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Disqualification Newsletter

Newsletter Editor
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Dear Subscriber,

This Newsletter contains summary reports of five recent decisions on directors' disqualification. The first case involves an abrogation of all directorial responsibilities by a wife. This lack of activity was held to amount to unfit conduct pursuant to CDDA 1986, s 6, and led to the imposition of a two-year disqualification order against her (*Secretary of State for Business, Innovation and Skills v. Ferdousi Reza*).

The second case involves a long and detailed judgment by District Judge Watson concerning a failure to keep, maintain and/or preserve and/or deliver adequate accounting records as well as a failure to comply with statutory obligations to make payments and returns to HMRC with regard to VAT, Corporation Tax, PAYE and NIC, resulting in the imposition of a disqualification order of nine years (*Secretary of State for Business, Innovation and Skills v. Mr Pervez Akhter*).

The third case concerns a large fraud and failure to pay VAT liability leading to the imposition of a disqualification order for the maximum period of 15 years under CDDA 1986, s 6 (*Re Autogas* (*Europe*) *Ltd, Secretary of State for Business, Innovation and Skills v De Bont*).

The fourth case is a Scottish decision by Sheriff Braid of the Haddington Sheriff Court. The case concerned a failure to deliver adequate books and records of the company to the liquidator that in turn hampered the liquidator's investigation, inter alia, into payments made to the ex-wife of the director totalling £214,000 (*Secretary of State for Business, Innovation and Skills v. Jeromson*).

The fifth and final case involved an application for a disqualification order against a defendant who acted as a director whilst bankrupt in breach of CDDA 1986, s 11. Mrs Registrar Barber dismissed the claim holding that, on the facts, the defendant was not unfit (*Secretary of State for Business, Innovation and Skills Secretary of State for Business, Innovation and Skills v. Spyros Ioannou Melaris*).

There has been some interesting policy development news since the last edition of this Newsletter that has led to legislative change in the field of early discharge in bankruptcy. Early discharge from bankruptcy allows a bankrupt to be discharged in less than one year if the Official Receiver files a notice with the court stating that an investigation of the conduct and affairs of the bankrupt is unnecessary or concluded – see IA 1986, s 279(2), considered at length in *Mithani: Directors' Disqualification at III[1226] ff.* The Enterprise and Regulatory Reform Act 2013 (section 73 and Part 3 of Schedule 21) repeals the early discharge provision – the suggestion for its repeal having been made by the editors of the main work. For any bankruptcy order made on or after 1 October 2013, a bankrupt will be automatically discharged after 12 months providing his discharge has not been suspended. Early discharge will no longer apply to these cases. The repeal is not retrospective. All bankruptcy orders made up to and on 30 September 2013 will remain eligible for consideration for early discharge after 1 October 2013. Official Receivers will continue with their present practice when considering early discharge in these cases.

Finally, the Newsletter editor has recently published an article in an Australian journal that readers may find of interest particularly as there is a companion piece by Dr. Chris Symes exploring the Australian directors' disqualification regime – see further Tribe, J. *The Disqualification of Company Directors: Background to the Regime and Some Recent Reform Activity in the United Kingdom* (2013) Australian Insolvency Law Bulletin (forthcoming).

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 in general. Letters which raise issues of general interest may be published in this 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 Leamington House Ltd, Secretary of State for Business, Innovation & Skills v. Ferdousi Reza [2013] CSOH

Court of Session, Outer House, Lord Malcolm.

Directors' disqualification – unfitness – CDDA 1986, s 6 – abrogation of all duties as a director for 18 years – company's failure to pay £137,750 PAYE and NIC to HMRC – allowing the company to trade without paying tax.

The Secretary of State for Business, Innovation and Skills (the petitioner) sought a disqualification order pursuant to CDDA 1986, s 6 against Mrs. Ferdousi Reza (the respondent). The respondent was a director of Leamington House Ltd (the Company).

