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Wrongful Trading : Problems and Proposals

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I Introduction

One of the critical elements of a liquidator's remit is to ascertain if there are any assets or funds that belong to the company that can be recovered in order to swell the dividend that will be paid to the unsecured creditors.[1] As part of his or her investigations the liquidator may determine that transactions entered into before the commencement of the winding up can be challenged as transactions which might be adjusted. Examples of these are preference payments[2] and transactions at an undervalue.[3] In the liquidator's investigations he or she may find that the directors have engaged in what the UK's Insolvency Act 1986 ("the Act") (the Insolvency (Northern Ireland) Order 1989) ("the Order") refers to as "wrongful trading." A right to take action against directors for wrongful trading was first introduced in the Act and is found in s.214 and the corresponding article in the Order is art.178 (for the balance of the paper there will be a reference to the relevant article of the Insolvency (Northern Ireland) Order 1989 in brackets). The section provides, in essence, that unless a director takes every step to minimise the potential loss to creditors the director is liable for wrongful trading if at some time prior to the commencement of winding up he or she knew or ought to have concluded that there was no reasonable prospect of the company avoiding going into insolvent liquidation. The UK is not alone in providing a liquidator with the right to bring an action against directors, where they have, when their company is in danger of insolvency or is actually insolvent, failed to take special care concerning the trading activity and other actions of their company, and to act in such a way that will minimise losses to company creditors.[4] Many Commonwealth jurisdictions[5] as well as Ireland,[6] include in their company or insolvency legislation such a provision.

The aim of this article is to examine the issues that exist in relation to the bringing of actions for wrongful trading in the UK, and to determine if the law should be reformed. It is argued that because of the way that the wrongful trading provision has been drafted and applied by the courts, it does not achieve what was intended when introduced, for it does not provide the liquidator with an effective weapon in recovering funds for the benefit of creditors and it fails to act as a mechanism that will

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1 S Wheeler, "Swelling the Assets for Distribution in Corporate Insolvency" [1993] JBL 256; D Milman and R Parry, "Challenging Transactional Integrity on Insolvency: An Evaluation of the New Law" (1997) 48 NILQ 24.

2 Insolvency Act 1986, s.239 (Insolvency (Northern Ireland) Order 1989, art.203).

3 Insolvency Act 1986, s.238 (Insolvency (Northern Ireland) Order 1989, art.202).

4 Notably, the United States and Canada, do not, and have never done so.

5 For example, see New Zealand (Companies Act 1993, s.135); Australia (Corporations Act 2001, s.558G); South Africa (Companies Act 1984, s.424); Singapore (Companies Act 1990, s.339).

6 Companies Act 1963, s.297A.

encourage directors to minimise losses to creditors. As a result the article submits that reforms are needed.

The article is structured as follows. First, it provides some brief background to the wrongful trading provision. Second, the Chapter sets out the conditions that must be established if a liquidator is to succeed in an action under s.214. Third, the Chapter identifies areas of difficulty facing liquidators in both bringing actions and establishing the conditions necessary for a successful claim. Fourth, the Chapter proposes some reforms to the law. Finally, some concluding remarks are provided.

II. Background

The advent of wrongful trading was due primarily to the perceived inadequacies of the fraudulent trading provision.[7] The Report of the Insolvency Law Review Committee, *Insolvency Law and Practice* ("the Cork Report")[8] was of the opinion that the fraudulent trading provision[9] possessed significant inadequacies in dealing with irresponsible trading.[10] The Cork Committee was concerned that unsecured creditors were not protected adequately and it took the view that compensation ought to be available to those persons who experience loss due to unreasonable behaviour as well as fraudulent action.[11] It was concerned that the existing fraudulent trading provision had failed in curbing directors who ran up losses when their companies were in deep financial difficulty.[12] Consequently, the Cork Committee recommended that a new provision be introduced to provide civil actions for unreasonable trading where only the civil burden of proof would apply.[13] In the past directors were only liable if they were proved to have intended to defraud creditors. The Committee favoured including in legislation a provision that provided that directors who anticipated insolvency and did nothing to prevent it or seek to minimise creditor losses, would be personally liable for company liabilities.[14] To achieve this, the Committee proposed liability being imposed on directors (and any others taking part in the carrying on of the company's business), if the company incurred liabilities when it was insolvent and without a reasonable prospect of satisfying the debts in full.[15] The directors would be liable if they knew or ought to have known that the trading was wrongful.[16] What the Committee envisaged was legislation that acted so as to encourage company directors to satisfy themselves concerning the company's ability to discharge commitments.

