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Carillion's demise – personal liability for directors

The news of the outsourcing giant's collapse has put many directors on notice, and left them asking, "could I be personally liable if my company falls into insolvency?"

Following the well-publicised demise of Carillion plc, the business secretary has asked that the Official Receiver's investigations into the company's directors be "broadened and fast-tracked". In addition, the Insolvency Service announced, "Any bonus payment to directors, beyond the liquidation date, have been stopped and this includes the severance payments which were being paid to some senior executives who left the company".

Can a director be personally liable in insolvency situations?

There are several ways in which both civil and criminal liability can attach to directors in an insolvency situation, and these issues will no doubt be brought into sharp focus during the investigation into Carillion. Although all company directors need to be mindful of these points, the issues are particularly acute for non-executive-directors (NEDs) and directors put on boards by owners/investors, such as private equity (PE) houses, as these directors have the same liability as full-time executive directors (but do not have the same day-to-day oversight of the business).

Personal liability of business leaders can arise in several ways including:

- **Wrongful trading** - Insolvency Act 1986, s214: this occurs whereby a director knew or ought to have concluded at some point before the commencement of the liquidation or administration that there was no reasonable prospect that the company would avoid going into insolvent liquidation or insolvent administration – i.e. the directors kept the company trading when in reality it was insolvent. In these circumstances, the administrator or liquidator can seek a court order requiring the director to contribute personally to the company's assets. A finding of wrongful trading may also lead to the individual being disqualified from being a company director.

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- **Fraudulent trading** – Insolvency Act, s213: if a director carries on the business of the company with an intent to defraud creditors (including potential creditors), they may be held personally liable both criminally and civilly. To be guilty of fraudulent trading, dishonestly must be proven.

- **Misfeasance** – misfeasance is defined as a willful action which injures another party. In insolvency situations, a director of a company can be held personally liable if they are found guilty of misfeasance or breach of their fiduciary duty. Examples include: improper payment of dividends or bonuses, using money for improper purposes or unauthorised payments to the directors.

- **Redundancy notifications:** Where collective redundancies are envisaged, the company is obliged to notify the government using a prescribed form. Failure to do so has always been a criminal offence, but

until relatively recently there had never been any prosecutions. 2015 marked a profound shift in the government's approach to this issue, when prosecutions were brought in relation to directors of City Link and Sports Direct. Although in those cases the prosecutions were against directors, the legislation provides that any manager to whom the failure to notify is attributable can be charged with the offence. Fines for a failure to notify used to be capped at £5,000, but are now unlimited.

Those holding senior roles in financial services and insurance also face significant personal liability under the Senior Managers and Certification Regime – see here for our article about the SMCR's extension of scope to all financial services firms.

How can I protect myself from being personally liable as a director if a company becomes insolvent?

If you are going to be appointed as a company director or another senior leadership role, you can protect your position in the following ways:

- **Knowledge is power**: Ensure you are up to date on all of your obligations, particularly your statutory obligations as a director.
- **Indemnity protection:** See that your service agreement contains an indemnity from the company in relation to third-party claims and that the indemnity complies with the requirements under the Companies Act.
- **Directors & Officers (D&O) insurance:** Make sure that the company has adequate D&O cover, and your service agreement obliges the company to maintain it in respect of you, during and after your employment (although note that this will be of limited assistance in relation to criminal liability).

In summary

It is imperative directors understand their duties and obligations, not only during an insolvency, but prior to the company's collapse. Even if personal liability is not established, in cases where there is significant media interest, such as that of Carillion, the reputational damage caused by allegations of improper and/or fraudulent actions can be severe

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