

Directors in the
Dock
Restrictions and
Disqualification

DILLON  EUSTACE

DUBLIN CORK BOSTON NEW YORK TOKYO

DIRECTORS IN THE DOCK – RESTRICTIONS AND DISQUALIFICATION

Introduction

The culture of corporate enforcement has become a very real issue for directors. In the last two years in particular there has been an increase in the number of directors who have found themselves in the High Court facing applications to restrict or disqualify them for various breaches of the Companies Acts or their general duties as directors. A restriction or disqualification order obviously has extremely serious implications for a director and any company they are involved in. This article looks at the two relevant sections of the Companies Acts and the approach taken by the Courts.

The Company Law Enforcement Act 2001 requires a liquidator of an insolvent company to report to the Director of Corporate Enforcement and then to apply to the High Court for the restriction of each of the directors of the company, unless the Director of Corporate Enforcement has relieved the liquidator of the obligation to apply. If a liquidator does not do so he is guilty of an offence. The provisions relating to liquidators apply equally to receivers. Therefore, the likelihood of directors appearing in Court has increased significantly.

Restrictions

Section 150 of the Companies Act 1990 (“the Act”) allows the Director of Corporate Enforcement, a liquidator or a receiver to apply to have a person who was a director or shadow director of an insolvent company within 12 months prior to its winding up, restricted from being appointed or acting in any way, whether directly or indirectly, as a director or secretary or being concerned or taking part in the promotion or formation of any company unless that company meets certain requirements relating to share capital. The names of restricted directors are kept in a register maintained in the High Court.

This does not apply where a person was a director simply because he was nominated by a financial institution as part of a credit facility (provided that the financial institution has not obtained a personal guarantee from a director of the company) or where a person is a director as nominee for a venture capital company in connection with a share purchase.

The application is based on an affidavit sworn by the liquidator setting out all the facts he considers should be brought to the attention of the Court for the purpose of determining whether the director has acted honestly or responsibly in relation to the conduct of the affairs of the company or whether there is any other reason for which it would be just and equitable to restrict the director. If the director wishes to contest the application, he must file an affidavit setting out his reasons for contesting the application.

Mandatory Period

The Court must impose a five year restriction unless the director can convince the Court that he acted honestly and responsibly in relation to the conduct of the affairs of the company and that there is no other reason why it would be just and equitable that he should be subject to the restriction. The onus of establishing that he acted responsibly rests on the director. The Court has total discretion in respect of ordering any party to pay costs and in some cases may make no order so that all sides pay their own costs which could mean that a director who successfully defends an application may still have to pay his own costs. Where a restriction order is made the director may have to pay not only the costs of the application but also any costs incurred by the liquidator in investigating the matter. In some cases the Court has ordered a director to pay the costs but has measured the level of costs at a figure significantly less than the actual costs.

It is important to bear in mind that the principal purpose of the Act is to protect the public against the future conduct of companies by persons whose past record as directors of insolvent companies has shown them to be a danger to creditors and others, rather than to punish the individual director. If a liquidator or a receiver believes that the interests of a company or its creditors are being put at risk due to the fact that a restricted director is acting directly or indirectly as a director or is taking part in the promotion or formation of that company then he must inform the Court immediately and if he fails to do so he is guilty of an offence.

The Courts' Approach

While some of the cases which have come before the Courts have involved dishonesty, this is not always the case and the Courts are frequently asked to decide whether a director acted responsibly. While each case will be decided on its own circumstances, it is possible to distil from the decisions a scheme or set of criteria against which the conduct of directors will be assessed.

For a restriction order to be made the conduct would need to go beyond simply making bad commercial decisions and would have to tend towards gross negligence or incompetence. The Courts will require the liquidator to show a lack of commercial probity on the part of the director. While, by definition, a director's actions will be scrutinised with the benefit of hindsight, Judges are keenly aware of the dangers this creates.

In deciding these cases, the Court will examine the extent to which a director has complied with the obligations imposed by the Companies Acts or under the law generally. An important factor in this regard would be the extent to which there were proper books and records so as to enable the liquidator to investigate the affairs of the company.

The Court would consider whether the director's conduct could be regarded as so incompetent as to amount to irresponsibility and the extent of the director's responsibility for the insolvency of the company or the deficiency in assets disclosed at the date of the winding up or thereafter. It would not be sufficient for a director to say that these were the responsibility of his co-directors and that he presumed that all was being attended to. Each director has a personal duty to act responsibly, with his fellow directors and must satisfy himself with certainty that proper books and records are being kept and that the company's affairs are being properly supervised and controlled. This may be delegated to suitably senior staff but the director himself must be sure that all matters of that kind are looked after and being attended to as required.

