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INSOLVENCY: OBLIGATIONS AND LIABILITIES OF DIRECTORS

Nicole Ferreira-Aaron

At the Association of Caribbean Corporate Counsel's (ACCC) Annual Conference in April 2016, Mrs. Nicole Ferreira-Aaron, Managing Partner of Hamel-Smith, delivered a presentation on the responsibilities and liabilities of directors in insolvency. We are pleased to share with our clients the essential elements of that presentation in this two-part article.

In this first part, we will explore the general duties and obligations owed by directors at all times, certain salient events in the life of a company when the law demands that directors withhold approval unless they are satisfied as to solvency, liquidity and general financial health of a company; and the higher standard of care to which directors might be held when dark clouds of insolvency approach.

Duties and Obligations owed by Directors

Firstly, directors have a fiduciary role which involves several concomitant duties, including the duty:

- to avoid conflicts of interest;
- not to use his or her position for personal gain;
- to maintain the confidentiality of the company's information;
- to serve the company selflessly, honestly, and loyally; and
- to exercise independent judgment.

Secondly, directors are required to provide a minimum standard of care in carrying out their responsibilities. This minimum standard is generally described in the statutes as exercising 'the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances'.

It is important to note that while a company remains financially buoyant, these duties are owed to the company. When the company is threatened by insolvency, certain duties may well extend to creditors of the company. In short, being a director is serious business.

When Directors need to be Satisfied as to Solvency

The law identifies certain specific decisions and events which could pose a risk to a company's financial health. These include:

- a company purchasing its own shares;
- a decision to reduce its stated capital;
- a decision to pay a dividend;
- a decision to provide financial assistance by way of guarantee, provision of security or otherwise for the obligations of another;
- a decision to amalgamate; and
- a decision to pay a dissenting shareholder for their shares in the event of oppression.

On each such occasion, directors must be satisfied that there are no reasonable grounds for believing that the company is or will, after the occurrence of such event, be unable to pay its liabilities as they come due, or that the realizable value of the assets would be less than the aggregate of its liabilities and stated capital. If those tests are not satisfied, a director may be personally liable to restore to the company any amounts so distributed or paid.

Higher standard of care to which Directors might be held

During the lifetime of a company, some of the most difficult problems that a director faces are encountered if the company is in financial difficulty - not yet unable to pay its bills or insolvent, but with a possibility that it may get to that position. At that stage, the decisions made by a director may affect not only the survival and future of the company, but also the director's own position.

(cont'd on page 2)

C O N T E N T S

Insolvency: Obligations and Liabilities of Directors (cont'd)

Upon a company's liquidation, directors (past or present) may be liable for the following offences, if committed at the time of liquidation:

- failing to disclose all real and personal property of the company, and their values, other than property disposed of in the ordinary course of the company's business;
- failing to deliver up all such property that was in his possession and control;
- in the 12-month period leading up to liquidation, making false representations when getting credit for the company, and then failing to pay the debt, or in the same period charging the company's assets to obtain credit that is then not repaid;
- making false or fraudulent representations to creditors to obtain their consent in relation to the company's affairs or to the liquidation;
- destruction, mutilation, alteration or falsification of the books, or making false or fraudulent entries in any register, book of account or other company document intending to defraud or deceive;
- conveying company property with the intention of defrauding creditors or preventing creditors levying against the company's property;
- through fraud inducing a creditor to give credit to the company;
- concealing or removing property to prevent a creditor from satisfying a judgment made against the company;
- failing to keep proper books of account.

Directors are liable on summary conviction to a fine of TT$10,000 for these offences.

Fraudulent Trading

Directors are potentially liable to criminal proceedings, as well as personally liable to the company, for the value of all company debts that are unsatisfied as a result of fraudulent trading. Additionally, these directors can be debarred from serving as directors of companies for a period of five years from the date of the court's guilty verdict. Any failure to cease acting as a director for the period in question is an indictable offence that can lead to imprisonment for two years, or on summary conviction to a fine of TT$10,000 and imprisonment for six months.

Under the Companies Act, fraudulent trading is defined to include the carrying on of business by a company:

(a) with intent to defraud creditors of the company or the creditors of any other person or for any fraudulent purpose;
(b) with reckless disregard of the company's obligation to pay its debts and liabilities; or
(c) with reckless disregard of the insufficiency of the company's assets to satisfy its debts and liabilities.