While, in 1984, the Government stated in a White Paper, entitled "A Revised Framework for Insolvency Law"[17] that it agreed that there had to be a tighter rein on directors' activities in order to prevent irresponsible trading where insolvent

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[7] Now Insolvency Act 1986, s.213 (Insolvency (Northern Ireland) Order 1989, art.177).
[8] Cmnd 858, HMSO (1982).
[9] At the time the provision was s.332 of the Companies Act 1948.
[10] Ibid, [1776]-[1780].
[11] Ibid, [1777].
[12] Ibid, [1776]-[1778].
[13] Ibid, [1777].
[14] A. Walters, "Enforcing Wrongful Trading – Substantive Problems and Practical Incentives" in BAK Rider (ed), *The Corporate Dimension* (Bristol, Jordans, 1998), 146.
[15] Cmnd 858, HMSO (1982), [1781]
[16] Ibid.
[17] Cmnd 9175.

companies were concerned, it declined to take up many of the recommendations of the Cork Report relating to wrongful trading. This attitude continued to prevail when the Insolvency Bill was introduced in late 1984 (later to become the Insolvency Act 1985). The reason that the Government gave for this opinion was that the Cork Report's approach imposed too severe a responsibility on directors for their companies' liabilities. The provision that was proposed, and which was first contained in s.15 of the Insolvency Act 1985, and later in s.214 of the Act, provided for a concept that was more limited than that recommended by the Cork Committee and it reflected legislative caution against diluting the law of limited company liability. The provision focused on the making of directors liable for creditor losses when the former failed to take appropriate steps where the avoidance of insolvent liquidation was not a reasonable prospect. Len Sealy records that one reason that was given for the decision not to follow the Cork Report proposal was that it was not envisaged that the conduct covered should be restricted to the incurring of liabilities when insolvent.[18]

The provision was introduced in order to regulate directors in an attempt to prevent directors from externalising the cost of their companies' debts and placing all of the risks of further trading on the creditors. For, if a company is heading for insolvent liquidation, the creditors of the company are effectively the ones who have a residual claim (this is the claim of those whose wealth directly rises or falls with changes in the value of the company[19]) over the company's assets,[20] and so the directors should be taking action to minimise the losses of the creditors.

It is generally accepted that directors may well, when their companies are in difficulty, embrace actions which involve more risk,[21] because the shareholders, given the concepts of limited liability and separate legal entity, have little to lose where their company is in financial distress. If the risk-taking pays off, then the shareholders will see their wealth maximised, but if it does not, then they have lost nothing more. As mentioned above, it is the creditors who will bear the cost.

Provisions like s.214 have been controversial.[22] It has been argued that the provision makes directors overly risk averse and it deters people from accepting posts as

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[18] "Personal Liability of Directors and Officers for Debts of Insolvent Corporations : A Jurisdictional Perspective (England)" in J Ziegel (ed), *Current Developments in International and Comparative Corporate Insolvency Law* (Oxford, Clarendon Press, 1994), 491.

[19] D Baird, "The initiation problem in bankruptcy" (1991) 11 *International Review of Law and Economics* 223, 228-229; S Gilson and M Vetsuypens "Credit Control in Financially Distressed Firms : Empirical Evidence" (1994) 72 *Washington University Law Quarterly* 1005, 1006.

[20] S Schwarcz, "Rethinking a Corporation's Obligations to Creditors" (1996) 17 *Cardozo Law Review* 647, 668.

[21] K Daigle and M Maloney, "Residual Claims in Bankruptcy : An Agency Theory Explanation" (1994) 37 *Journal of Law and Economics* 157; B Adler, "A Re-Examination of Near-Bankruptcy Investment Incentives" (1995) 62 *University of Chicago Law Review* 575, 590-598; R Barondes, "Fiduciary Duties of Officers and Directors of Distressed Corporations" (1998) 7 *George Mason Law Review* 45, 46, 49. See Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: Final Report* Vol 1 (DTI, London, 2001), [3.15].

