CHANCERY BAR

The Transparent Veil

The Department of Business, Innovation and Skills ("BIS") published a discussion paper in July 2013, entitled "Transparency & Trust: Enhancing the Transparency of UK Company Ownership and Increasing Trust in UK Business". The Chancery Bar Association ("ChBA") published its response on 16th September 2013. The Discussion Paper focuses on two areas. The first is greater transparency in the beneficial ownership of UK companies. The second is the improvement of transparency and accountability in relation to company directors, principally by enhancing the sanctions available against them.

This paper addresses the second area of focus and is largely based on the ChBA Response, which was written by Paul Marshall and the author of this paper, with the approval of the ChBA Committee.

The section of the Discussion Paper that deals with directors is itself divided into three major parts. The first relates to nominee directors, the second to corporate directors and the third to sanctions against directors.

Nominee directors are commonly found in trust structures. Often a company may be used as a vehicle for holding or dealing with property. One or more nominees hold the shares in the company. The directors may be corporate service providers or may be individual officers or employees of such providers. In neither case is there, at present, any formal means of disclosing either the nominee status of a particular director or the identity of the nominating party.

Apart from the lack of transparency, it is a sad fact that nominee directors are on occasion unaware that they owe fiduciary duties to the companies that they control.

Alternatively, they may believe that they are able to delegate the whole exercise of their discretion to the nominating party. The ChBA response suggested the twin approach of licensing nominee directors, so as to ensure at least a basic knowledge of their duties and requiring disclosure on the company register of the nominating party, which would also reveal the nominee status of the relevant director.

Corporate directors create problems of accountability and liability and recovery in the event of breach of duty. The Patton Committee and the Jenkins Committee identified the problem of accountability in 1962. As a practical matter, a corporate director must delegate the exercise of its functions to an officer or employee of the corporate director. Except by examining the minutes, it is impossible to tell who has the day-to-day control of the company. The problem of liability and enforceability is that it is often the case that a corporate director has few or no assets and the law is not clear as to the possibility of imposing a vicarious liability on the directors of the corporate director.

The ChBA agreed with the Jenkins Committee that the situation was unsatisfactory. It remains to be seen whether the intervening 50 years have led to any impetus for reform.

The section of the discussion paper dealing with sanctions is subdivided into a further three parts. The first relates to the assignment of causes of action arising under ss. 213 and 214 of the Insolvency Act 1986, which provide for remedies for fraudulent and wrongful trading. The second relates to the making of compensatory orders as part of proceedings under the Company Directors Disqualification Act 1986. The third relates to a proposed further matter to be taken into account when making a disqualification order.

Claims under ss. 213 and 214 of the Insolvency Act 1986 arise with a degree of frequency. However, they are subject to a number of inherent difficulties. Section 213, which relates to fraudulent trading, requires a liquidator to prove that a director acted with fraudulent intent – a high hurdle. In a s. 214 claim, it can be difficult to prove that there was no real prospect of avoiding insolvency. Further, the director may be able to show that he or she took sufficient steps to avoid loss to creditors.

Costs are also a factor in a liquidator's decision as to whether to start proceedings and whether and how far to continue them. At present, liquidators are able to fund claims by way of CFAs and ATE insurance. That may change in the future. In addition, liquidators have the assets of the insolvent company at their disposal – assuming that there are any.

Liquidators are also in a position to investigate claims thoroughly before instigating proceedings. They have powers to require the delivery up of books and records. The Insolvency Act also imposes a duty of cooperation on a wide range of persons.

While it is clearly BIS's objective to encourage more claims for the benefit of creditors and, perhaps, *pour encourager les autres*, it is not clear that the proposals will have the desired effect. There is no proposal to alter the criteria for successfully bringing a claim. Assignees of causes of action will not have the investigatory powers or be owed the duties of cooperation that permit liquidators to investigate claims. Assignees will be self-funding, so that their costs risk will be fundamentally different. That is likely, in turn, to reduce the price that a potential assignee might be willing to pay for a cause of action.

