

The 5th September 2011 saw the dawn of a new era for insolvency practitioners in Gibraltar. Much awaited legislation in the field of insolvency was finally passed and a new regime for both personal and corporate insolvency has been put in place.

The question many may ask is – how is this relevant to me and my practice if I am not insolvent? The answer is that the Insolvency Act 2011 (the “Act”) is highly relevant, particularly to any business which may be on the brink of insolvency. It is also extremely relevant to any individual or business providing directorship services to any company which may be technically insolvent. It is important to bear in mind that the Act allows the Court to look back as far as two years in some instances to determine whether an act done by the company was an unfair preference or a transaction at an undervalue. Therefore, insolvency does not have to be an imminent possibility for the Act to be relevant.

The impact of the Act goes beyond mere insolvencies though. Companies that are looking to borrow money and as therefore granting a floating charge over their assets will have to give some thought to how, in the worst possible case scenario, the matter of insolvency should be handled. The floating charge itself will determine what remedies may be available to creditors in the case of an insolvency.

Below we will analyse one of the many ways in which the Act changes the responsibilities of company directors. This Article will focus on Insolvent Trading, but there are also provisions relating to transactions at an undervalue, fraudulent preferences etc., which will also be very relevant to company directors.

Insolvent Trading

Under the Act the liability for a director in the case of a company nearing insolvency may be quite severe. It goes without saying that if it can be proven that a director has been fraudulently trading it follows that the repercussions are quite severe and may include criminal convictions. This is both reasonable, to be expected and applauded.

The problem is that the director may be guilty of Insolvent Trading (pursuant to section 260 of the Act) without necessarily realising that he is. If a director, prior to the commencement of the liquidation of the company “knew or ought to have concluded” that there was no reasonable prospect that the company would have avoided going into insolvent liquidation, the director may be found to have breached the provisions of the act in relation to insolvent trading and may be ordered by the Court to make a contribution to the company’s assets. This is, unless the Court is satisfied that after he first knew, he “took every step reasonably open to him to minimise the loss to the Company’s creditors”.

This effectively means that if the director ought to have concluded that the company would go into insolvent liquidation, there may be a personal liability on that director to contribute to the company’s assets. This is one of the very few instances in law where the Court is permitted to pierce the corporate veil and make the director personally liable for the liabilities of the company.

The test to determine what the director “ought to have concluded” is both a subjective *and* an objective test. Normally, a subjective test assists the person who is seeking to rely on it, but, in my opinion, this is not the case in this instance. The Act states that the test of what the director ought to have concluded is that which a reasonably diligent person having both:

- (i) The general knowledge, skill and experience of a person carrying out the same functions as are carried out by that director in relation to that company; and
- (ii) The general knowledge, skill and experience that that director has.

You may therefore begin to understand why the subjective element is not particularly helpful in these circumstances. What the Act is effectively saying is that a director is assumed to have the general skill and experience of another director in the same circumstances **AND** the information and experience which the relevant director has. Effectively this demands a minimum standard of competence from the director of a company. Although no director will be expected to be Warren Buffet, a director will be deemed to have the skill of a reasonably competent director.

This may seem perfectly reasonable but a director cannot fall back and argue that he did not open an attachment to an email (to give but one example), and as a result was unaware of the cash flow situation of a company. If the information was in the director's possession or was readily available to the director it will be deemed that he ought to have known.

Once an Order has been made by the Court pursuant to section 260 of the Act, the Official Receiver may apply to the Court for a Disqualification Order which prohibits the director from providing directorship services for a specified period of time. The consequence of Insolvent Trading are therefore both personal liability and the possibility of a Disqualification Order being made against the director.

Conclusion

Although UK Courts have been unwilling to enforce similar provisions against directors of UK Companies without good cause, the fact remains that these provisions are in place. The Act can be seen to be very creditor friendly as would be expected in cases of insolvency, where the Court is looking to protect the interests of the creditors of the company and not those of the shareholders. Directors should therefore bear these provisions in mind and be alert (though not paranoid!) to the possibility of an insolvent liquidation.

Gemma Arias is a Senior Associate at Hassans, Law Firm. For any queries, please contact her on +350 20079000.

Contact



Gemma Arias - Associate
gemma.arias@hassans.gi

The information contained in this article is intended for guidance only and is not intended to provide specific legal advice to you or your business. Expert advice on any issue should always be obtained. Hassans do not accept liability for any loss that may arise from relying on or using the information contained in this article.