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Disqualification Newsletter

Newsletter Editor
Dr John Tribe

Dear Subscriber,

This Newsletter contains summary reports of four recent decisions on directors' disqualification; and summaries of five recent disqualification cases published by the Insolvency Service on its website where disqualification orders have been made by the courts. Subscribers may be interested to know that the Insolvency Service website also contains numerous cases where disqualification undertakings have been entered into in favour of the Secretary of State.

In the wider world of directors' disqualification, the former editor of this Newsletter and contributor to the main work, Professor Rebecca Parry, has been contracted to lead a team of investigators from the Centre for Business and Insolvency Law, Nottingham Trent University, which is looking into whether foreign director disqualifications that have been imposed in selected countries should be extended to restrict behaviour in the United Kingdom. Section 1184 of the Companies Act 2006 includes the power for the Secretary of State to make regulations to this effect.

Dr John Tribe

Newsletter Editor

FEEDBACK

We would be pleased to hear from subscribers who have any comments or suggestions regarding the content of this Newsletter, or any comments or queries on disqualification law, practice and procedure in general. Letters which raise issues of interest may be published in the Newsletter. Please address letters to the editor of this newsletter: Dr John Tribe, Kingston Law School, Kingston University, Kingston Hill, Kingston upon Thames, Surrey, England, KT2 7LB, Email: j.tribe@kingston.ac.uk.

CASE LAW UPDATE

Re Lawyours LLP, Official Receiver v John Wilson

High Court of Justice, Chancery Division, Leeds District Registry, His Honour Judge Roger Kaye QC, sitting as a Judge of the High Court, [2013] EWHC 3146 (Ch).

Directors' disqualification – unfitness – solicitor – income tax and VAT arrears – poor financial systems – inability to ascertain firm's financial position.

The Official Receiver sought a disqualification order pursuant to section 6 of the Company Directors Disqualification Act 1986 against the Defendant, John Wilson, a solicitor. The Defendant was the effective sole owner, manager, and controller of a limited liability partnership called Lawyours LLP ("Lawyours"). Lawyours went into liquidation on 23 June 2010 on a petition presented by Her Majesty's Revenue and Customs ("HMRC") on 12 March 2010 in respect of arrears of income tax and VAT. HMRC claimed a total of some £605,517 in the liquidation. The only other creditor of Lawyours was the Defendant for a relatively modest amount.

Lawyours was incorporated on 25 June 2007 and commenced trading almost immediately in September 2007. On the same day as Lawyours was incorporated (25 June 2007), the Defendant incorporated his legal firm, Wilsons Solicitors, as an LLP. Wilson Solicitors LLP ("Wilsons") too (like its predecessor firm) was (and had been) substantially owned and controlled by the Defendant. It carried on a practice largely based on property work and conveyancing. The aim was for Lawyours to provide a service for solicitors as office support in the form of staff, accommodation, equipment and administrative services. Lawyours thus would (and did) incur the cost and liability for all these expenses. It proposed to meet the cost by billing the solicitors so served for the costs incurred plus (at least that appeared to be the idea) an amount as profit (said to be 10%). In fact throughout its history, Wilsons was Lawyours' only client.

Throughout their combined history, Lawyours and Wilsons enjoyed the benefit of group overdraft and loan facilities from National Westminster Bank plc ("the bank"). The bank's lending was secured by cross-guarantees from each entity, by debentures from each and by the Defendant's personal guarantee (limited to £350,000) for the liabilities of Wilsons. Thus, as a result of the cross-guarantees, the Defendant's personal guarantee indirectly also secured the borrowing of Lawyours.

The allegations against the Defendant were that: (a) between October 2008 and June 2010, he had caused Lawyours to trade at the risk and to the detriment of HMRC by which time £605,517 was owing to HMRC in respect of unpaid VAT, PAYE, income tax and NIC; and (b) on 31 August 2009, following the demand for immediate repayment by HMRC on 25 August 2009, and when financial constraints had been placed on the business by its banks, he had caused Lawyours to credit £700,000 to the account of Wilsons, writing down the balance owed by Wilsons to Lawyours and resulting in £26,645 being owed by Lawyours to Wilsons. This transaction was to the

detriment of Lawyours' creditors, in particular HMRC, which was Lawyours' majority creditor and was owed at least £405,650 as at 31 August 2009, and £605,517 by the date of liquidation.

