LEGALCOUNSEL

Defending company directors from restriction and disqualification

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Introduction

It is a nightmare of every company director that their company becomes insolvent and wound up, and that they are hauled before the court for their restriction and disqualification. No director is immune from this possibility, but not all seem to do enough to prevent it from happening. So common is this unfortunate scenario that the High Court has a special list dealing specifically with restriction applications (although admittedly the number of cases in that list has decreased significantly since the introduction of "voluntary" restriction and disqualification by the Companies Act 2014). In 2016 a total of 183 directors were restricted (increasing from 177 in 2015) and 19 were disqualified (increasing from 14 in 2015).[1]

What happens if you are threatened with restriction or disqualification? Should you consent to a voluntary order or fight it out in the courts? How do you defend such proceedings? What happens if an order is made against you? Those are some of the questions considered below.

What is restriction and disqualification?

In 1990 the Government decided to "get tough" on corporate governance and, specifically, the so-called "cowboy directors" who were seen as a significant problem at the time. They thus enacted the Companies Act 1990 which introduced the concept of restriction and disqualification into Irish law. According to it, the liquidator of an insolvent company could apply to the High Court for orders against the company's directors which effectively prevented those directors from acting in respect of Irish companies in future, for a period of five years in the case of restriction and an unspecified period (determined by the court) in the case of disqualification.

Later, in 2001, when the Office of the Director of Corporate Enforcement (ODCE) was established, it fell to the ODCE to decide whether applications for restriction and disqualification ought to be made by liquidators. Or more accurately, it fell to the ODCE to determine whether a specific liquidator ought to be relieved from his legal obligation to make restriction applications (for reasons discussed below,

[1] Annual Report 2016, ODCE

disqualification applications are far less common in practice). This remains the case today. The ODCE makes that decision based on the content of a report - often referred to as the "section 56 report" - which every liquidator of an insolvent company is required to furnish to it.

A director may be restricted either voluntarily or by order of the court. A restricted person "shall not, for a period of five years, be appointed or act in any way, whether directly or indirectly, as a director or secretary or be concerned or take part in the promotion or formation of any company". There is an exception to this, namely where the company in respect of which the restricted person wishes to act meets certain conditions, namely that the company has a minimum allotted share capital of €100,000 in the case of a public limited company and €50,000 in the case of any other company, which must all be paid up in cash.

A person may be disqualified voluntarily, by order of the court or automatically where he is convicted on indictment of any indictable offence in relation to a company, or involving fraud or dishonesty. A disqualified person may not act as a director or other officer, statutory auditor, receiver, liquidator or examiner of a company, or be in any way, whether directly or indirectly, concerned or take part in the promotion, formation or management of a company, friendly society or industrial and provident society irrespective of its paid-up share capital. The period of disqualification, unlike restriction which always lasts give years, will be determined by the court having regard to the seriousness of the misconduct. Since disqualification is seen as more serious than restriction, the period of disqualification will normally be more than five years.

Will I be restricted/disqualified?

By default, the directors of an insolvent company which commences to be wound up are liable to be restricted. Of course, if that rule was strictly applied then no one would ever want to be a company director. After all, companies often fail for reasons completely unrelated to the conduct of their directors. Thus, section 819 of the Companies Act 2014 states that a director will be relieved from being restricted if he can show that he acted "honestly and responsibly" in conducting the affairs of the company. What precisely "honestly and responsibly" means in a corporate context is not defined by the Act, and we therefore need to turn to the case law for guidance. In general, the requirement for honestly rarely causes problems. That is because most directors do not intentionally set out to destroy their companies by gross mismanagement. More likely, they make mistakes - sometimes serious mistakes - but usually not involving dishonesty. It is the "responsibly" part of the test with which directors often struggle.

Disqualification, on the other hand, is a punishment justified by conduct ranging from gross misconduct to criminal dishonesty. This can be seen from the grounds, contained in section 842 of the Act, upon which a court may make a disqualification order. They include things such as: where the person was guilty of fraud in relation to the company, where his conduct makes him unfit to be concerned in the management of a company, where the person has been in persistent default of his duties under company law, where he is disqualified under the law of another country for misconduct which would have justified his disqualification in Ireland and so on.