The Company became insolvent and was placed into administration. The Company's other directors included Humayan Reza, the respondent's husband. Mr Reza entered into a disqualification undertaking with the petitioner for a period of three years. The other director did not oppose the application, and Lord Hodge imposed a disqualification order against him for two years (see: [2012] CSOH 85).

The principal business of the Company was the operation of a nursing home. Mr Reza controlled the day-to-day financial affairs of the Company. For the tax years 2008/2009 and 2009/2010, the Company failed to make any payments to HMRC in respect of PAYE and NIC, which amounted to some £137,750 or thereabouts. The respondent knew, in principle, that the Company had an obligation to make payment of PAYE and NIC. However, she was unaware as to whether the Company had in fact complied with its obligations. The respondent had a series of health problems in the period from 2007 to 2010. However, those problems did not prevent her from performing the function and duties of a company director.

The petitioner sought the disqualification order on the ground that the respondent had allowed the Company to trade without paying tax. As a director, she was responsible for all aspects of the Company's business. She was obliged to acquire and maintain sufficient knowledge of the business to enable her to discharge her duties. However, she failed to comply with those duties. She took no part in the running of the Company, and left its affairs entirely to her husband.

HELD:

(1) The evidence given by the respondent and her husband clearly demonstrated that the petitioner's criticisms were justified. She was appointed a director when the Company was formed in 1991. She described her husband as the driving force behind the Company and its principal investor. She never took an active interest in the running of it. She did not attend company meetings. It was her husband and another director who met and made the business decisions.

(2) The respondent allowed the Company to trade without paying the tax liabilities. As a director, she was under an obligation to acquire and maintain sufficient knowledge of the business to allow her to discharge her duties as a director.

(3) The respondent's ill-health made no difference to her non-participation in the affairs of the Company. It played no causative role in what happened. It neither justified nor excused her failures. Over the whole of her 18 years in office as director, the respondent failed to carry out even the most basic of her duties. This neglect continued when the Company was in difficulties, and defaults occurred in respect of tax

liabilities. Throughout the time she was a director, she abdicated all interest in and responsibility for the Company's affairs, leaving them entirely to her husband.

(4) The court had to decide whether the director's past conduct, viewed cumulatively and taking into account any extenuating circumstances, had fallen below the standards of probity and competence for persons fit to be directors of companies: see *Re Grayan Ltd* [1995] Ch 241, per Hoffmann LJ at 253. The court could not shrink from its duty to disqualify a director who had fallen below the required standards.

(5) If a person accepted a directorship in a company and then abdicated all responsibility for the affairs of the company, that person had, on any common sense view, demonstrated that he was unfit to be a director of a company. The public interest demanded that a director of a company took an active interest in the affairs of his company, and was mindful of his personal responsibility for the proper running of the business of the company. Part of the court's task was to reflect that public interest and deter others from mistakes such as those made by the respondent. Her case was not one of delegation, but of abdication of responsibility. By virtue of sheer inactivity in office as a director of the Company, the respondent has been guilty of conduct which plainly made her unfit to be concerned in the management of a company. A disqualification order for a period of two years would be made against the respondent.

Mr D. Thompson (instructed by Burness, Paull & Williamson LLP) for the petitioner.

Mr Logan (instructed by Campbell Smith WS LLP) for the respondent.

Re Intouch Mail Systems Ltd, Secretary of State for Business, Innovation and Skills v. Pervez Akhter

Northampton County Court, District Judge Watson, 14 February 2013.

Directors' disqualification – unfitness – CDDA 1986, s 6 – failure to keep, maintain and/or preserve adequate accounting records – failure to deliver records to the administrator – failure to comply with statutory obligations to send payments and returns to HMRC with regard to VAT, Corporation Tax, PAYE and NIC.