[22] For instance, see J Mannolini, "Creditors' Interest in the Corporate Contract : A Case for the Reform of our Insolvent Trading Provisions" (1996) 6 *Australian Journal of Corporate Law* 14; D Morrison, "The Australian Insolvent Trading Prohibition – Why Does It Exist?" (2002) 11

directors. The Cork Committee was of the view that such a provision strikes a balance between the need to ensure that directors feel that they can engage in entrepreneurial activity on the one hand and they do not abuse the privilege of limited liability and face up to the consequences of their action, on the other.[23]

III. Elements of a Successful Claim

It is not intended to provide a detailed exposition of the elements which a liquidator must establish if he or she is to succeed in wrongful trading proceedings,[24] but it is helpful to lay down what circumstances have to have occurred and/or what needs to be proved to enable sense to be made of the proposed reforms argued for later.

First, the director's company must be in insolvent liquidation.[25] Second, and the main condition, at some time prior to the commencement of winding up the director knew or ought to have concluded that there was no reasonable prospect of the company avoiding going into insolvent liquidation.[26] This condition is then explained in s.214(4). It provides that the facts which a director ought to know or ascertain, the conclusions which he or she ought to reach are those that would be known or ascertained or reached or taken by a reasonably diligent person having both the general knowledge, skill and experience that may reasonably be expected of a person who carries out the same functions as are carried out by the defendant director (an objective requirement), and, in addition, that person has the general knowledge, skill and experience that the defendant director possesses (a subjective requirement). Obviously liquidators are more likely to rely on the fact that a director ought to have concluded that there was no reasonable prospect of the company avoiding going into insolvent liquidation rather than alleging and proving that the director knew that there was no chance of avoiding liquidation,[27] as it is usually going to be easier to establish.

It is notable that the director will not necessarily be liable if he or she was aware that the company was insolvent at a particular time. The critical issue is whether or not the director knew or ought to have concluded that insolvent liquidation was inevitable.[28] A director might be aware of, say cash flow insolvency at a particular date, but is fairly optimistic about the future as some debts owed to the company are coming due in the near future and new contracts have been entered into that will benefit the company in due course.

The third element for liability is that the defendant was a director at the time prior to the commencement of winding up when he or she knew or ought to have concluded that there was no reasonable prospect of the company avoiding going into insolvent

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International Insolvency Review 153, 161; A Keay, "Wrongful Trading and the Liability of Company Directors : A Theoretical Perspective" (2005) 25 *Legal Studies* 431.

[23] Cork Report, [1805].

[24] For such a treatment, see, for example, F Oditah, "Wrongful Trading" [1990] LMCLQ 205; Keay, *Company Directors' Responsibilities* n.24 above at pp81-110; A. Keay, *McPherson's Law of Company Liquidation* 3rd ed, (London , Sweet and Maxwell, 2013), pp747-765; R Goode, *Principles of Corporate Insolvency Law* 4th ed (London, Sweet and Maxwell, 2011), pp663-683.

[25] Section 214(2)(a) (art.178(2)(a)).

[26] Section 214(2)(b) (art.178(2)(b)).

[27] For example, see *Re Continental Assurance* [2001] BPIR 733; [2007] 2 BCLC 287.

[28] See, *Re Hawkes Hill Publishing Co Ltd* [2007] BCC 937; [2007] BPIR 1305.

liquidation.[29] In this context "director" can include shadow directors,[30] and there is authority for the proposition that liability may extend to *de facto* directors.[31]

IV. Difficulties Facing Liquidators

Following the enactment of the Act, and for some years after it academics and practitioners alike saw s.214 as having a bright future in providing much needed protection for creditors.[32] However, as time moved on optimism waned and subsequently later commentators were more circumspect about the potential, and impact, of the provision. Several negative assessments of the provision over the past 10 years, including a concern that few proceedings have been initiated, have been propounded.[33] Consequently, it has led one commentator to conclude that s.214 is little more than a "paper tiger,"[34] a view reflected in the business community.[35] While the volume of proceedings probably cannot determine the efficacy of s.214, it might well be seen as an element in the aim of deterring wrongful trading, for, as established already, it is generally accepted that directors can be expected, when their companies are in difficulty, to embrace actions which involve more risk.[36] Certainly there appears to be empirical support, in the form of a survey of disqualified directors conducted,[37] for the contention that the provision has not been used overly. Of those disqualified on the ground of unfitness, the survey concluded that the most common basis for this was trading while insolvent, yet no corresponding proceedings had been brought under s.214 against these directors.[38] More recently one leading UK law firm has confirmed that successful wrongful trading claims are rare.[39]

There are substantial difficulties that liquidators have to overcome, especially in terms of evidence, in bringing an action. Clearly, establishing a case is frequently not going to be easy, and, courts are going to require some convincing evidence where the directors have not acted in a patently irresponsible manner.

