



Court of Appeal:

Delinquent Directors Beware

By Robert Berry, Partner

Given the current economic climate it is not surprising that insolvency law has come to the forefront as more companies face collapse. Recent statistics from the Ministry of Economic Development record an almost 28% increase in liquidations in the past year. Economic forecasts make grim reading and this figure is set to rise.

Over the last few months Hesketh Henry has advised on a full range of insolvency issues including relatively simple insolvency and creditor issues through to complex liquidations and receiverships involving significant sums of money, complex property developments, questionable acts or omissions by directors, and the disposal of company assets both pre-and postreceivership or liquidation.

A common theme has been how directors have acted, particularly in relation to how and on what basis they have made decisions. When viewed objectively, either the directors have made decisions that were based more on hope than reality, or they simply failed to make and implement decisions when action needed to be taken.

Most people are aware that company directors must not allow the business of the company to be carried on in a manner which is likely to create a substantial risk of serious loss to the company's creditors. Although trading while insolvent is not in itself a breach of the Companies Act 1993, the Court may take the view that the directors are not making decisions that a reasonable director would make when allowing the company to continue to trade while it is insolvent.

The recent Court of Appeal decision delivered in *Global Print Strategies Limited (In Liquidation) v Lewis* has confirmed the importance of good corporate governance, and continued the move by the Court to be more willing to find directors personally liable for failing to discharge their duties under the Act.

Global Print Strategies Print Limited ("Global") was originally incorporated with six directors, two of whom were Mr and Mrs Lewis. The business operated by Global was managed on a day-to-day basis by Mr Grant, who was not a director. Three of the directors resigned within 15 months of the company being incorporated, leaving Mr & Mrs Lewis and Mr Grant's wife as the directors. Mrs Lewis resigned as a director three months before the company went into liquidation. From the day they commenced trading Global's business was wholly unsuccessful and it never became viable. Throughout its trading history its financial position went from bad to worse. In just over two years of trading the company had run up unpaid debts of \$1.6m.

The liquidators of the company brought proceedings against Mr & Mrs Lewis alleging reckless trading and failure to keep financial records. Also the liquidators sought an order that Mr & Mrs Lewis be personally responsible for Global's debt.

The High Court held that Mr & Mrs Lewis had not breached their statutory obligation as they had acted honestly and in good faith throughout the life of the company. However the Court of Appeal reversed the High Court's decision, finding that Mr & Mrs Lewis had indeed breached their statutory obligations. In particular the Court of Appeal found that Mr & Mrs Lewis, despite acknowledging that they were financially illiterate, did nothing more than rely on the advice of the company's day-to-day manager. The Court of Appeal found that Mr & Mrs Lewis did nothing in respect of the worsening financial situation, and that they:

- failed to call for expert independent analysis of information;
- failed to require acceptable accounting and financial records to be established and monitored;
- failed to convene directors meetings to establish what was really happening; and
- failed to control the day-to-day manager in his activities.

As a consequence they were required to pay to the liquidator a sum equal to 60% of the amount of the company's losses so the liquidator could distribute the money to creditors.

The key statements in the ruling (paraphrased) stated that anyone who takes on the role of director and obtains the limitations of liability provided by incorporation secures that privilege only where proper corporate governance principles are applied and there is full compliance with the Act.

The ruling also stated that company directors must take proper steps to guide and monitor the management of the company. The responsibility for the governance of the company is theirs. They cannot simply treat the appointment as a sinecure and then leave the duties of running the company and ensuring compliance to management, or other advisors.

Delinquent directors beware indeed.

As a firm we have the expertise and experience to assist companies, directors, creditors, liquidators and receivers no matter where in this equation you are sitting.

If you require any further information, call Robert Berry on 09 375 8716.