In any such case, in the course of winding up, the Court, on the application of the official Receiver, or the Liquidator or any creditor or contributory of the company may, if it thinks proper to do so, declare that any of the officers whether past or present, of the company, or any other persons who were knowingly parties to the carrying on of the business in that manner are personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company, as far as the Court may direct.

In a locally decided case, the Court found the following facts to be evidence of fraudulent trading:

- the disposition of the more profitable aspects of the company's business – life and property insurance, the disposition of real property assets associated with its life portfolio, the sale of its headquarters, and the possibility that the sale of the latter to its parent company was at an undervalue;
- the formation of a company ancillary to the insurance company controlled by a single director of the insurance company for his personal profit which derived all of its revenue from the principal company;
- an attempt to disclose ownership of a fictitious property in the company's financial statements for 5 years.

Consequently, two directors were held to be jointly and severally liable for the sum of $20 million in respect of the company's outstanding insurance debts and liabilities incurred by reason of their conduct (out of the sum of $23.6 million being the debts and liabilities of the company).

The judge also ordered that those two directors be disbarred from directorship in or being directly or indirectly involved in the management of a company incorporated in Trinidad and Tobago, without leave of the Court, for a period of five years from the date of the order. They were also held liable to pay the liquidator's costs of bringing the application.

The aim of the wrongful trading laws is to make directors of companies that are getting into financial trouble, who might otherwise try to trade their way out of trouble, stop and think carefully about whether they are being overly optimistic about the company's prospects.

When judging what the director knew or ought to have concluded, and the steps he should have taken, the Court:

- firstly, reviews the director's functions and asks what a reasonably diligent person with the general knowledge, skill and experience required of someone exercising those functions would have concluded and the steps he would have taken. This is an objective test under which, say, a finance director will be expected to reach the minimum threshold of competence required of all finance directors.

- Secondly, it considers the general knowledge, skill and experience the director actually has - a subjective test, under which a director with specialist skills or experience is expected to apply them, and is therefore subject to a higher standard than a director without those skills or experience.

The Court considered these issues in two Canadian cases. In the first case, a start-up company was set up in late 2002. By August 2005 the original, substantial, external investment in the company had been used up; it had lost a major customer; its revenue was insufficient to reduce the overall losses it had built up; and it was wound up as insolvent by a creditor in 2007.

The liquidator alleged wrongful trading because, for example:

- There was no evidence that the directors had considered the company's worsening financial situation and its potential effect on creditors. They ought to have done so and ought to have concluded that there was no reasonable prospect of avoiding insolvent liquidation.
- The directors had not economized - they had continued to spend money as they had previously, including paying themselves salaries and expenses. They had not taken 'every step' with a view to minimizing the loss to creditors.

The court decided that the directors were guilty of wrongful trading from June 2005.

In the second case, the directors conducted themselves much better. The company started trading in 2004. By December 2005, it was having trouble finding external funding. The directors accepted advice from a specialist insolvency practitioner and decided to carry on. However, a major supplier withdrew its services in January 2006 and the company was unable to find a replacement. The directors immediately decided to stop trading and the company was put into liquidation by creditors.

The liquidator alleged wrongful trading at four separate times. However, even though the company was under-capitalized and always had cash flow problems, the Court could understand why the directors had behaved as they did at each of those times, particularly as their decisions had been objectively justifiable and they had:

- taken creditors' interests into account in their decision-making;
- made sure they knew the company's financial position at all times;
- actively tried to find fresh funding;
- monitored and controlled the company's debts;
- tried to find new business;
- taken specialist advice; and
- made their own decision to stop trading.

Obligations and Consequences Under the Bankruptcy and Insolvency Act

The Bankruptcy and Insolvency Act (BIA) also imposes certain obligations on directors. Where an insolvent corporation pays a dividend (other than in stock) that causes the corporation to become insolvent, the directors may be liable for damages in the amount of the dividend paid. Where an offence is committed under the BIA by a corporation, any director who has had control, or controlled the company, or directed, authorised, acquiesced, assented to or participated in the commission of the offence is liable on conviction to the punishment provided for that offence (section 255, BIA). The High Court can also order the offender to do community service in addition to the punishment specified for the breach, as well as order damages payable to any person who has suffered a loss as a result of the offence.

