

Equitable Compensation Workshop

Company Directors' liability for Equitable Compensation

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Remedies against company directors for breach of duty

- Section 178 Companies Act 2006

“the consequences of a breach (or threatened breach) of ss.171 to 177 are the same as would apply if the corresponding common law rule or equitable duty applied”; and

“the duties in those sections (with the exception of s.174 (duty to exercise reasonable care, skill and diligence)) are, accordingly, enforceable in the same way as any other fiduciary duty owed to a company by its directors”

Directors' Fiduciary Duties

- S.171 Companies Act 2006 – “A director of a company must – (a) act in accordance with the company’s constitution, and (b) only exercise powers for the purposes for which they are conferred.”
- Cf the duty to avoid conflicts of interest – s.175
- Are they both “fiduciary duties” properly so-called?
- Does it matter?

EQUITABLE REMEDIES IN COMMERCIAL LITIGATION

Re Paycheck Services 3 Ltd: HMRC v Holland [2010] 1 WLR 2793 (SC(E)); [2010] Bus LR 259 (CA)

Facts

- 42 Composite Companies
- Contractors were employees and shareholders of these companies – paid mainly by dividends
- Scheme to ensure companies only liable for small companies corporation tax rate
- However, scheme flawed and companies actually liable for higher rate corporation tax
- Once realised, companies could not lawfully pay dividends
- But carried on for 2 months – during which time paid £1.5m of unlawful dividends
- Are directors liable for:
 - (a) £1.5m – full amount of unlawful dividends
 - (b) £144,000 – being the higher corporation tax due in 2 month period
 - (c) Nothing – on basis that companies did not actually suffer any loss

Supreme Court falling out

Lord Walker had the following (rather rude) things to say about the majority's judgments:

- “the court’s decision will, I fear, make it easier for risk averse individuals to use artificial corporate structures in order to insulate themselves against responsibility to an insolvent company’s unsecured creditors” (para 101)
- “In a section of his judgment headed “Mr Holland’s case” (there is no parallel section considering the appellant’s case) Lord Hope DPSC observes (para 41) “the facts of this case do not precisely match those of *Hydrodam*”. That is, with respect, a considerable understatement.” (para.113)
- The majority’s conclusion was “the most arid formalism” (para.115)
- Lord Collins’ theory has “some element of putting the cart before the horse in looking for a fiduciary duty before looking at what Mr Holland did...” (para 121)
- And the final coup de gras: “Lord Saville’s brief judgment overlooks the important difference between” (para 123).

What did the Supreme Court decide?

- Of the 9 judges who dealt with this:
 - (a) 3 (Rimer LJ and Lords Walker and Clarke) went for the full £1.5m
 - (b) 4 (trial judge; Elias and Ward LJJ; Lord Hope) thought it should be limited to £144,000
 - (c) 2 (Lords Collins and Saville) did not opine on the matter
- Therefore, it is arguable, just looking at the Supreme Court, that there is 2-1 in favour of £1.5m.

Breach of duty

- Two distinct lines of authority on whether liability is strict or fault based:
 - (a) strict – *Flitcrofts Case* [1882] 21 Ch D 519; *Re Lands Allotment* [1894] 1 Ch 616; *re Loquitur Ltd* [2003] 2 BCLC 442
 - (b) fault – *Re County Marine Insurance Co* [1870] LR 6 Ch App 104; *Re Kingston Cotton Mill Co (No 2)* [1896] 1 Ch 331; *Dovey v Cory* [1901] AC 477
- Lord Hope said (para.47):

“the better view seems to me that in cases such as this, where it is accepted that the payment of dividends was unlawful, a director who causes their payment is strictly liable, subject of course to his right to claim relief under the statute.”

Correct measure of recovery

- Rimer LJ:

“the basic remedy is one of restitution. That is because directors of a company, if not trustees in the strict sense (because its assets are not vested in them), owe a like duty as a trustee not to misapply the company’s assets and a like duty to make restitution to the company if they do.” (para. 96)

“I agree with the Judge that the established remedy against a director liable in respect of the payment of an unlawful dividend is to require the director to reinstate the amount of the payment. The court does not in such a case embark upon an inquiry as to the loss said to be suffered by the company as a result of such breach of duty.” (para. 98)

- Lord Hope agreed (para. 49):

“I agree with the Court of Appeal that the obligation is to restore the moneys wrongfully paid out. This as the deputy judge accepted, is the established remedy. Where dividends have been paid unlawfully, the directors’ obligation is to account to the company for the full amount of those dividends: see *Bairstow*.”

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The width of the discretion in s.212 Insolvency Act 1986

- Section 212 (similar to s.341 Singapore Companies Act)

(1) This section applies if in the course of the winding up of a company it appears that a person who – (a) is or has been an officer of the company... has misapplied or retained, or become accountable for, any money or other property of the company, or been guilty of any misfeasance or breach of any fiduciary or other duty in relation to the company...

(3) The court may, on the application of the official receiver or the liquidator, or of any creditor or contributory, examine into the conduct of the person falling within subsection (1) and compel him – (a) to repay, restore or account for the money or property or any part of it, with interest at such rate as the court thinks just, or (b) to contribute such sum to the company's assets by way of compensation in respect of the misfeasance or breach of fiduciary or other duty as the court thinks just."

- Rimer LJ: “just as section 212 does not create new rights and obligations, nor in my judgment does it create new discretionary defences as to liability” (para. 110)
- Ward LJ: “since Rimer and Elias LJ have expressed their views, I offer my tentative conclusions secure in the knowledge that they can be disregarded henceforth as obiter dicta...[the court can] decide according to the justice of the case whether only a part of it should be repaid. The criterion for the exercise of the latter discretion is the justice of the case depending on all the circumstances of the case. I have no difficulty in considering justice to be a proper, principled guide to the exercise of

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Relieving provisions – s.1157 Companies Act 2006; s.61 Trustee Act 1925

- S.1157 Companies Act 2006

“If in proceedings for negligence, default, breach of duty or breach of trust against – (a) an officer of a company...It appears to the court hearing the case that the officer or person is or may be liable but that he acted honestly and reasonably and that having regard to all the circumstances of the case (including those connected with his appointment) he ought fairly to be excused, the court may relieve him, either wholly or in part, from his liability on such terms as it thinks fit.”

- Standard required for reasonableness:

(a) for company directors – must prove that their conduct was not “gross” or “pervasive and compelling” unreasonableness – see *Re D’Jan of London Ltd* [1993] BCC 646 and *Barings plc v Coopers & Lybrand* [2003] BCC 646.

(b) for trustees (s.61 Trustee Act 1925) – must prove not perfection but reasonable conduct connected with, though not necessarily causative of, the relevant loss – *Santander UK v RA Legal Solicitors* [2014] EWCA Civ 183

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