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Directors' Duties During Administration and Liquidation

Robert Mundy

Administration; Corporate insolvency; Directors' powers and duties; Liquidation

Do directors owe their general duties once a company goes into administration or liquidation? This is an important question, affecting how willing directors may be to buy their company's business or assets from an administrator or liquidator.

The question arose in *Re System Building Services Group Ltd*.[1] In that case, ICC Judge Barber held that directors owe their general duties even after their company goes into administration or voluntary liquidation. That decision has been welcomed elsewhere.[2] This article argues—contrary to *System Building Services*—that once a company goes into administration or liquidation its directors owe only limited duties.

From the one who has been entrusted with much, much more will be asked

The general duties on directors, imposed by the Companies Act 2006 (CA 2006) ss.171–177, protect companies from directors misusing their powers. The "core duty", the duty under s.172, is to act in the way the director honestly thinks to be the company's best interests.[3] Buttressing that duty are the duty under s.171 not to exceed his powers, the duty under s.174 requiring due care and the duties under ss.173, 175, 176 and 177 designed to insulate the director from improper influence.[4]

Because the duties protect against directors misusing their powers, one would expect a close link between the extent of a director's powers and the extent of his duties. And that is so.

As one would expect, once a director leaves office, his duties largely end. The only duties that linger are identified in the CA 2006 s.170. Those are the duty under s.175 to avoid conflicts of interest "as regards the exploitation of any property, information or opportunity of which he became aware at a time when he was a director" and the duty under s.176 not to accept benefits from third parties "as regards things done or omitted by him before he ceased to be a director". The duty under s.175 prevents an ex-director abusing the privileges of his office even after he has left it. The duty under s.176 ensures that while a director is in office he is not swayed from proper performance because he hopes for a benefit after he leaves office. Aside from these duties, the ex-director is free to act in his own interests. He no longer owes any duty to prefer the company's interests over his own.

Even while he holds office, the extent of a director's duties is tied to the extent of his powers. This is because, as the courts have recognised for fiduciaries generally, the "scope of a fiduciary duty must be moulded according to the nature of the relationship" between fiduciary and principal.[5]

For directors, the tie between duties and powers is illustrated by *In Plus Group Ltd v Pyke*.[6] In that case, one shareholder-director effectively excluded the other, Mr Pyke, from management of a four-company group. The Court of Appeal held that, in the circumstances, Mr Pyke was released from his (assumed) duty not to set up a competing business. Brooke LJ reasoned that the Mr Pyke had been "effectively expelled from the companies".[7] Jonathan Parker LJ agreed, saying, that had Mr Pyke resigned, "his resignation would have done no more than reflect what had in practice already happened".[8] Sedley LJ explained that his

> "role as a director of the claimants was throughout the relevant period entirely nominal … in the concrete sense that he was entirely excluded from all decision-making and all participation in the claimant company's affairs".

In the circumstances, his duties had been "reduced to vanishing point".[9]

Directors' powers in administration and liquidation

If a company goes into compulsory liquidation, the directors' appointments are terminated automatically.[10] The former directors are free of their general duties, except those that linger under s.170.

If a company goes into voluntary liquidation, the directors do not lose their office but they do lose their powers. Their powers cease "except so far as the company in general meeting or the liquidator sanctions their

