Going for broke

Elliot Green explains what happens when the voluntary liquidator investigates directors of insolvent companies

The relationship between liquidator and director does not always finish up as it started. The reason can be because of the change in the nature of the role of the insolvency practitioner (IP) before he or she is appointed as the liquidator, from the time when they were advising the director of the procedures to place the company into liquidation.

Liquidations are divided into three types: Creditors Voluntary Liquidation; Members Voluntary Liquidation (for solvent companies); and Compulsory Liquidation (a court orientated procedure). This article confines itself to the consideration of investigations into directors in Creditors Voluntary Liquidation and how the relationship can change.

Voluntary liquidation has two distinct phases: the build up and the main event.

In the build up (pre-appointment phase), the relationship between the company and the IP is very much rooted in matters of contract, whereas the main event (liquidation) is dominated by statute. The notable difference is that of control. In the build up the director remains in control of the process with the IP assisting with provision of the navigational information to ensure regulations are complied with. In liquidation, the liquidator assumes the helm and sets about on a voyage of, amongst other things, discovery.

Whilst in both phases, the duty to provide creditors with accurate information is very important, once a company is in liquidation, the liquidator is no longer merely a helpful coastguard; he or she is now the captain of the ship required to deploy an enquiring mind, assemble the company's information and investigate.

Period prior to liquidator's appointment

Whilst the pre-appointment phase is procedural in focus, concentrated on the need to prepare documentation to convene a creditors' decision procedure, a statement of affairs and a report to creditors, the role does not end there. It necessitates an information gathering process as the IP enters the role as a stranger.

It is, however, commonplace and indeed expected for the IP to sprinkle advice into the pre-appointment phase, so that the director does not avoidably breach their duties in the company's dying days. This will include information about the risks that they are facing. Warning about wrongful trading if they continue to trade and make the situation worse is the norm. Other advice may highlight that a director of a company that goes into insolvent liquidation will have restrictions on the re-use of the company name and trading styles, except if one or more of the exceptions apply. Furthermore, further credit should not be accepted in the name of the Company and creditors should not be preferred.

Post-appointment metamorphosis

Once the liquidator is appointed, he or she now acts instead of the directors who have lost their powers to operate the company. The duty of the liquidator upon appointment is to get in, realise and distribute the assets of the company. That encompasses the need to identify, discover and recover its property.

There is perhaps a need for more than a mere subtle shift in emphasis once the liquidator is appointed. That is the point behind having a regulated independent party scrutinise the prior conduct of the directors and explaining to creditors why they might well have to stomach a loss.

Liquidator investigation

Before appointment as liquidator, the primary source of information will be the directors. Once appointed, the aim is not simply to realise assets that have been disclosed by the directors, but also, if relevant, to discover assets which have not been disclosed. Plainly the extent of this duty can depend on the facts of the case and the concerns of creditors.

A liquidator will need to put on their investigation cap and consider if there might be any hidden treasures amongst the islands through which they pass. Such fishing trips need to be proportionate and consider their impact on returns for creditors before hoovering up too great a proportion of the available funds. The liquidator may well need to consult with the creditors to whom they are perhaps ultimately answerable as a whole.

Regulatory requirements

Two notable regulatory requirements dictate a liquidator's duty to investigate the conduct of those who will, in many instances, have initiated and may even have paid for their involvement in the company in the first place.

The first requirement starts on appointment, which is set out in Statement of Insolvency Practice Number 2, that requires the liquidator in each and every case to embark on a course of some discovery to at least try to see if there could be claims capable of swelling the assets of the company. An initial assessment of the same must be made and reported to creditors. Creditors can then resolve whether they wish to fund further investigations.

Secondly, there is also the requirement in a Creditors Voluntary Liquidation for the Liquidator to issue a report within 12 weeks to the Insolvency Service in relation to any person who has been a director in the previous three years prior to liquidation. That report takes the form of an online series of questions that the liquidator is required to answer and declare as being correct to the best of their knowledge.

In order to complete both of these obligations, the liquidator will need to seek the co-operation of the directors by trying to obtain the relevant books and records of the company and asking questions. If co-operation was not to be forthcoming, relations may get a bit rocky, particularly perhaps if obtaining disclosures seems to necessitate deployment of a liquidator's powers of enforcement under Section 236 of the Insolvency Act 1986.

Investigating your appointor

Notwithstanding that it can sometimes be challenging and prior working relations may get strained, there is no doubt a liquidator has an ethical duty to be vigorous, efficient and unbiased in the performance of their duties, including but not limited to the investigations that need to be undertaken into the conduct of the directors.

Whilst the board of directors may initiate the liquidator's appointment, they cannot direct the operation of the liquidation.

It is well established that a liquidator "should not be a person nor be the choice of a person who has a duty or purpose which conflicts with the duties of the liquidator… should not be the nominee of a person: (a) against whom the company has hostile or conflicting claims…" (Fielding v Seery [2004] BCC 315).

That principle is strict, such that in cases when the directors may also be creditors of the company, if they have engaged in misconduct and the liquidator is inclined to bring legal proceedings against them for compensation to produce better realisations for creditors, then a director will typically face an uphill struggle to exercise their creditor rights to replace the liquidator and frustrate the progression of such proceedings.

Involvement with HMRC

A liquidator's involvement with HMRC will vary from case to case.

Investigations may uncover that a company's debts to HMRC could be different to what has been declared on the statement of affairs. For example, additional HMRC debt might sprout if a director were to underestimate the extent of their overdrawn director's loan account. It is conceivable that a company's liability under Section 455 of the Corporation Tax Act 2010 could therefore have been understated.

The liquidator has a bit of a tightrope to walk where HMRC is concerned because, whilst HMRC is a creditor in virtually every case, it is nevertheless just another creditor. Perhaps with one notable difference. Unlike most creditors who will readily know what they are owed, HMRC usually relies upon the regime of self-assessment to determine the extent of a taxpayer's liability and if not, it will conceivably expect the company (as the taxpayer) to come clean if an enquiry is opened rather than HMRC digging through the vaults: "It is the duty of every individual taxpayer to make his own return and, if challenged, to support the return he has made, or, if that return cannot be supported, to come completely clean…" (Nicholson v Morris (HM Inspector of Taxes) 51 TC 95).

In cases of fraud and when HMRC is owed substantial sums of money, it may choose to look to see if it might be able to exercise a more influential role by engaging with the liquidator and highlighting matters that may require investigation. Of course, if HMRC is, as is often the case, the largest creditor, they are in a position to influence the choice of the liquidator. Whilst not a particularly common event, it is certainly not unknown for HMRC to look to appoint a liquidator of their choice and even in some cases replace a liquidator.

Conclusion

There is a reasonably clear change of emphasis on the part of an IP who then becomes the liquidator of a company after the period prior to their appointment. In perhaps most cases, even if the voyage gets a bit rocky, relations with the former directors tend to reach calmer waters but every now and then, the waves of litigation can hit the deck.

• Elliot Green is CEO of Oliver Elliot Chartered Accountants and Licensed Insolvency Practitioner