The ChBA Response was therefore not in favour of permitting the assignment of a cause of action. If causes of action were to be made assignable, the ChBA saw no objection to allowing the delinquent directors to purchase them. Such directors are likely to be highly motivated to do so. However, the ChBA recommended ensuring the transparency of any such transaction by requiring that any assignment of a cause of action be put to a vote of the creditors.

The next proposal was to empower the court to make a compensatory award in the context of disqualification proceedings against directors. At present, the range of remedies against directors is fairly limited. The liquidator may bring claims against directors under ss. 213 and 214 of the Insolvency Act 1986. In addition, there may be a claim against directors based on any breach of one of the duties that they owe to the company. It is important to note that the claimant in such a claim is the company. The principle of separate corporate liability prevents the members from making a claim against a director except in the limited circumstances of a derivative action. The creditors are in an even worse position, in that they are unable to bring derivative claims, even for the benefit of the creditors as a whole. The only potential recourse is under s. 212 of the Insolvency Act, which permits creditors to bring misfeasance claims against officers of the company and the liquidator.

It was envisaged by the Discussion Paper that the court would have the power, exercisable on a summary basis, to make a an order that the director subject to disqualification proceedings contribute a sum of money by way of compensation. The Discussion Paper left open the amount of any such payment and did not address the details as to who might benefit from it. The ChBA Response suggested that if the power were available, it was likely that the court would use it. Further, the Response suggested that the payment ought to be for the benefit of all creditors, subject to discretion to order otherwise.

However, the ChBA Response identified two difficulties, one conceptual and one practical. At a conceptual level, the proposal contemplates using a public power, namely the power to disqualify and make a compensation order, for a private end, namely the financial compensation of creditors. That is likely to be objectionable in itself, but the more so in a situation where a floating creditor –usually a bank – is likely to take the benefit of the order, subject only to the prescribed part under s. 175 of the Insolvency Act 1986. A further aspect is one that impinges directly on members of the ChBA. Solicitors and barristers who accept instructions to act for the Secretary of State in disqualification actions do so at public rates. The proposal contemplates private creditors taking the benefit of work done far below the market value.

The practical objection to the proposal is the effect that it might have on the ease of compromising disqualification proceedings. In common with other types of litigation, disqualification claims are often compromised. The mechanism for doing so is for the director to give an undertaking not to act as such for a specified period of time and, usually to pay the costs. If in addition to haggling over period and the incidence of costs, the parties had to agree on a level of compensation, the ChBA Response was concerned that the number of compromised cases would fall, thus placing an additional burden on public funds and on the court.

The last major proposal relating to sanctions was the proposal to amend Schedule 1 to the Company Directors Disqualification Act 1986. Schedule 1 contains a list of matters for the court to take into account in all cases (Part I) and in cases where the company is insolvent (Part II). Those matters, in summary, are as follows:

- Misfeasance or breach of fiduciary or other duty
- Misapplication or retention of company money or property
- Responsibility for entering into transactions set aside
- Responsibility for failure to comply with registration and records
- Responsibility for failure to supply returns
- Responsibility for insolvency
- Responsibility for failure to supply goods or services paid for
- Responsibility for entering into transaction post-winding up or at preference
- Responsibility for failure to call creditors' meeting in CVL
- Failure to supply statement of affairs etc.

To those matters, it was proposed to add "the wider social impact". The ChBA Response did not comment on that proposal, since it contained insufficient detail as to what was meant by "wider social impact" and how it might be applied. The phrase stands in contrast to the rigid and well-defined matters that populate the other paragraphs of Schedule 1.

In conclusion, the BIS Discussion Paper provides some valuable opportunities to increase the transparency of corporate affairs and the accountability of directors who are delinquent in their duties. The attention that has been focused on remedies against directors emphasises the difficulties faced by injured parties in obtaining compensation against the individuals who are ultimately to blame for losses suffered. It is noteworthy, however, that the emphasis is on transparency rather than permeability of the corporate veil.

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