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Disqualification Newsletter

NEWSLETTER EDITOR
Rebecca Parry

Filing Instructions: Please file at the front of Binder 1 of *Mithani: Directors' Disqualification.*

Dear Subscriber,

This newsletter contains summaries of three recent unfitness cases and an older case dealing with an application for a BRO.

Rebecca Parry

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 in general. Letters which raise issues of general interest may be published in this newsletter. Please address letters to the editor of this newsletter: Rebecca Parry, Academic Legal Studies, Nottingham Law School, Nottingham Trent University, Burton Street, Nottingham NG1 4BU or e-mail: rebecca.parry@ntu.ac.uk.

RE CHILTERN INVADEX LTD, SECRETARY OF STATE FOR BUSINESS, INNOVATION AND SKILLS V HALE

High Court of Justice, Chancery Division, Companies Court, Mr Deputy Registrar Garwood, 28 November 2012

Unfitness – self-represented person not present at trial – adjournment – tax evasion – serious case – mitigation on grounds of age

This was an application by the claimant, the Secretary of State for Business, Innovation and Skills, for a disqualification order against the defendant, "H", under CDDA 1986, s 6. H was not present or represented at the proceedings. However, a corporate financial advisor, "B", who had advised H from time to time, was present and he had been given permission to explain why H was not in attendance. B had been advised by H's daughter that H had suffered a recurrence of medical problems. No medical evidence was presented but B sought an adjournment of the trial. However, a month or so earlier, solicitors acting for H had written to the claimant's solicitors indicating that H was prepared to agree a disqualification undertaking for a period of two years and, if that was not acceptable to the claimant, H would appear in person to present a plea in mitigation. This offer had been rejected by the claimant.

H had controlled a company which had gone into administration. Through a new company, "Newco", of which he had been the only director and shareholder, he had purchased its business back from the administrators. The Transfer of Undertakings (Protection of Employment) Regulations 2006, "TUPE", applied to the purchase, with the consequence that staff employed in the company became employees of Newco by operation of law. However, Newco claimed to have had no staff on the basis that their employment had been transferred to "outsource providers".

When the business had been acquired by Newco, H had anticipated that suppliers would supply on credit and that there would be no significant difficulty in arranging bank borrowing. However, creditors had mostly required deposits and the bank had been unwilling to make borrowing facilities available. Newco had, therefore, experienced a cash flow problem, made worse because most customers were NHS Trusts, which required extended credit. Newco had factored its debts in response to this requirement but that did not wholly address the cash flow problem as the factoring company would only advance a percentage of the face value of invoices and the company still had cash flow problems pending the advances by the factoring company.

H had accepted that this position had been hopeless from the outset. However, he had been determined to keep the business going, as there was a significant degree of interdependence between the business of Newco and those of three other companies that he controlled.

Held:

(1) B's suggestion that the trial should be adjourned was a significant change of position on the part of H, and this change had not been told to B by H but rather by H's daughter, based on her understanding from when she had last discussed the matter with H.

(2) Where a self-represented person was seeking an adjournment, the court should be very careful before concluding that it would be appropriate to refuse it. However, the fact that genuine grounds might be presented in support of an adjournment would not lead to the inevitable conclusion that the adjournment should be granted. Rather, there might be circumstances in which a court would conclude that the refusal of an adjournment would cause no material prejudice to the self-represented person. In particular, it would likely be so if his or her case was demonstrably hopeless and bound to fail and he had been given a proper opportunity to present it in writing: *Arnold J Smithkline Beecham Ltd v GSKline Ltd* [2011] EWHC 169 (Ch) considered.

(3) It was concluded that there would be no material prejudice to H resulting from the claim proceeding in his absence, against the background of H having said, through solicitors, that he was no longer seeking to defend the claim, and H then not having served any further evidence as to the appropriate period of disqualification. It was notable that H had accepted that a disqualification would be appropriate and, if the trial was adjourned until such time as he was able to attend, he remained free to be able to act as a director.

(4) There was no evidence that anything ever happened which resulted in the staff becoming employees of the outsourcing providers, following the transfer of the business to Newco. No function performed within the company had been "outsourced" to the purported outsourcing providers. These purported outsourcing arrangements had been a fiction. In addition, the purported outsourcing arrangements had been concealed from employees, who had been paid their salaries in the same way as they would have been paid, had they continued to be employees of Newco.