A. Establishing Blame

[29] Section 214(2)(c) (art.178(2)(c)).
[30] Section 214(7) (art. 178(7)).
[31] *Re Hydrodan (Corby) Ltd* [1994] BCC 161, 162.
[32] For instance, see Oditah, n.24 at p222; D. Prentice, "Creditors' Interests and Directors' Duties" (1990) 10 OJLS 265, 277.
[33] For instance, see Walters, n.14 above.
[34] C Cook, "Wrongful Trading – Is it a Real Threat to Directors or a Paper Tiger" [1999] *Insolvency Lawyer* 99, 100.
[35] "Wrongful Trading Laws that Directors Ignore" *Accountancy Age*, 29 October 1992, 8.
[36] Adler, n.21 above at pp575, 590-598; Daigle and Maloney, n.21 above. See Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: Final Report* Vol 1 (DTI, London, 2001), [3.15].
[37] A Hicks, *Disqualification of Directors : No Hiding Place for the Unfit,* (Research Report No.59, Chartered Association of Certified Accountants, London, 1995).
[38] D Arsalidou, "The impact of section 214(4) of the Insolvency Act 1986 on directors' duties' (2001) 22 *Company Lawyer* 19, 20. An example appears to be *Official Receiver v Zwirn* [2002] BCC 760.
[39] Lawrence Graham, "Nice Try" *Lexology* 30 September 2009.

The use of the title "wrongful trading" for s.214 (although it is not mentioned in the text of the section) is not helpful. As Marion Simmons QC has noted,[40] the Oxford Dictionary definition of "wrongful" is "full of wrong, injustice, or injury; marked…by wrong, unfairness or violation of equity." This definition seems to suggest that there is a need to establish blame, something which does not accord with the wording of the section, and certainly is something which was never envisaged by the Cork Committee.

There are indications in the cases that courts are going to consider issues of blameworthiness in determining liability. In the longest judgment dealing with s.214, *Re Continental Assurance Co of London plc*[41] ("*Re Continental Assurance*") Park J[42] made a lot of the fact that the directors were conscientious and that no wrong could be apportioned to them. This was notwithstanding the fact that the company had incurred losses so significant that they had eradicated the company's reserves and taken a quarter of the share capital.[43] In his judgment Park J seemed to be looking for some clear wrongdoing on the part of the directors, and found none. His Lordship said, in considering the fact that the financial figures of the company presented at a board meeting were worrying, that he was of the opinion that the directors were not expecting figures which showed a bad financial situation, and this appears to have been a factor in his Lordship's decision to find in favour of the directors. [44] This was notwithstanding expert evidence from one of the liquidator's witnesses that indicated that the figures suggested a worse financial position.[45]

It is submitted that the courts have often taken the view that unless a director can be said to be irresponsible then he or she should not be held liable. This places an added onus on the liquidator to establish not only that the director knew or ought to have concluded that there was no reasonable prospect that the company would not end up in insolvent liquidation, but that the director(s) acted in a way that was not responsible, such as ignoring advice or the clear signs of the inevitable demise of the company's business. There is nothing in s.214 that suggests that the liquidator is required to prove that a director participated in some kind of irresponsible conduct. In fact, both the Cork Committee and the Government were trying to get away from the need to prove some kind of subjective culpability.

Rarely, it would seem, where directors have made an effort to understand the position of their company, and where they decided to continue doing business, will they be held liable.[46] Certainly, it would seem, given the case law, that the courts can take into account how culpable the defendant(s) has been, and Vanessa Finch feels that this has diminished the effect of s 214.[47]

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[40] "Wrongful Trading" (2001) 14 *Insolvency Intelligence* 12.

[41] [2001] BPIR 733.

[42] Ibid, 769-770.