The Defendant, while accepting that he substantially owned and controlled both entities, essentially sought to portray himself as the victim. The thrust of his entire evidence was to accept no responsibility whatsoever for the demise of Lawyours, but to blame the bank, HMRC and others for it.

HELD:

(1) The Defendant was in sole effective charge of all financial and business matters in both entities, especially Lawyours. It was clear, from the evidence, that the Defendant had caused Lawyours to withhold payment from HMRC, while continuing to meet liabilities to trade creditors, and while repayment was steadily being made of the liabilities owed to the bank. From at least October 2008, the Defendant knew that Lawyours was insolvent and knew that Lawyours had substantial arrears to HMRC. Thereafter, it was the Defendant who decided who would be paid, what and when. He did pay some HMRC liabilities from time to time, but the arrears substantially accumulated. He made a concrete decision to defer payment to HMRC and pay other creditors instead.

(2) The first allegation was substantively and factually made out. The Defendant pursued (and indeed was solely responsible for) a policy of unfair discrimination against the Crown as regards the liabilities due to HMRC.

(3) The second allegation was also substantively and factually made out. Consistent with the way in which the Defendant managed things it was he who decided to issue a credit to Wilsons for £700,000 in or about August 2009 when he knew Lawyours was insolvent, knew it had substantial arrears due to HMRC, and knew by then that the liability to the bank was steadily reducing. Despite repeated opportunities, even at trial, Mr Wilson had no explanation as to how the £700,000 was calculated. The entire transactions (or transaction) were shrouded in obscurity. This was a fair reflection of the Defendant's own lack of business, financial and managerial competence. Indeed, the whole justification for the payment was his failure to manage Lawyours and its relationship with Wilsons in any proper or competent fashion.

(4) The Defendant's conduct in relation to the two allegations of unfitness showed incompetence in a marked degree and fell far short of the standards to be expected and encouraged a person fit to be involved in the management of a company. He was not dishonest or lacked probity. What he lacked was an ability to appreciate that his own actions might be wrong, or to take responsibility for his own decisions, instead seeking, unjustifiably, to cast blame on almost everyone with whom he came into contact.

(5) A disqualification order for a period of seven years would be made against the Defendant.

Miss Eleanor Temple* (*instructed by Bond Dickinson LLP*) *for the Official Receiver.

The Defendant appeared in person.

Re P E Realisation Ltd, Secretary of State for Business, Innovation and Skills v Andre Carl Clifford Parsons

In the High Court of Justice, Chancery Division, Birmingham District Registry, District Judge O'Regan, 4 November 2013.

Directors' disqualification – unfitness – failure to pay PAYE and VAT – failure to pay business rates – trading to the detriment of specific creditors.

The Secretary of State applied for a disqualification order against the Defendant, Andre Carl Clifford Parsons pursuant to section 6 of the Company Directors Disqualification Act 1986 against the Defendant.

The Defendant was the sole shareholder and director of PE Realisation Ltd ("PERL"). The Secretary of State's principal complaint was that prior to its liquidation, PERL had a policy of treating creditors of PERL differentially, and that treatment had been to the detriment of HMRC and Walsall Metropolitan Borough Council ("the Council").

On liquidation, PERL had no assets, but liabilities of £297,785. Of these, PERL owed HMRC £137,218 in respect of PAYE and a further £31,653 in respect of VAT. It also owed the Council £42,209 in respect of unpaid business rates. It was the Secretary of State's case that, for identified periods prior to its liquidation, PERL had operated a policy of discriminating against HMRC and the Council, in that other creditors were preferred for payment to the detriment of HMRC and the Council. The Defendant contended that there was no such policy.

HELD:

(1) The commentary in various parts of *Mithani: Directors' Disqualification* correctly set out the approach of the court in deciding whether a company had operated a policy of discrimination.