(5) Newco had failed to account to HMRC for PAYE and NIC deductions. Therefore, Newco had enjoyed the benefit of retaining these sums from month to month. It had got away with this by failing to disclose to HRMC that it actually employed its staff. It had claimed to have had no employees. HMRC had submitted claims in the liquidation of Newco that had totalled £3,013,965, mostly on account of sums that should have been paid but which had been evaded on the pretence that no staff were employed. The purported outsourcing providers had not accounted to HMRC in respect of the PAYE and NIC that they would have been accountable for if they had employed the employees.

(6) There was evidence that Newco had been involved in a scheme, the purpose of which was tax evasion, not only in respect of PAYE and NIC but also the wrongful extraction of VAT repayments. Although H had said that the company had been offered a genuine outsourcing arrangement to ease the cash flow difficulties, this arrangement could not have had that benefit. The outsourcing company would have charged the cost of the employment of the employees to Newco with a profit margin added. This would have worsened the cash flow of Newco. The purported outsourcing arrangements were not commercially credible. It was inconceivable that H could have believed that the outsourcing arrangements would have resulted in the suggested benefits. It did not follow automatically that because H was the sole director, he had been a knowing, willing and culpable participant. However, it must have been obvious to H that Newco was surviving only by evading payment of PAYE and NIC.

(7) H had said that he had left the day-to-day running of the outsourcing arrangements to others, in particular three "de facto" directors. However, these individuals had made statements by reference to which there was no possible basis for describing them as de facto directors. H

had known full well, at all material times, that the scheme in which he had caused or permitted the company to become engaged with had the nature, and was used for the purpose, of evading the payment of tax – and thereby, at the expense of HMRC – Newco had been able to continue its business, which it would not otherwise have been able to do.

(8) Although H was not present to present his mitigation, it was not the case that he had had no opportunity to add to what he had said in his evidence. He had been invited by the claimant's solicitors to file any further evidence on which he sought to rely by way of mitigation in relation to the appropriate period of disqualification but had chosen not to do so. There were two extensive witness statements and neither gave any reason to conclude other than that H had knowingly and deliberately caused the company to engage in a wholly improper and unlawful scheme in complete dereliction of his duties as a director. H's conduct made a period of disqualification of between 10 and 15 years appropriate. There was no possible argument that this might be a "middle band" case, even less a "lower band" case, as H had sought to suggest in offering a two-year period only. Without any possible justification, H had sought to put the blame on others and, only at a late stage, had he accepted that his conduct had been below the standards expected of him, and only then to a limited extent.

(9) B had pointed out that, since H was now 74 years old and in poor health, anything other than a relatively short period of disqualification would almost certainly mean that H would never again be able to act as a director. However, a relatively short period of disqualification could not be considered in this case. A period of 12 years was appropriate.

Tiran Nersessian (*instructed by Howes Percival LLP*) *for the claimant.*

The defendant did not appear. A Mr Bower from Bean Bower & Co (*a firm of* "*corporate financial advisors*") *appeared on his behalf and sought an adjournment which was not granted.*

OFFICIAL RECEIVER V SIMON PETER MARK TANSER

Worcester County Court, District Judge Mackenzie, 3 October 2008

Bankruptcy Restrictions Order – failure to co-operate with the Official Receiver and to keep records – professional man

This was an application for a Bankruptcy Restrictions Order ("BRO") against the respondent, "T". T had been an accountant in sole practice in Worcester. His bankruptcy was ordered in January 2007 upon the application of a factoring company. In November 2007, an order was made, upon the application of the Official Receiver, for the suspension of T's automatic discharge. This suspension was to apply until such time as T had fully co-operated and supplied all the accounting records in relation to his former accountancy practice to the Official Receiver.

The skeleton argument for the Official Receiver expanded upon the matters that he had asked the court to take into account in support of his application for the BRO. There was a complaint that T had not co-operated with the Official Receiver and/or his trustee in bankruptcy, which was expanded to say that T had not kept any proper record of his property dealings, in addition to not co-operating with the Official Receiver/trustee.