[43] See T. Bachner, "Wrongful Trading Before the High Court" [2004] EBOR 195, 198.

[44] The judge also took a benign view in *Re Cubelock Ltd* [2001] BCC 523, an application for an order of disqualification against a director on the basis, inter alia, that he engaged in wrongful trading.

[45] [2001] BPIR 733, 753.

[46] *Re Sherborne Associates Ltd* [1995] BCC 40; *Re Continental Assurance* [2001] BPIR 733; [2007] 2 BCLC 287.

[47] V Finch, *Corporate Insolvency Law : Perspectives and Principles* (2nd ed, Cambridge University Press, Cambridge, 2009), 702.

B. The Point of Time When Liability Fixes[48]

It appears to have been generally assumed[49] that a liquidator will need to decide on an exact point of time at which it is alleged the director knew or ought to have concluded that there was no reasonable prospect of the company avoiding going into insolvent liquidation, and plead that point of time. This is probably because s.214(2)(b) states that for a defendant to be liable then "at some time" before the commencement of the winding up the defendant must have known or ought to have known that insolvent liquidation could not be avoided. It has been suggested that the point from which liability commences is likely to be a crisis point in the life of the company when directors have to acknowledge the inevitable.[50] So reliance has to be placed on a particular date and it has been referred to as "the moment of truth."[51] Harry Rajak explains this as the point "when the reasonably diligent person would have said, "Oh dear (or words to that effect), while yesterday I thought that we could pull through, today I see that that is highly unlikely."“[52] But while these observations are helpful, there are likely to be many situations where it will be difficult for the liquidator to settle on the exact point when wrongful trading commenced.[53]

The liquidator is hampered by the fact that some cases, notably *Re Sherborne Associates Ltd*[54] and *Re Continental Assurance,*[55] have held that a liquidator is not entitled, where the case presented is not made out in relation to the dates pleaded in the claim, to argue for wrongful trading in respect of other dates once the evidence has been heard, or to invite the court to select a date subsequent to that which had been pleaded. But there are other cases that suggest a more liberal approach might be adopted.[56] Quite recently, the courts in *Roberts v Frohlich*[57] and *Re Kudos Business Solutions Ltd*[58] did not express any concern with the liquidators in fact nominating dates in the alternative. Furthermore it seems that dates can be estimates. For instance, in *Roberts v Frohlich* the case pleaded was that the wrongful trading occurred "around 1 July 2004 (or alternatively on or around 1 September 2004)".[59] In this case the judge found that wrongful trading had occurred by 14 September and allowed the liquidator's claim. Even in *Re Sherborne Associates Ltd* the judge appeared to offer some hope to liquidators when he said that he would not wish his decision:

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[48] For a detailed discussion of this matter, see A. Keay, "Wrongful Trading and the Point of Liability" (2006) 19 *Insolvency Intelligence* 132.
[49] For instance, see Simmons, n.40 above at pp12, 13.
[50] T Cooke and A Hicks, "Wrongful Trading – Predicting Insolvency" [1993] JBL 338, 339.
[51] H Boschma and L Lennarts, "Wrongful Trading in a Comparative Perspective" in J Wouters and H. Schneider (eds), *Current Issues of Cross-Border Establishment of Companies in the European Union* (Maklu, Antwerp, 1995), 205.
[52] "Wrongful Trading" (1989) NLJ 1458, 1459.
[53] Finch, n.47 above at p700.
[54] [1995] BCC 40, 42.
[55] [2001] BPIR 733, 766-767. Also, see p899.
[56] For instance, see *Official Receiver v Doshi* [2001] 2 BCLC 235; *Rubin v Gunner* [2004] EWHC 316 (Ch); [2004] BCC 684; [2004] 2 BCLC 110.
[57] [2011] EWHC 257 (Ch) [2011] 2 B.C.L.C. 635 at [6].
[58] [2011] EWHC 1436 (Ch) at [3], [131].
[59] [2011] EWHC 257 (Ch) [2011] 2 BCLC 635 at [6].