(2) It was clear, on the facts, that the Defendant had caused PERL to operate such a policy. During the period from 1 April 2009 and 8 January 2010, HMRC, and during the period 1 April 2008 to 8 January 2010, the Council, had remained largely unpaid (and the amounts due to both those creditors had substantially increased) when other creditors, (including the amount due to the Defendant from PERL under his loan account) had been discharged or substantially reduced.

(3) While there was no allegation of dishonesty against the Defendant, the policy of discrimination was operated for a considerable period of time – some two years of the four years that PERL traded. In addition, there

was a substantial amount which was due and owing to the creditors against whom the policy of discrimination had operated.

(4) A disqualification order for a period of four and a half years would be made against the Defendant.

Mr Mathew Weaver* (*instructed by Wragge & Co LLP*) *for the Secretary of State.

Mr Richmond* (*instructed by Bell Lax*) *for the Defendant.

Re Wood Norton Hall Hotel Ltd, Official Receiver v Christopher Francis O'Grady

In the High Court of Justice, Chancery Division, Companies Court, Deputy Registrar Middleton, 13 December 2013.

Directors' disqualification – unfitness – failure to pay PAYE and national insurance contributions – trading to the detriment of HMRC.

The Official Receiver applied for a disqualification order against the Defendant, Christopher Francis O'Grady, under section 6 of the Company Directors Disqualification Act 1986 in respect of his conduct of a hotel business, Wood Norton Hall Hotel Limited ("the Company").

The Official Receiver alleged that the Defendant had caused the Company to trade to the detriment of HMRC from 30 November 2007 to cessation of trading in September 2009 in respect of VAT, and from 19 May 2008 to September 2009 in respect of PAYE/NIC. The Official Receiver asserted that the decision to continue to trade between November 2007 and September 2009 was made in circumstances in which such trade was necessarily at the risk and to the ultimate detriment of HMRC, involving the Company in taking unwarranted risks with HMRC's money. In particular: (a) during this period, the Company was, and the Defendant knew or ought to have known that it was, cash-flow insolvent and unable to pay its debts as they fell due; (b) nonetheless, he caused the Company to continue to trade throughout this period; (c) the continued trading resulted in a significant increase in the Company's VAT and PAYE/NIC liabilities to HMRC so that this continued trading was conducted at HMRC's risk and expense and to its ultimate detriment; (d) the continued trading exposed HMRC to an unreasonable risk that the Company would fail; (e) the continued trading was unreasonable in all the circumstances – in particular, it was unreasonable for the Defendant to base the decision to continue to trade on the speculative hope that a sale agreement would result in a payment to the Company for its business in time and in sufficient sum to save it from an insolvent liquidation; and (f) in all the circumstances, the Defendant's conduct, although apparently honest and well-intentioned, was seriously misguided and irresponsible, entailed a serious breach of his obligations to take proper account of and to act in the interests of the Company's creditors, fell short of what was expected of a company director in managing the affairs of a company and demonstrated him to be unfit to discharge that responsibility.

Further, and in any event, the Official Receiver contended that (whether or not the decision to continue to trade at the risk of its creditors generally could be justified in respect of some or all this period): (a) the risk of such strategy to avoid an insolvent liquidation would fail was disproportionately visited on HMRC through the adoption of an illegitimate and unfair policy which involved treating HMRC less favourably than general trade creditors; (b) the Defendant was responsible for such policy; and (c) the Defendant's conduct in relation to that policy involved a failure to comply with his responsibilities to ensure a fair and even handed treatment of creditors during this period and made him unfit to be concerned in the management of a company.

HELD:

(1) The Company had, at all material times, been loss-making with capital limited to the sum of £100. The only working capital available was that provided as a result of the failure to pay the amounts that were due and owing to HMRC.

(2) The Defendant was well aware of the Company's precarious financial state. He made a deliberate and conscious decision to defer making payments to HMRC in the hope that there would be a purchaser for the Company's business and that it would resolve the Company's financial difficulties. However, he should have appreciated that given the time the hotel had been on the market and given his duty towards the general body of creditors whose interests had intervened, he needed to put in place an arrangement with the creditors who were at risk by the continuation of trading – at least with HMRC which was the major creditor. If necessary, a Company Voluntary Agreement should have been considered. Progress in this regard should have commenced at least from mid 2008, and progressed with diligence thereafter. This was not done.