Held:

(1) It was regrettable that the effects of a BRO and its wider consequences were not set out in any comprehensible piece of legislation. This made it difficult for a person who was subject to it to know exactly how he was affected by the restrictions that arose under it from time to time.

(2) T was not evidentially or otherwise prejudiced by the skeleton argument expanding upon the matters that the Official Receiver wished the court to take into account. This was not a case of the Official Receiver trying to trawl far and wide beyond the allegations he had made in the written evidence in support of his application. It was merely a more precise "honing" in on the perceived mischief of the case.

(3) A BRO was clearly not intended for the routine bankruptcy caused by circumstances such as ill luck or misfortune. It required a degree of culpability going beyond mistakes forged in the dying days of a business and/or a requirement for added protection of the public to guard against the unscrupulous.

(4) It was clear that T was an articulate and intelligent man. He accepted that he was aware of the general obligations involved in being bankrupt. He knew full well his obligation to candidly provide information and documents to the Official Receiver. On more than one occasion he had signed statements that he would provide specific documents, yet he had failed to do so between February and September 2007. Certain Sage computer accounting disks had only been provided some seven or eight months after they should have been provided. The fact that the records had been held for such a long period of time gave rise to the reasonable suspicion that some impropriety on the part of T might be involved and the court could take that into account.

(5) Various documents were found in bin bags which suggested that there were documents in existence and that the documents might show that at least £38,000 was due to T from clients after the sale of the business. There was concern regarding the failure to hand over the Sage information, not least because there was *prima facie* concern that the business had been sold at an undervalue, although the Official Receiver had not pursued that head of claim in view of a lack of evidence. A reasonable *prima facie* concern over the value put the failure to provide documents in a much more important context. There was evidence from management accounts of a level of turnover such that the accountancy business could not have been regarded as worthless.

(6) T had failed to declare the name of his bookkeeper in the preliminary information questionnaire. In addition, T had failed to state where his records were held on computer, merely referring to "Sage".

(7) Since T was an accountant, he might have been expected to recognise the importance of keeping some records of the disposal of the business, yet he had said that there were none. If this was so, it was a material failure on T's part.

(8) No failure to keep records in relation to property matters could be found. These records were in the hands of the bookkeeper. All that T could do was to request and require the bookkeeper to make the documents available. T had done this.

(9) T had claimed that he had been unable to account to the factoring company for sums that he had collected directly from clients since these sums had been subsumed into his bank account. This explanation was unconvincing since R had clearly had a contractual obligation to relay to the factoring company any payment that was received directly. In addition, T had failed to declare a material interest, in spite of a fiduciary relationship. He had also signed up to the factoring agreement companies that he had known were not on a sound financial footing in order to maximise cash from the factoring company for his business.

(10) It followed that T had been guilty of significant failings in his responsibilities. He had failed to co-operate and to keep records, and he had managed his dealings with the factoring company so as to take advantage of them. A more serious view was to be taken because of T's profession as an accountant. He was an intelligent, professional man who had known what he was doing. The public needed to be warned that they could not rely on T's probity. A BRO for a period of ten years would be made against T.

Mr Russel, counsel, for the Official Receiver.

Miss Bristoll, counsel, for T.

RE OBERON PROPERTIES LTD, SECRETARY OF STATE FOR BUSINESS, INNOVATION AND SKILLS V MUSMAR

High Court, Chancery Division, Companies Court, Mr Registrar Nicholls, 23 November 2012

Unfitness – loans to related company – credit crisis

The claimant, the Secretary of State for Business, Innovation and Skills, applied for a disqualification order under CDDA 1986, s 6 against the defendant, "M", arising out of his involvement with a company, "Oberon", which had gone into creditors voluntary liquidation in 2008 with an estimated deficiency of around £535,000.

The allegations against M were based on a series of transactions consisting of 12 payments totalling £640,000–£650,000 made to Roca, a company of which M and his co-director of Oberon, "F", were directors. It was contended that, in making the payments to Roca, Oberon had divested itself of all of its assets, leaving unpaid corporation tax due to HMRC. Initially, the Secretary of State had not accepted that the payments were loans. However, this issue had been conceded by the Secretary of State at trial. The contention of the Secretary of State was that these loans had not been in the company's best interests and that they had been detrimental to the interests of Roca's creditors. In addition, it was contended that Oberon had ignored the advice of accountants and had failed to make provision for the payment of corporation tax.

