into administration or [CVA]". Instead, the Court held that "it simply reflects the fact that, for the most part, licensed insolvency practitioners in this country are highly effective guardians of the assets of those companies in respect of which they are appointed."

What are the consequences of this case?

7. In one of the few cases in this area (counsel for the Applicant liquidator had described the lack of authorities "as the dog that does not bite"), it was made plain that a director's independent duties to a company and, by extension, creditors continue following the entry of a company into an insolvency process. It is therefore important that directors or former directors remain mindful of their fiduciary duties when dealing with assets that could be said to belong to an insolvent company in which they held office.

19 February 2020

For more information please contact David Harby at dmh@pcblitigation.com or for any other enquiries please contact us by email at enquiries@pcblitigation.com or by phone +44(0)20 7831 2691.