"Honestly and Responsibly"

The Companies Act does not define the phrase "honestly and responsibly". The omission is deliberate since there are an endless number of acts and omissions which may or may not fall under the heading depending on the specific circumstances of a case. Judges have been left to grapple with that difficult question, which means we need to look at the decided cases to get a sense of the indiscretions deserving of restriction or disqualification. From those cases we can see that there is a common trend. Certain breaches of company law crop up over and over again. Failing to keep proper accounts, failing to file returns, using VAT receipts to cover operating costs, trading while insolvent and so on. After that come the more serious breaches: misleading the Revenue Commissioners, fraudulent transfers of company assets, selling liquor without a licence. Thus, the level of misconduct ranges from trivial regulatory omissions to criminal activity. There is also a trend in the kinds of defences relied upon by directors facing restriction orders. Many have pointed to the fact that their company was trading during a difficult economic environment in which they, the directors, were under tremendous pressure worthy of the court's compassion. Others have pointed to the fact that, as professional men, their livelihoods (a constitutional right, after all) depend almost entirely on their eligibility to act as company directors. In that regard, it is worth noting that certain professional bodies do indeed frown on their members being restricted, to the point that their membership of that body may be revoked altogether. In one case I came across in the course of my own practice, a person ceased to be a member of a lucrative partnership upon being restricted. The partnership agreement contained a specific clause stating that no person could be a partner if restricted. Then of course there are the ones who claim ignorance, that they had no executive role in the company whatsoever, that they only agreed to act as directors to satisfy the former requirement that a company must have a minimum of two directors.

Do the courts have much sympathy for these kinds of defences? The short answer is "it depends". In practice, it often depends on the identity of the judge dealing with the case. There is no doubt that some are less forgiving than others when it comes to breaches of company law. That is not to say that our judicial system is based entirely on the whims of a particular judge on a particular day: it isn't. But these kinds of cases have characteristics not dissimilar to criminal sentencing hearings. Judges will consider the legal and moral culpability of the individual directors and, since two cases are rarely identical, it becomes difficult to distil any meaningful principles from the cases. Nevertheless, it is worth looking at a couple of recent decisions.

In *Wood Products (Longford) Limited (in liquidation) v. Companies Act 2014 [2017] IEHC 314* the court made a disqualification order against a company director who sought to defend himself on the basis that he played no executive role in the company. The court, rejecting that defence, noted that he was an accountant who had been appointed as director specifically to ensure that the company complied with its obligations under company law, which it failed to do. The company had been struck off the register, missed significant tax payments, traded while insolvent, made an unexplained payment of €10,000 to the director and provided misleading information to the liquidator in the directors' report. The court also took into account the director's profession but noted that a disqualification order would have no impact on this because he was not the director of any other companies and neither did he intend to act as a director in future.

In *Director of Corporate Enforcement v. Walsh [2016] IECA 2* the Court of Appeal held that it was not appropriate, in deciding whether to make a restriction or disqualification order, for a judge to have regard to the fact that the company was trading in difficult economic conditions or that the company was a small, family-owned business where the directors had no qualifications or experience of corporate management.

The High Court had more sympathy for the company director in *Tadhg O'Conaill Heating and Plumbing Limited v. Companies Acts [2015] IEHC 4.* That was a successful company which found itself in financial difficulty at the time of the recession. As a result, it was forced to let go of a number of its employees. The director then failed to make what were effectively pension contributions for the remaining employees, using the money instead to cover operating costs. The court found that he did this in the best interests of the company and the employees, in a desperate attempt to salvage its business. Moreover, he had every intention of making the missed payments once business picked up. This, combined with the fact that the director had an otherwise spotless record, resulted in no order being made against him. An order was also refused against the second director, his mother, who had no executive role in the business and had only become a director to meet the "two directors" rule.

Substantive defence

The best way for a company director to escape restriction or disqualification is, of course, to show that his actions were entirely reasonable in the circumstances. In other words, to prove that he actually did act honestly and responsibly. And the best way to do that is to show that he acted at all times on the advice of specialists retained for that purpose. The case of *Pearse Contracting v. Companies Acts [2015] IEHC 74* provides a good example of this. The liquidator in that case sought disqualification orders on a number of grounds, including that the company had traded while insolvent, that its accounts overstated the value of its assets and that it had made illegal payments to its directors. However, the directors were able to show that all of their relevant decisions were taken on the advice of solicitors, accountants and estate agents independently engaged by the company. The court refused to make any order against them because they had acted prudently by acting in accordance with the advice of professionals. This was certainly sufficient to satisfy the test of acting "honestly and responsibly".

Costs

Since the introduction of the Companies Act 2014, it is possible to for directors to submit to voluntary restriction and disqualification orders. This has resulted in many such voluntary arrangements and fewer court applications. The advantage for the company director is that he can avoid paying the legal costs involved in bringing the matter to court. Typically, such directors tended to defend themselves without legal representation, but were still liable to pay the liquidator's legal costs. In the *Pearse Contracting* case, discussed above, it was held that, even where directors successfully defended themselves, there would be no costs order in their favour since this would discourage liquidators from making future applications. They would not have to pay the liquidator's legal fees, but would still need to pay their own.

Since there is a sense of finality of a voluntary restriction/disqualification undertaking, and given that its consequences can be severe for some people, it is always recommended to take legal advice before agreeing to submit to the request. However, it is envisaged that directors will only engage lawyers to defend themselves in those cases where (a) they are able and willing to spend money on a defence and/or (b) there is too much at stake to go down without a fight!

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Important Note

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