Held:

(1) M had been aware of the financial predicament of both Roca and Oberon, and he had been aware of the making of the loan payments. An attempt by M to place responsibility on F was rejected.

(2) Although Roca and Oberon had had common directors, the shareholdings were different and M and F, as directors of both companies, faced a conflict of interest which they appeared not to have recognised. They both had a duty to protect and have regard to the interests of the creditors of the company, one of which was HMRC.

(3) The suggestion that M had agreed to the payments to Roca as inter-company loans to relieve Roca's cash flow difficulties during the height of the credit and banking crisis was wrong. Oberon's monies were used by Roca at a time when it was already having cash flow difficulties. M had admitted that property sales, which it was hoped Roca would make, were not guaranteed, whereas if the company's funds had been retained on Treasury deposit, they would have been available, with interest, to pay the company's creditors, including HMRC, and returned to shareholders. A decision of one potential purchaser to pull out of a deal had had a material impact on the return of Roca's funding and had delayed repayment to Oberon. The property market had been in decline by the end of February 2008 but F and M had caused additional funds belonging to Oberon to be loaned to support Roca, reducing the level of funds available to Oberon below the amount due to HMRC and eventually to zero. Other sales had fallen through during 2008 and, against this background, the other transfers from Oberon to Roca had taken place.

(4) The effect of two transfers in September 2008, after corporation tax became due, was to put monies out of the reach of Oberon, its creditors and shareholders at a time when the prospects of repayment would have been understood by a reasonably competent director to have been negligible.

(5) The company's accountant had noted that F and M had become less optimistic during 2008, and that F had been more involved in the financial aspects than M.

(6) Although M had gained no personal benefit, the fact was that he was responsible for diverting company money to support the activities of an associated company of which he was a director without due regard, or reasonable consideration, of the liabilities and interests of the company.

The problems affecting Roca had increased over time and M had addressed this situation by participating in, or permitting, increased payments out of Oberon's account in an attempt to alleviate the problems of Roca. The economic decline and cash flow crisis had exacerbated the problems for Roca but this had not excused M's actions, as he should have taken proper steps to protect the assets of the company and the interests of its creditors. Instead, he had simply increased their vulnerability by paying more and more funds to Roca. This demonstrated a failure of duty on his part and incompetence in respect of the management of company assets.

(7) The consequence of M's conduct was that creditors and shareholders were not paid or protected. A disqualification order for a period of four years would be made against M.

Christopher Buckley (*instructed by Howes Percival LLP*) *for the claimant.*

Giles Maynard Connor (*instructed by Clarion*) *appeared on behalf of the defendant*.

SECRETARY OF STATE FOR BUSINESS, INNOVATION AND SKILLS V DYSON

District Judge Truman, Chancery Division, Birmingham District Registry, 16 January 2013

Unfitness – payment of sums into account guaranteed by director – professional advice

This was an application for a disqualification order under CDDA 1986, s 6, against the defendant, "D", based on transactions undertaken by D shortly before the company, of which he was sole director, went into liquidation. In July 2008, D had made an unsecured loan to the company of £500,000. He had caused the company to repay this loan in December 2008, increasing the company's overdraft from £500,000 to nearly £1 million. A related company had bought the company's assets at an arm's length value, and the sale proceeds had been paid into the company's account, clearing the overdraft. Since D had given a personal guarantee to the bank in respect of the overdraft, his personal liability to the bank was removed. On the same day, the company had gone into voluntary liquidation. Since the majority of assets had been sold, there was little remaining to distribute to the company's other creditors.

It was accepted that the company had a substantial turnover prior to its difficulties in 2008, that D had been the sole director, and that he had neither taken excessive remuneration nor "milked" the company.

The allegation relating to the payment had not been raised until February 2012, only five days before the trial was due to start. The three-year delay between the start of the liquidation and the raising of the allegation was said to be due to the bank statement having been "somewhat illegible".