[1] *Re System Building Services Group Ltd* [2020] EWHC 54 (Ch); [2020] B.C.C. 345.
[2] Wright, "Re System Building Services Group Limited (in Liquidation)" (2021) Int. C.R. 73; Wood, "Directors' Duties Post Insolvency" (2021) 32 I.C.C.L.R. 371.
[3] *Madoff Securities International Ltd v Raven* [2013] EWHC 3147 (Comm) at [188] per Popplewell J; [2014] Lloyd's Rep. F.C. 95.
[4] See Conaglen, "The Nature and Function of Fiduciary Loyalty" (2005) 121 L.Q.R. 452.
[5] *Hospital Products Ltd v United States Surgical Corp* (1984) 156 C.L.R. 41 at 97, HC Australia per Mason J, approved by the Privy Council in *Kelly v Cooper* [1993] A.C. 205 at 214 (agents); [1992] 3 W.L.R. 936 and by the House of Lords in *Hilton v Barker Booth and Eastwood* [2005] UKHL 8; [2005] 1 W.L.R. 567 at [30] (solicitors). See also *University of Nottingham v Fishel* [2000] I.C.R. 1462 at 1491; [2000] I.R.L.R. 471 (employees).
[6] *In Plus Group Ltd v Pyke* [2002] EWCA Civ 370; [2003] B.C.C. 332.
[7] *In Plus Group* [2003] B.C.C. 332 at [76].
[8] *In Plus Group* [2003] B.C.C. 332 at [94].
[9] *In Plus Group* [2003] B.C.C. 332 at [90].
[10] *In Re Ebsworth & Tidy's Contract* (1889) 42 Ch. D. 23 at 43 CA. *Measures Brothers Ltd v Measures* [1910] 2 Ch. 248 at 256 CA.

continuance".[11] Similarly, if a company goes into administration, the directors stay in office, but are rendered powerless. They can no longer exercise any management powers except with the administrator's consent.[12]

Leaving aside the cases in which a director is permitted to exercise management powers, a director of a company in administration or voluntary liquidation is as powerless as a director of a company in compulsory liquidation. He ought to owe the same (minimal) duties.

Put another way, a director of a company in administration or voluntary liquidation is, like Mr Pyke in *In Plus Group*, a director "in name only".[13] With no management powers, his duties, like Mr Pyke's, ought to be minimal. There is no reason to treat a director whose powers are removed by the appointment of an insolvency practitioner differently than from a director whose powers are removed by the hostile acts of a co-director.

Of course, if a director is permitted to exercise management powers, he will be subject to the general duties of directors. He will owe a core duty, under s.172, to act in the way he honestly thinks to be the company's best interests, to the extent his powers allow him to act. So far as they relate to the powers he has, the director will owe the buttressing duties under s.171 and ss.173–177. But when not wearing his director's hat, he will not owe those duties. So he will be free to act in his own interests when voting as a creditor or contributory,[14] or deciding whether to resign.[15] Likewise, he ought to be free to act in his own interests when acting as the company's counterparty.

System Building Services

System Building Services was a case about an officeholder selling company property to the company's director.

The company went into administration in the summer of 2012. The administrator appointed was Gagen Sharma, later to be found to have committed misfeasance in an unrelated case.[16]

Among the company's assets was a two-bedroom house in Billericay, bought as accommodation for its director and subcontractors to use when they needed it. Shortly after she was appointed, Mrs Sharma had the house valued. She was told it was worth £195,000.

A few months later the company's director, Mr Michie, agreed "in principle" to buy it for a price reflecting it "proper value", with no specific price being agreed. Mrs Sharma did not progress the sale for several months.

By the summer of 2014, the company had moved from administration into creditors' voluntary liquidation and the mortgage lender was pressing for its sale. Mr Michie then offered to buy the house for £120,000. Without haggling, Mrs Sharma accepted the offer. She did not draw up a sale contract but, once the price had been paid, she conveyed the house to the director. In 2016, the company was dissolved.

In 2017, after Mrs Sharma was found to have committed misfeasance, the company was restored to the register and another insolvency practitioner, Stephen Hunt, was appointed as liquidator in her place. After investigating the sale, Mr Hunt sued for an order unwinding the sale. Perhaps because Mrs Sharma was bankrupt, Mr Hunt sued only Mr Michie.