Offences caught by section 255 of the BIA are set out under section 247 of the BIA include:

- Fraudulent disposition of the company's property before or after bankruptcy;
- Refusal or neglect to provide full disclosure on an investigation initiated under the BIA;
- Making false entries or material omissions in a statement or account;
- After or within one year before the bankruptcy:
  - concealing, destroying, mutilating, falsifying, omitting from or disposing of books or documents affecting or relating to the corporation's property or affairs;
  - obtaining credit or property by false representations;
  - fraudulently removing or concealing property worth TT$200 or more or any debt due to or from the insolvent corporation; or
  - charging company property to obtain credit that remains unpaid.

In each case, a director is liable on summary conviction to a fine of TT$10,000 and imprisonment for one year, or on conviction on indictment, to a fine of TT$20,000 and three years' imprisonment.

The obligations for which directors are responsible, and the possible consequences which they may face for breaching same are not to be taken lightly. These obligations and potential consequences are heightened significantly when a company, on whose Board the Director sits, faces financial difficulties.

In our next issue, Part II will examine some protective measures directors might consider taking to safeguard themselves.

A CLIENT'S GUIDE TO CIVIL LITIGATION REVISITED

Krystal Richardson

While in many cases it is advisable to avoid litigation in favour of less contentious ways of managing disputes, like mediation, sometimes recourse to litigation is unavoidable. In those cases, understanding the process and stages of litigation may seem confusing and daunting, particularly to a client who has never gone through the process before. Having some knowledge of the stages will undoubtedly prepare a client for the rigorous and time-consuming process. In this article, we will examine the process briefly, from the stage prior to filing a claim, to the laying down of judgment by the Court.

OVERVIEW

It is important to note from the onset that each stage of the litigation process is outlined in the Civil Proceedings Rules (CPR) which govern the civil litigation process at the High Court in this jurisdiction. The CPR is aimed at efficiently and justly managing cases with the overriding objective of these rules being *"to enable the court to deal justly with cases."* The court, in managing the cases before it, must apply this overriding objective when it is seeking to interpret the rules or to exercise its discretion at any stage of the litigation process.

THE PROCESS

The Pre-action Stage

The Pre-Action stage is governed by pre-action protocols in the CPR. The pre-action protocols are aimed at promoting prompt resolution of disputes, ensuring early and sufficient notification of potential claims; encouraging Defendants (the persons against whom a Claim is initiated) to make admissions of liability; or if liability is disputed, to give reasons for the dispute. In order to achieve these aims, a Claimant (the person bringing a claim) is required to write informing the Defendant of the Claimant's intention to file a claim. In so doing, the Claimant must give the Defendant a reasonable time (at least 14 days) within which to respond to the claim.

The Defendant, upon receipt of the pre-action letter, may respond to the Claim giving details as to why the Claim (as alleged) is either disputed or accepted. Typically, the Defendant should provide copies of those documents upon which he wishes to rely to defend his position. If the Defendant fails to respond within the time stated in the pre-action letter, the Claimant may proceed to file their Claim without any further communication with the Defendant.

Initiating the Claim

The general rule is that a Claimant will commence proceedings by completing and filing with the Court a Claim Form and Statement of Case. The Claim Form will contain bare details such as the names of the parties, the cause of action (legal basis for the claim) and specifics as to what is being claimed. The Statement of Case, on the other hand, will contain details of all the facts on which the Claimant intends to rely, along with any documents which are essential to the Claimant's case. The Claim Form and Statement of Case must be served on the party against whom the claim is being initiated. Typically a Claim Form may only be served within four months of the date of filing with the Court. For service outside of the jurisdiction, it must be served within six months of the date of filing.

The Defendant's Entry of Appearance

Upon receipt of the Claim Form and Statement of Case, a Defendant must "enter an appearance". In entering an appearance, the Defendant declares to the court, on a form attached to the Statement of Case, whether or not they intend to defend the Claim.

Defence

The Defendant, after entering an appearance, files a defence which must set out all the facts on which the defendant relies in opposing the claim, and must specifically state what facts, as outlined in the Statement of Case, are disputed.