Held:

(1) The investigation by the Insolvency Service did not seem to have been very thorough, and it was surprising that the allegation relating to the payment had not been made until such a late stage, even though the payment had not been disguised by D. The bank statement had not been clear but it could be seen that there had been at least one debit of over £100,000, due to the amount of zeros that could be seen, and the overdraft was clearly shown as increasing. The Insolvency Service had been unclear as to whether the payment of £500,000 was a loan or a gift, but it was not apparent why it might have been thought that it was a gift, since it was clear from the circumstances of the payment and the information provided to the Insolvency Service that it was a loan.

(2) The repayment of the loan had resulted in an increase in the overdraft for which D was personally liable, so the two actions could be said to have balanced each other out. The payment had not diminished the sums available for creditors and it was likely that the bank would have chased D under the guarantee rather than proving in the liquidation.

(3) The evidence indicated that D had not been aware, at the material time, that the sale proceeds from the assets should not be paid into an overdrawn account that he was personally guaranteeing, but he had been aware of the implications when he caused the company to repay the £500,000 loan.

(4) D had not been involved in an insolvency previously and, as a layman, he would have needed professional advice and would not have appreciated that, even where a company had only one bank account, and the company was the person that had owned the assets and, thus, that should have been paid for the assets, the purchase monies should not have been paid into an account which the sole director had personally guaranteed.

(5) The insolvency practitioner who had been consulted by D had suggested that she had given professional advice to D regarding the payment and that he had ignored this advice. However, this allegation had first been made in January 2012 and it was unlikely that her memory would have been clearer at that time than at the time of the creditors' meeting or her report to the Insolvency Service. A responsible insolvency practitioner would have thought that a material matter to be mentioned in such a report. D's recollection of the substance of his meeting with the insolvency practitioner was to be preferred, since it was an unusual event for him, rather than a run-of-the-mill meeting.

(6) Based, *inter alia*, on D's position as novice within the insolvency process; the insolvency practitioner's agreement that a director would not know, without advice, about paying sale proceeds into the intended liquidator's client account or asking the bank to open a separate account to pay the money into; and D's direct evidence that he did not know that he should not pay the sums into the overdrawn account, his

actions did not render him unfit to be a director, even though his actions had resulted in the overdraft being wiped out and his personal guarantee being reduced to zero, to his own benefit and that of the bank. D had made the payment innocently in circumstances where professional advice was needed to avoid the pitfall and where he had taken professional advice but this had not included advice regarding the pitfall, and where he was trying to keep the company afloat by buying the assets, which would put money into the company. The correct arm's length value had been paid for the assets and he had left the assets where they were so that the company could continue to use them, even though they were now owned by another company. The first part of the payment had enabled the company's employees to be retained if the company's position improved in the new year, as D had hoped would be the case.

(7) The repayment of the loan had been a clear preference arranged by D with the sole intention of protecting himself. He had worried that the loan was unsecured and he had wanted to make it secured, knowing that the company was at risk of going under and his funds were, therefore, at risk. This had not been a payment made with the intention of saving the company but only with the intention of protecting D's own position. He had been in the same position as other unsecured creditors when he had made the loan and it had been wrong, when the company had started to go under, to protect his payment before theirs. Although it had been contended that the payment had a neutral effect, because the payment had increased the overdraft that D had guaranteed, D would not have arranged the repayment if he did not think there was going to be a benefit to him.

(8) D's conduct had fallen below the level of commercial probity that could reasonably be expected of a director who was trading with the benefit of limited liability. The level of preference had been large. However D had not been actively dishonest. He had been trying to save the company and he had not drawn excessive remuneration. He had paid approximately £1 million for assets which had remained with the company for its own use. No allegations of improper record keeping had been made and D had tried to act properly by taking advice. A disqualification order for a period of five years would be made against D.

(9) Approving and applying the guidance in *Mithani: Directors' Disqualification* at VII[21] ff, the appropriate order for costs was that D should pay 35% of the costs of the Secretary of State to reflect the above matters.

Mathew Weaver (*instructed by Wragge and Co LLP*) *for the claimant.*

Tom Gentleman (*instructed by Neil Davies & Partners LLP*) *for the defendant.*

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