The Secretary of State for Business, Innovation and Skills brought an application for a disqualification order pursuant to CDDA 1986, s 6 against the Defendant, Mr Pervez Akhter. The application concerned the Defendant's conduct as director of a company, Intouch Mail Systems Limited ("Intouch"). Intouch entered into a company voluntary arrangement (CVA) on 6th April 2009, administration on 10th September 2009 and creditors' voluntary liquidation on 14th May 2010.

The Secretary of State alleged that the Defendant's conduct made him unfit to be concerned in the management of a company in two respects: (a) first, in the period from at least 1st April 2008 to 10th September 2009 (the date of

administration), as a director of Intouch, the Defendant had failed to keep, maintain and/or preserve adequate accounting records or, alternatively, had failed to deliver up such records to the administrator. As a consequence, it was not possible to account for company expenditure totalling £190,565, to verify that such payments were made in the ordinary course of the business of Intouch and/or to account for the book debts of Intouch; and (b) second, from at least 31st October 2006 (when the VAT liability in respect of the quarter ended 30th September 2006 fell due) to 10th September 2009 (the date of administration), the Defendant had failed to ensure that Intouch complied with its statutory obligations to make payments and returns to HMRC with regard to VAT, Corporation Tax, PAYE and NIC, as a result of which a total indebtedness of some £282,346 became due and owing to HMRC. In addition, as a result of these failures, from 10th April 2008, the Defendant had caused Intouch to be in breach of the CVA that it had entered into.

The Defendant contended that he had encountered problems with the Sage accounting system that Intouch used for its accounting records. These problems had caused the accounting data to become corrupted. In addition, the Defendant contended that as a result of Intouch's landlord's repossession of the premises that Intouch occupied, both electronic and paper records relating to Intouch were lost.

HELD:

(1) There had been a problem with Sage. It had corrupted data, but that data had been restored, or if it was not fully restored, it could have been restored, as was clear from the documentary evidence and the fact that at least the year ended 2008 records were restored to the point that it was possible for the accounts for that year to be signed off and filed. There was no reason why the historical issues with Sage meant that adequate records could not be kept after July 2008 using Sage. Even if there had been a continuing problem, the Defendant, who was well aware of the problem, could and should have made alternative arrangements to ensure the records were kept. The issues with Sage did not prevent the Defendant from complying with his obligations.

(2) There was no truth in the allegation that any documents, computer or server were removed from site by the landlord. These items were neither removed by the landlord nor by any other person. They were either were removed by the Defendant and his colleagues, or were destroyed by him.

(3) The Defendant had failed to ensure that Intouch had complied with its statutory duty to file returns over a prolonged period. The Defendant was in breach of his duties as a director pursuant to the Companies Act 2006, and in breach of his duties to provide information to the administrator under the Insolvency Act 1986. The consequences of his failures made it impossible to ascertain the true financial state of the Intouch, or to ascertain whether transactions entered into on its behalf were for its benefit or in its interest. Transactions adding up to

substantial sums had been entered into by Intouch, which could not be explained, in circumstances where very substantial amounts were due and owing to HMRC and to Intouch's other creditors.

(4) The conduct of the Defendant made him unfit to be concerned in the management of a company. He would be disqualified for a period of nine years.

Mr Shepherd (instructed by Howes Percival) for the Secretary of State.

Mr Booth QC and Mr Ensaff (instructed by Simon Burn Solicitors) for the Defendant.

Autogas (Europe) Ltd, Official Receiver v De Bondt

High Court of Justice, Chancery Division, Companies Court, Chief Registrar Baister, 27 March 2013.

Directors' disqualification – unfitness – CDDA 1986, s 6 – failure to discharge VAT liability – fraud.

The Official Receiver sought a disqualification order against Mr. Marc Henri De Bondt (the First Defendant), arising from the demise of Autogas (Europe) Limited ("Autogas Europe" or "the Company"). Autogas Europe was incorporated on 1 May 2002. The Company traded as a petrol station until July 2009 from which point it submitted nil VAT returns. It had been registered for VAT from 29 April 2003. The VAT default period occurred when the Company traded in carbon and electricity credits, a complete change of business. The Company was wound-up on 11 August 2010. The Official Receiver contended that the First Defendant had been a *de facto* director before he became a *de jure* director.