(3) A disqualification order for a period of three years would be made against the Defendant.

Ms Fiona Dewar* (*instructed by Bond Dickinson LLP*) *for the Official Receiver.

Professor Mark Watson-Gandy* (*instructed through the Bar's Direct Access Scheme*) *appeared on behalf of the Defendant.

Re Excel Automation Ltd, Secretary of State for Business, Innovation and Skills v Hunter

Worcester County Court, District Judge Parry, 1 February 2013.

Directors' disqualification – unfitness – serious breaches of trust and duty.

The Secretary of State applied for a disqualification order against the Defendant under section 6 of the Company Directors Disqualification Act 1986 in respect of his conduct of the affairs of Excel Automation Ltd ("the Company").

The Defendant was director and chief executive of the Company which carried on business as a manufacturer of lift and handling equipment. In 1995, there was a management buyout of which the Defendant was the prime mover. The Defendant became the majority shareholder and managing director of the Company.

In late 1997, the Company decided to set up an employee life assurance scheme with American Life (later L & G). In the event of the death of an employee, a lump sum based upon a multiple of his or her earnings would be paid to the Company and then onto the employee's dependents ("the scheme"). In order to protect such funds, the Company set up a separate named account with Bank of Scotland and executed a declaration of trust ("the trust"). The Defendant executed the trust and was also one of the three persons authorised to complete claims documentation.

In November 2006, a Mr C was appointed as a replacement financial director for the existing financial director. He had an obligation to report to the Defendant. Mr C was also the company secretary. On 25 April 2007, a Mr S was appointed as an additional director. The Defendant asserted that these appointments were part of a process by which he stepped back from the day-to-day management of the Company. The Secretary of State accepted that the Defendant may have reduced his day-to-day involvement in the Company but contended that he retained overall control of the business and remained deeply involved in its affairs as indicated by his level of remuneration.

During 2008, the Company performed reasonably well making a profit of approximately £65,000 and having substantial net assets. The Company had banking facilities with Bank of Scotland which included an overdraft of £550,000. However, during 2009, the Company's fortunes appeared to have taken a turn for the worse. It began to suffer from poor trading conditions caused in part by the global recession. The minutes of the board meetings during 2009 described the Company's cash position as being "very tight". The Defendant was aware of the cash position and requested current financial information including the up-to-date bank position be reported as a regular feature of board meetings.

On 6 July 2009, one of the Company's employees, a Mr P died. On 9 July 2009, Mr C completed the notification form to L & G under the scheme. On 14 July 2009, a cheque for £152,768 was sent to the Company and duly paid into the Company's trust account. On 30 July 2009, instead of paying the monies to Mrs P, Mr C and Mr S transferred £150,000 from the trust account to the Company's ordinary trading account, thereby reducing the overdraft from its relatively high level of around £495,000. It was accepted by the Defendant that this amounted to a gross breach of trust.

On 4 August 2009, another employee of the Company, a Mr B, died. Mr C made another claim to L & G under the scheme. On 17 September 2009, L & G sent a cheque to the Company for £166,000. It was duly paid into the trust account. The money should then have been sent immediately to Mrs B. Instead, on 30 October 2009, Mr C and Mr S signed a transfer form and sent

£152,768 from the trust account to Mrs P. In other words, Mrs P had been paid using the money that had been received in respect of Mrs B. This left approximately £18,000 in the trust account.

A board meeting was held on 2 November 2009 and the minutes recorded that a loss for the year was being forecast of approximately £188,000. The Defendant was at that board meeting. On 17 December 2009, the Board met again. The minutes recorded some improvement in the margins but that a loss had been recorded for the period.

On 21 December 2009, Mr H, a former director of the Company, sent an e-mail to the other directors complaining about the fact that Mrs B had not been paid. The Defendant asserted that immediately upon receipt of the e-mail, he sought out Mr C and discussed the matter it with him. He said that Mr C informed him that the money had been paid over to solicitors and the Defendant was satisfied with that response.