Mr Hunt might still have based his claim on Mrs Sharma's conduct. As liquidator, she had owed the company a fiduciary duty to act in good faith: to act in the way she considered would best serve the company.[17] It was arguable that she had breached this duty by selling the house for £120,000, knowing an expert had valued it at £195,000. If she had breached the duty, and Mr Michie's knowledge was such as to "make it unconscionable for him to retain the benefit of the receipt", Mr Michie would be liable for knowing receipt.[18] It was arguable Mr Michie knew enough about the breach to render unconscionable his receipt of the house at an undervalue: he knew that he was getting the house at a significant undervalue and he "had a lot to do" with Mrs Sharma.[19] In other words, Mr Hunt might have alleged primary liability against Mrs Sharma and secondary liability against Mr Michie. Mr Hunt could have done so without joining Mrs Sharma as a party.

Rather than sue Mr Michie for knowing receipt, Mr Hunt sued him for breach of his own duties. He said that Mr Michie owed the duties under the CA 2006 ss.171–177 even after the company went into administration and voluntary liquidation and that Mr Michie had breached the duty under s.172 to promote the success of the company.

In his points of defence, Mr Michie accepted that he owed the duties under ss.171–177 even after the company went into administration and liquidation. But just before trial he backed away from this concession. After adopting a "number of differing positions on the existence and scope of the duties owed by a director to a company in administration and in voluntary liquidation", Mr Michie adopted the position that, once a company enters administration or liquidation, the duties under ss.171–177 apply only to an exercise of a director's powers qua director.[20]

[11] Insolvency Act 1986 s.91(1) (IA 1986).
[12] Under the IA 1986 Sch.B1 para.64(1), a director of a company in administration "may not exercise a management power without the consent of the administrator".
[13] *In Plus Group* [2003] B.C.C. 332 at [28] per Brooke LJ.
[14] See *North-West Transportation Co Ltd v Beatty* (1887) 12 App. Cas. 589 PC (Can).
[15] The power to resign is a personal, not a fiduciary, power: *CMS Dolphin Ltd v Simonet* [2002] B.C.C. 600 at [87]; [2001] 2 B.C.L.C. 704.
[16] *Re Mama Milla Ltd* [2014] EWHC 2753 (Ch); [2015] 2 All E.R. 581, upheld on appeal [2015] EWCA Civ 1140; [2016] B.C.C. 1.
[17] See *Brewer v Iqbal* [2019] EWHC 182 (Ch); [2019] B.C.C. 746.
[18] *Bank of Credit and Commerce International (Overseas) Ltd v Akindele* [2001] Ch. 437 at [455]; [2000] 3 W.L.R. 1423.
[19] *Re System Building Services Group Ltd* [2020] B.C.C. 345 at [113] and [106].
[20] *Re System Building Services Group Ltd* [2020] B.C.C. 345 at [43] and [46].

After acknowledging that she had heard only "limited argument", ICC Judge Barber rejected Mr Michie's arguments and held that a director's general duties continue to apply after a company goes into administration or liquidation. She gave five reasons for her conclusions. First, she noted that by s.170 the duties under s.175 (to avoid conflicts of interest) and s.176 (not to accept benefits from third parties) apply in some cases even after a director retires. A fortiori, they must apply "beyond the point at which a given individual is exercising any powers as a director".[21] Secondly, she noted the CA 2006 does not say that the duties end on administration or voluntary liquidation. Thirdly, she thought that the common law and equitable principles on which s.171–177 are based are flexible enough to apply even once a company goes into administration or liquidation. Fourthly, she had not been referred to any case law which suggested that duties ended when a company goes into administration or voluntary liquidation. Fifthly, she noted a director is not automatically removed from office when a company goes into administration or voluntary liquidation.[22]

Having held that Mr Michie continued to owe a duty to promote the company's success after it went into liquidation, the judge held that Mr Michie breached that duty. She held that, when he agreed to buy the house for £120,000, Mr Michie acted out of self-interest and failed to consider the company's or its creditors' interests.