The general rule is that a Defendant is required to file a defence within 28 days. For claims filed against the state, the time is increased to 42 days. A Defendant may, by consent or application to the court, extend the time for the filing of the defence by 3 months. A copy of the filed defence must be served on the claimant.

Preliminary Judgments

At this stage of the Civil litigation process, parties may wish to consider whether or not they are eligible for early judgment in the matter. There are two types of preliminary judgments: Default Judgments and Summary Judgments.

Judgment in Default

A Claimant may apply for Default Judgment where a Defendant has failed to enter an appearance giving notice of intention to defend or has failed to file a defence. It is noteworthy that a claimant cannot obtain Default Judgment where the claim was initiated by a Fixed Date Claim Form, is an admiralty claim, or a claim in probate proceedings.

A Client's Guide to Civil Litigation Revisited *(cont'd)*

(cont'd from page 4)

Summary Judgment

Summary judgment is available to either the Claimant or the Defendant. A Claimant or Defendant may obtain a judgment dismissing the other's claim on issues of fact and/or law. In order to be awarded summary judgment, a Claimant would have to satisfy the court that the Defendant has no realistic prospect of success on their defence to the Claim, and a Defendant would have to satisfy the court that the Claimant has no realistic prospect of success on the claim.

The Case Management Conference Stage

Parties and their Attorneys are required to attend Case Management Conferences (CMC). The intention of these hearings is for the Court to prepare a timetable to ensure that the claim is dealt with as quickly and economically as possible, in keeping with the overriding objective of the CPR. Typically, a date for the first CMC will be fixed immediately after the defence is filed. At the CMC, the court will hear any preliminary applications and issues in the matter, and is also likely to look at possibilities for settlement.

In addition, the Court will further give directions for the disclosure and inspection of documents (parties must provide a list and copies of documents on which they intend to rely); the preparation and disclosure of witness statements, the disclosure of expert reports, and dates for the pre-trial review and trial.

Filing of Witness Statements

Both parties are required to file witness statements in support of their respective cases prior to the trial of the matter. A witness statement is essentially a written summary of the evidence of persons with intimate knowledge of the case. Witness statements are considered the chief evidence before the Court and must be tendered on appearance of the witnesses at trial. They must be filed at the High Court Registry and be served on the other party. In some cases where witnesses cannot appear by reason of death or otherwise, the court will allow witness summaries to be filed on their behalf.

In cases where expert witnesses are required, special rules apply. Expert witnesses are deemed to be witnesses appointed to assist the court in technical areas and the rules impose a duty on the court and the parties to seek to limit expert evidence by imposing general duties such as duty to use jointly instructed experts where possible, and a duty to arrange joint inspections/examinations where more than one expert is involved.

Offers to Settle and Payments Into Court

At any stage before and up to the trial of the matter, either party may make an offer to settle a case. Parties may opt to do so privately or via application in accordance with the rules. Although not necessary, an offer made in accordance with the rules can be accompanied by a payment into court. Where a party does not accept an offer, and the Court eventually makes an order for a similar amount, the party who made the offer will be entitled to costs.

The Pre-Trial Review

At the Case Management Conference stage, the Court in setting its timetable will determine a date for the pre-trial review to be held. Preliminary issues are dealt with and parties are given final directions for the trial. The judge at this hearing is likely to determine the length of time that should be allocated for the trial and how much time each party should be allowed in the presentation of its case.

The Trial

At trial, the Claimant will present his case first, and the Claimant's witnesses will be cross-examined by the Defendant's Attorney. Thereafter, the Defendant will present its' case and the Defendant's witnesses will be cross-examined by the Claimant's Attorney.

When all evidence is completed, the Judge will hear the parties' Attorneys present legal arguments in the form of submissions. The Court will determine whether these submissions will be heard orally, or whether they should be presented in written form.

Judgment

Once all evidence and submissions are before the Court, the Judge will consider the evidential and legal arguments and deliver his ruling. Typically, the judgment is delivered at a hearing after the conclusion of the trial. In smaller cases, the Judge has the discretion to deliver the ruling after hearing oral submissions on the last trial date.

Thus far, we have explored the general stages of litigation. However, in many cases, parties will have to consider what steps they must take after judgment is handed down. In our next issue, we will discuss the enforcement of judgments, and the options available to clients who receive judgment in their favour.

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