On 14 January 2012, Mr C and Mr S signed a further transfer request and £15,000 from the trust account was paid to the Company's landlord. It was undeniable that this was a further very serious breach of trust by the Company. Mrs B engaged solicitors to try and recover the money due to her and it would seem that they communicated with Mr C and Mr S. However, no payment was made and on 17 March 2010, the Company went into administration.

The Secretary of State alleged that from 21 December 2009, the Defendant had allowed the Company to breach its duties as trustee of the scheme and further allowed the misapplication of the £15,000 that had been held in the trust account. Although the Secretary of State accepted that the Defendant had played no part in the breaches of trust, he contended that the conduct of the Defendant in failing to exercise any or any proper control over the administration of the scheme amounted to incompetence of a sufficient degree to warrant the making of a finding of unfitness, particularly as the Defendant was described as the "chief executive", and was the highest paid director of the company.

HELD:

(1) The commentary in various parts of *Mithani: Directors' Disqualification* correctly set out the law that applies to breaches of directors' duties, and to the approach of the court in deciding whether there had been breaches of duty on the part of the Defendant and whether those breaches constituted unfit conduct;

(2) The breaches complained of by the Secretary of State were both serious and dishonest. However, the Defendant was "chief executive" of the Company in name only, and although he was the highest paid director, he had "stepped back" from the business and had made satisfactory arrangements for the Company to employ directors who were well qualified to undertake the administration of the scheme. He was, therefore, entitled to rely upon them to administer the scheme lawfully and correctly

(3) Although certain aspects of the Defendant's conduct could be criticised, there existed no grounds for suspicion that such reliance was misplaced or inappropriate. Accordingly, the conduct of the Defendant did not warrant the making of a finding of unfitness.

Mr James Morgan* (*instructed by Wragge & Co LLP*) *for the Secretary of State.

Miss Olivia Chaffin-Laird* (*instructed by MFG Solicitors LLP*) *for the Defendant.

Insolvency Service Case Summaries

The Insolvency Service has been continually active in its reporting of directors' disqualification cases and its successes in obtaining orders against unfit directors. The following case extracts demonstrate some of the more recent cases in which disqualification orders were made by the court.

(*1*)*Re Titcombe Garage Ltd, 8 May 2013, District Judge Ralton, Swindon County Court*

A disqualification order for a period of six years was made against Linda Ann McCracken for having caused the above company, which went into liquidation on 25 November 2010, to make payments of £38,000 to herself (£18,000 in respect of wages owed and £20,000 in respect of a moving allowance) and £209,436 to a consultancy creditor in circumstances where she had received specific advice that such payments should not be made having regard to the financial position and status of the company.

(*2*)*Re 7 Stars* (*Recruitment*) *Ltd, Secretary of State for Business, Innovation and Skills v Howard and Carroll, 15 October 2013, District Judge Richmond*

A disqualification order for the maximum period of 15 years was made against John Simon Howard and one for 12 years was made against Lee Daniel Carroll in respect of their conduct of the affairs of the above company which went into creditors' voluntary liquidation on 19 May 2011.

The court found that the defendants had failed to ensure that the Company complied with the Gangmasters (Licensing Authority) Regulations 2005 – legislation which is designed to ensure that employees are not exploited – and that this caused the Company's gangmaster licence to be revoked. In particular, in relation to Mr Howard, the court found that he failed to ensure that the Company had traded in a manner that was compliant with the conditions of the gangmaster licence issued by the Gangmasters Licensing Authority ("GLA"). Specifically, Mr Howard had: (a) failed to be candid and truthful with the GLA and had deliberately sough to conceal facts from it, which made the appropriateness of his fitness to be a licence holder to be brought into question; (b) failed to keep the GLA informed of the address of the Company; (c) failed to ensure that the Company complied with its statutory obligation and licence condition to pay HMRC as and when due as a result of which the Company incurred a VAT debt of £142,850 for the period when he

was a director; (d) failed to ensure that the employees of the Company were free from mistreatment which GLA inspections previously conducted found they had been both from verbal and physical threats made to them; (e) failed to ensure that the Company paid the national minimum wage to its employees; (f) failed to ensure that the Company allowed their workers freedom of movement as the Company offered work conditional on the basis that the workers used connected accommodation which restricted their ability to seek work elsewhere; (g) failed to ensure that the accommodation provided to workers was to a suitable standard; (h) failed to ensure that workers should be able to give ten working days' notice when leaving a property as required by the GLA Licence Standards; (i) failed to ensure that the Company complied with the GLA Licence condition not to charge work-finding fees for workers; and (j) failed to ensure that the Company used licensed gangmasters to supply them with workers as the GLA investigation showed that the Company had used unlicensed UK and foreign sources for the supply of labour.