Comment

It is unfortunate that the court only got the chance to hear "limited argument" before deciding *System Building Services*. If a court had heard full argument on the same point and considered *In Plus Group*, it might have decided the case differently.

If *System Building Services* were followed, the law would draw arbitrary distinctions and impose unworkable duties on directors.

The law would treat directors of companies in voluntary liquidation or administration differently from directors of companies in compulsory liquidation, and would treat resigning directors differently from those rendered directors in name only.

Suppose the company in *System Building Services* had gone into compulsory liquidation, but otherwise the facts were the same. It could not sensibly be argued that this ought to change the result. Yet, on the analysis in *System Building Services*, it would. Mr Michie would not have been a director when he negotiated to buy the house and would not have owed the company any duties.

Or suppose Mr Michie had resigned before negotiating to buy the house. Again, this ought not to change the outcome: Mr Michie's resignation would have done no more than reflect what had in practice already happened. But on the analysis in *System Building Services*, resignation would have turned the case. Mr Michie would not have breached any duty by resigning, since a director may resign at any time and for any reason.[23] Having resigned, he would not have breached any duty by buying the house from the company: the lingering duty under s.175, not to exploit opportunities that he found out about as a director, does not apply to transactions the company enters.[24]

Besides creating inconsistency, following *System Building Services* would create practical difficulties. It would put directors in impossible positions of conflict.

Take the negotiations for a director to buy the company's business from an administrator or voluntary liquidator. If *System Building Services* were followed, the director, as well as the administrator or liquidator, would owe a duty to act in good faith in the best interests of the company. Taken to its logical conclusion, that will mean that the director would have to seek to achieve a sale at the best price. In other words, the director would have to offer the maximum he is willing to pay. It cannot be right to impose on the director such a duty; if there were such a duty, few directors would countenance buying from an administrator or liquidator. Even if the duty were only to pay a fair price, directors would be more cautious about buying from the administrator or liquidator, particularly when views about the fair price might greatly differ.

For a starker example, take the common situation in which a director of a company in administration or liquidation (OldCo), incorporates a new company (NewCo) to buy OldCo's business and assets. If *System Building Services* were followed, the director would owe a duty to OldCo to seek a sale at the highest price possible, or at least a fair price, and a duty to NewCo to seek a sale at the lowest price possible. The director may well not be able to reconcile his conflicting duties.

Or starker still, suppose a liquidator or administrator causes the company to sue the director for past misfeasance. In the settlement negotiations, would the director owe a duty to promote the success of the company? If not, why not? The answer cannot be that the interests of the director and company are opposed or that the company's interests are protected by the insolvency practitioner, since these are features in common with *System Building Services*.

These examples show that imposing duties on directors in name only is arbitrary and impractical. It is also unnecessary. As ICC Judge Barber noted in *System Building Services*,

> "for the most part, licensed insolvency practitioners in this country are highly effective guardians of the assets of those companies in respect of which they are appointed".[25]

[21] *Re System Building Services Group Ltd* [2020] B.C.C. 345 at [50].
[22] See IA 1986 ss.91, 103, 114; Sch.B1 paras 61 and 64.
[23] See *CMS Dolphin Ltd* [2002] B.C.C. 600 at [87]; [2001] 2 B.C.L.C. 704
[24] CA 2006 s.175(3).
[25] *Re System Building Services Group Ltd* [2020] B.C.C. 345 at [58].

An insolvency practitioner who fails to safeguard his company's assets can be sued for negligence or breach of fiduciary duty. The law can afford to leave it to insolvency practitioners to protect companies' interests.

Conclusion

The law should treat directors of companies that go into administration or voluntary liquidation as it treats directors of companies that go into compulsory liquidation, and as it treats directors who leave office or are effectively expelled from office. Unless they are permitted to exercise management powers, they ought to be subject only to the duties preserved by the CA 2006 s.170 and otherwise free to pursue their own interests.