The allegation of unfitness was essentially one of fraud. It was alleged by the Official Receiver that between 12 March 2010 and 11 June 2010, or alternatively between 27 April 2010 and 11 June 2010, the First Defendant caused Autogas Europe to trade in a manner preventing it from being able to discharge its liability for VAT. In relation to the Company's trading between 12 March 2010 and 11 June 2010, Autogas Europe bought and sold credits. It made 115 deals for electricity and 26 deals for carbon credits. The VAT liability incurred for output tax for the electricity (carbon credits were zero rated) was never paid by the Company. The Company failed to submit any returns from June 2010 onwards. HMRC petitioned for a VAT debt of £6.8m.

In the midst of this trading, no VAT was paid and no provision for VAT was made, even though the sums involved were substantial. Transfers were made to third parties in circumstances where the VAT would deliberately be left outstanding. This was a species of fraud that was well known to the Court, involving a high volume of trade and no obvious purpose for a company conducting it. There was no conceivable reason why the Company should have been involved in these transactions. The end result was a substantial loss of VAT to HMRC because the sums generated by the Company had been paid elsewhere.

HELD:

(1) The First Defendant ran the Company from the earlier date but, in reality, whenever he started running the Company, it made very little difference to the outcome of the case against him. The First Defendant was aware of the Company's affairs before his appointment.

(2) The First Defendant was plainly unfit. The prevalence of this type of fraudulent activity meant that the appropriate period was one within the top bracket. The First Defendant's conduct warranted the imposition of a disqualification order for the maximum period of 15 years under CDDA 1986, s 6.

Ms. Lucy Wilson-Barnes (instructed by Howes Percival) for the Official Receiver

The Defendant did not appear and was not represented

Re Jonathan Masters Property Limited, Secretary of State for Business, Innovation and Skills v. Jon Jeromson.

Sheriffdom of Lothian and Borders at Haddington, Sheriff Braid, 13 March 2013.

Directors' disqualification – unfitness – CDDA 1986, s 6 – failure to deliver adequate books and records of the Company to the Liquidator thus hampering the Liquidator's investigation into the bona fides of payments made by the company – payments included payments to ex-wife totalling £214,000.

The Secretary of State for Business, Innovation and Skills sought a disqualification order against Jon Jeromson (the defender) for unfitness under CDDA 1986, s 6. The defender was a director of Jonathan Masters Property Limited (the Company).

The conduct of the defender which formed the basis of the application was that he had failed to deliver to the Company's liquidator adequate books and records of the Company, despite being repeatedly requested by her to do so. His failure to do so had hampered the Liquidator in her administration of the Company's affairs; in particular, she was unable to verify whether certain transactions were bona fide. Those transactions comprised, in the main, payments to his ex-wife, totalling £214,000. The transactions also included payments to or for the benefit of the defender's son and other associates. All of these payments were made at a time when creditors of the Company were not being paid.

The defender contended that the payments to his ex-wife were in part repayment of a loan made by her for a racehorse. He no longer had the horse. He also averred that the other payments were also for loan repayments. The failure to make available the Company's books and records rendered further investigation into these and other impossible. No explanation had been forthcoming as to why certain creditors had been repaid at a time when other creditors were going unpaid.

HELD:

(1) The defender had failed in his duty either to keep or maintain proper accounting records, or to deliver the accounting records to the liquidator. The failure to do so had severely restricted the liquidator's ability to investigate the validity of the payments made to his ex-wife, son and other associates.

(2) There was clearly a question mark over the bona fides of the payments made by the Company to the ex-wife, son and other associates. There had been a clear breach of the standards of commercial morality, and the public clearly require protection from the defender.