A restricted director may within not more than one year after a declaration has been made, apply to the Court for relief from some or all of the restriction. If a director intends to apply, he must notify the liquidator (if any) of the insolvent company and the liquidator must immediately notify such creditors and contributories of the company about the application. The liquidator or any creditor or contributory of the company may appear and give evidence. A question for the liquidator in considering whether to participate in such applications is whether the costs associated with participating can be justified, particularly to creditors.

If relief is granted the register of restrictions will be amended accordingly. Particulars of restrictions are removed from the register after five years.

Disqualification

In addition to the provisions of Section 150, directors need also be aware of the possibility of an application being brought under Section 160 which would seek a disqualification. A disqualified person could not act as an auditor, director or other officer, receiver, liquidator or

examiner or be concerned in any way, directly or indirectly in the promotion, formation or management of any Company. Section 160 applies where a person is convicted of an indictable offence in relation to a company or involving fraud or dishonesty. There are other specific incidences which may trigger an application for a disqualification order. These essentially involve allegations of serious wrong-doing by a director which would render him unfit to be concerned in the management of a Company.

There have been a number of applications under Section 160 which have arisen out of reports of Court-appointed inspectors. The most notable examples are applications arising from the Ansbacher Report and the Report of the Inspectors into NIB. Some of these are still presently before the Court. In two of these cases which have been decided the directors did not contest the applications. However, those cases give a clear indication of the approach to be taken by the Court. Again the main purpose of the section is the protection of the public rather than punishment of the director. However, the Courts recognise the serious implications for the individual director and will approach the case so as to protect the right of the director to a full and fair hearing.

A difficulty which can arise is that the application to restrict may be made many years after the events have happened and in some cases directors may argue that they are hampered in their defence by the unavailability of witnesses or other evidence. In such cases the Court will have to consider whether justice can be done if the case is to go ahead.

The onus of proof in disqualification cases is on the applicant and not the director even where the director consents the applicant still has to establish the facts. The Court has a discretion about the 160 Order but not the 150 Order.

If a Court decides to disqualify a director it will then have to consider the appropriate duration of the disqualification. There are no minimum or maximum periods in the Act and a Judge could decide to restrict under Section 150 rather than disqualify under Section 160.

The Courts recognise the need to have a deterrent effect and will want the period of disqualification to reflect the seriousness of the misconduct and will take into account any mitigating factors on the director's behalf. The trend emerging from recent cases is that the period of disqualification is likely to be in excess of five years but not more than ten years except in the most serious cases. The Court is likely to take account of whether the director admitted the misconduct and the attitude he adopted in the course of the case. The Court will not usually get involved in examining the periods imposed in other cases since each particular case should be judged on its own particular facts.

Conclusion

As can be seen, the Courts have shown a willingness to support the aims of the Company Law Enforcement Act 2001 and in addition the Director of Corporate Enforcement has reported a very significant increase in the number of disqualification orders made, up to 21 in 2005 from only 3 in 2004. The ODCE is seeking to increase its staff and to target new areas for compliance and enforcement. Directors need to be aware of the onerous duties imposed on them and they need to take all possible steps to conform to the acceptable standard. The responsibility is personal and directors need to be vigilant to protect the interests of their company and thereby to protect their own interests.

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Author: John Doyle

CONTACT US

Our Offices

Dublin

33 Sir John Rogerson's Quay,
Dublin 2,
Ireland.
Tel: +353 1 667 0022
Fax.: +353 1 667 0042

Cork

8 Webworks Cork,
Eglinton Street,
Cork, Ireland.
Tel: +353 21 425 0630
Fax: +353 21 425 0632

Boston

26th Floor,
225 Franklin Street,
Boston, MA 02110,
United States of America.
Tel: +1 617 217 2866
Fax: +1 617 217 2566

New York

415 Madison Avenue
15th Floor
New York, NY 10007
United States
Tel: +1 646.673.8523
Fax: + 1 646.683.8524

Tokyo

12th Floor,
Yurakucho Itocia Building
2-7-1 Yurakucho, Chiyoda-ku
Tokyo 100-0006, Japan
Tel: +813 6860 4885
Fax: +813 6860 4501

e-mail: enquiries@dilloneustace.ie
website: www.dilloneustace.ie

Contact Points

For more details on how we can help you, to request copies of most recent newsletters, briefings or articles, or simply to be included on our mailing list going forward, please contact any of the team members below.

John Doyle

e-mail: john.doyle@dilloneustace.ie
Tel : +353 1 667 0022
Fax: + 353 1 667 0042

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DILLON  EUSTACE

DUBLIN CORK BOSTON NEW YORK TOKYO

33 Sir John Rogerson's Quay, Dublin 2, Ireland.
www.dilloneustace.ie

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