In relation to Mr Carroll, the specific allegations – which the court found proved – were those set out at (a), (b), (c) (but the VAT debt to HMRC was £325,361 for the period when he was a director), (e), (f) and (j).

(*3*)*Re Network Publishing Ltd, Official Receiver v Marshall, 9 September 2013, District Judge Falvey, Luton County Court*

A disqualification order for a period of eight years was made against Peter John Marshall in respect of his conduct of the affairs of the above company, which was wound up by the court on 12 January 2011.

The court found that: (a) contrary to a contractual obligation with the States of Jersey, the Company failed to pay over advertising revenues totalling £265,000 for its 2009/10 holiday brochures, despite collecting the money on behalf of the States of Jersey between October 2009 and March 2010. The Company had then used the funds in the ordinary course of business. One payment for £84,380 was made to the States of Jersey customer but the cheque bounced; (b) On 1 October 2009, the Company changed from the original company that supplied its printing services, and to which it owed £184,101, to another print supplier which provided the Company with a £100,000 credit facility. This facility was used towards reducing the original print supplier's liability to £84,000 without the knowledge or consent of the management of the new supplier. The Company then incurred additional liabilities to the new supplier of approximately £35,000 resulting in a total debt to this supplier of nearly £135,000, still remaining at the date of the liquidation. With over £200,000 owing to the two print suppliers, the Company opened a third print account with another supplier in May 2010. Only one invoice was paid from this account, with ten invoices totalling £27,214 remaining unpaid. Additionally, the Company owed a further £29,504 to this print supplier for work completed on behalf of another of the Defendant's companies, resulting in a total liability of £58,718 to this new supplier at the date of the liquidation; (c) the Defendant had inflated the Company's balance sheet by creating an unrealistic "goodwill" figure which stood at

£391,000 in the December 2009 year-end accounts and which the court agreed did not follow acceptable accounting procedures. Further, when the Company's bank called in the Defendant's personal guarantee of £150,000 after the winding up order, he sought to use this as mitigation, describing it as a "loan" he had made to the company.

The Defendant also suggested that the States of Jersey and the Official Receiver were somehow complicit in conspiring against him to seek to have him disqualified. The judge described these claims as being "Walter Mitty-esque" in their absurdity.

The Defendant did not submit a formal defence but, among other matters, attributed the Company's failure to his inability to fully attend to its affairs, having been diagnosed with cancer in August 2010. The Defendant's illness was accepted as mitigation by both the Official Receiver and the court, and was taken into account when fixing the period of disqualification.

(*4*)*Re Yorkspeed Ltd tlas City Cabs, Secretary of State for Business, Innovation and Skills v Battle, 20 September 2013, District Judge Sykes, Liverpool County Court*

A disqualification order for a period of eight years was made against Lee Michael Battle in respect of his conduct of the affairs of the above company, which went into creditors' voluntary liquidation on 6 April 2011.

The court found that the accounting records of the Company which were delivered up to the liquidator of the Company were insufficient to explain more than £700,000 cash withdrawals, over £40,000 of bank transfers and more than £13,500 of cheques, between August 2009 and March 2011. In addition, the Defendant failed to explain why the Company made lump sum payments of over £40,000 each to both himself and a family member.

(*5*)*Re Hamptons Manufacturing Ltd, Secretary of State for Business, Innovation and Skills v Bright, 4 December 2013, District Judge Vesey, Portsmouth County Court*

A disqualification order for a period of 11 years was made against Shaun Bright, who was found to be a de facto director of the above company, which went into administration on 15 June 2011, for having acted as a director or in the management of the Company when he was prohibited from doing so by reason of a disqualification order made against him in 2006.

Case Law Update