(3) The failure to keep or deliver accounting records had a serious detrimental effect on the Company and its creditors. The conduct of the defender fell within the mid-range of the middle category of disqualification periods set out in *Re Sevenoaks Stationers* (*Retail*) *Ltd* (1991) Ch. 164. The defender would be disqualified for a period of seven years.

Ms MacDonald appeared for the Secretary of State.

The Defendant did not appear and was not represented.

The Secretary of State for Business, Innovation and Skills v. Spyros Ioannou Melaris

High Court of Justice, Chancery Division Companies Court, Mrs Registrar Barber.

Directors' disqualification – unfitness – CDDA 1986, s 6 – acting as a director whilst bankrupt in contravention of CDDA 1986, s 11.

The Secretary of State for Business, Innovation and Skills sought a disqualification order against Mr. Spyros Ioannou Melaris (the Defendant) under CDDA 1986, s 6 in respect of his conduct as a director of Waterfall Media Limited (the Company).

The Secretary of State alleged that the Defendant was unfit because he had acted as a director of the Company between the periods 24 October 2002 to 15 November 2005 and 1 August 2007 to 10 July 2009 whilst he was an undischarged bankrupt in breach of CDDA 1986, s 11. The Defendant accepted that he had acted as a director whilst he was an undischarged bankrupt during those periods. However, he disputed that, on the facts, his conduct made him unfit to be concerned in the management of a company.

The court noted that the effect of section 11(1) was that a bankrupt was, inter alia, automatically prohibited from acting as a company director without the permission of the Court for so long as he remained un-discharged, and that he committed an offence if he acted in breach of that prohibition. The court also noted that the offence was one of strict liability. However, the Defendant argued that at the time of taking up his appointment as director of the Company in 2002, he did not know that he was an undischarged bankrupt. It was not until approximately 2007 that he was even aware of the possibility

that he might be an undischarged bankrupt, and that even then, having made numerous enquiries of both the Official Receiver's office and the Trustee in Bankruptcy, the position remained confused. He asserted that having discussed the matter with various people at the Official Receiver's office on numerous occasions over the course of 2007 to 2008, he was left wholly unaware that he was doing anything wrong in continuing to be a director of the Company.

HELD:

(1) The Defendant was not unfit merely by reason of having acted as a director of the Company when he was prohibited from doing so as a result of being bankrupt. An individual who committed a strict liability offence under section 11, as the Defendant had done, was not thereby, without more, rendered 'unfit' for the purposes of section 6.

(2) the court was satisfied, on a balance of probabilities, that the Defendant had not been served with a copy of the bankruptcy order, and that he had genuinely not appreciated in 1994, or indeed at any time up until 2007 at the earliest, that he had been made bankrupt.

(3) Having heard nothing from the Official Receiver and having, in the meantime, encountered no difficulties at all with his credit-rating, or in gaining credit or opening bank accounts, at any time before taking the appointment as director of the Company in 2002, some 8 years after the bankruptcy order was made, wholly ignorant of the fact that his discharge had been suspended, it was incorrect to say that the Defendant had shown either a lack of probity, or incompetence to a marked degree, in being a director of the Company.

(4) The Defendant could have sought specialist legal advice as to the consequences of bankruptcy, and in particular as to whether it carried with it any prohibitions relevant to him. He could, however, be excused for believing that if there were any such prohibitions, the Insolvency Service would have appraised him of them during one of his many, conversations with them or sent him a standard issue information pack relating to bankruptcy. Those steps were not taken.

(5) Whilst the Defendant may be said to have demonstrated a degree of incompetence and perhaps naivety in relying upon the Insolvency Service to tell him what he needed to know, such incompetence was not of a 'high' or 'marked' degree. It was an honest and wholly understandable error which fell firmly within the realm of 'oversight or ignorance'. It did not warrant a finding of unfitness. The claim would accordingly be dismissed.

Mr. Daniel Burton (instructed by Howes Percival LLP) for the Claimant

The Defendant appeared in person

Case Law Update