> to be cited hereafter as authority for the proposition that in all cases under s 214 the liquidator must always specify his starting date, and must lose the whole case if he cannot satisfy the Court that his case is made out by reference to that particular date. Cases vary in detail and complexity.[60]

As a consequence a fair degree of uncertainty exists in relation to this matter. And while there might be a chance that a judge will be willing to give some leeway to a liquidator, the liquidator cannot be certain that that in fact will be the case. The risks are that the courts either may be inclined to give directors the benefit of the doubt and not to adopt too early a time from which liability should run,[61] or hold that because the liquidator could not prove that at the time pleaded in the claim the defendants were engaging in wrongful trading, they are not liable.

C. Funding

Andrew Hicks, writing in 1993, following a survey he conducted amongst insolvency practitioners and solicitors, said that the greatest inhibition to wrongful trading proceedings was the cost of investigating and then pursuing the action.[62] This issue remains an important one for liquidators. A solicitor, Peter Fidler, said in 2001 that anecdotal evidence suggested that a minimum of £50,000 was needed to run a wrongful trading case, even where the claim was relatively small.[63] Ensuring that the liquidator has sufficient funds behind him or her is critical, for cases can take a long time to be heard. For instance, the trial in *Re Continental Assurance* lasted for 72 days, three times as long as the period that had been estimated.[64]

Obviously, any liquidator has to be concerned about the costs and expenses of litigation. First, he or she has to ensure that the funds of the company are not needlessly wasted, thereby reducing the dividend payable to creditors. Second, liquidators will want to ensure that they are not liable to pay for litigation out of their own pocket. The latter is particularly relevant to s.214 actions because, as the action has to be brought by the liquidator personally in his or her own name, the liquidator will be personally liable for any costs incurred.[65]

Liquidators are helped to some extent by the fact that r. 4.218(3)(ii) of the Insolvency Rules 1986 (and r.4.218(1)(a) before it[66]) provides that expenses or costs which are properly chargeable or incurred by the official receiver or the liquidator in preserving, realising or getting in any of the assets of the company or otherwise relating to the conduct of any legal proceedings which he has power to bring or defend whether in his own name or the name of the company, are payable out of company funds before

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60 [2001] BPIR 733, 899.

61 "Wrongful Trading – Predicting Insolvency" [1993] JBL 338, 341.

62 "Wrongful Trading – Has it been a failure?" (1993) 8 *Insolvency Law & Practice* 134, 134.

63 "Wrongful trading after Continental Assurance" (2001) 17 *Insolvency Law & Practice* 212, 212.

64 [2001] BPIR 733, 765.

65 *Van den Hurk v Martens & Co Ltd* [1920] 1 KB 850; *Re Wilson Lovatt & Sons Ltd* [1977] 1 All ER 274; *Re MC Bacon Ltd (No2)* [1990] BCLC 607.

66 Rule 23 of Insolvency (Amendment) (No2) Rules 2002 (SI 2002/2712). It was amended in 2008.

any other sums (save for expenses incurred by a provisional liquidator). Whether this is the case as far as an adverse costs order made in wrongful trading proceedings against the liquidator or the company, is not clear, and that does, obviously, present some concern for a liquidator.[67] Any expenses or costs awarded to a successful litigant against the company in liquidation or its liquidator were at common law to be paid in priority to the general expenses and costs of the liquidation and any subsequent priority claims, such as preferential creditor claims.[68] The difficulty for liquidators is that adverse costs are not prima facie within r.4.218(3)(ii) and it was held by the House of Lords that if any expense claim is not covered by r. 4.218 then it cannot be deducted under that provision.[69]

It might be thought that if a liquidator has a particularly strong case, he or she should not be so worried about funding because a significant part of the liquidator's costs will usually have to be paid by the defendant. But, of course, all sorts of problems might ensue. The defendant might prevaricate in making payment, and the liquidator, therefore, may have to bear the cost until payment is forthcoming, if at all. Further, a defendant might disappear or might be impecunious and so the liquidator may recover little or nothing in terms of costs. A further issue is that the liquidator's legal advisers will want paying fees during the course of the litigation, so there has to be money available to the liquidator.

So, funding can be an issue that presents difficulties for liquidators. This is particularly so in all cases except where there is a significant amount of assets of value in the company's estate. Often, a liquidator will have to consider finding some way of financing the action, or at least safeguarding his or her own financial position. Realistically, funding will need to be sought from creditors or even outside sources. While a liquidator might be able to obtain funding through fighting funds or indemnities from creditors,[70] these are not favoured so much nowadays. There is little incentive for creditors to provide indemnities when any fruits obtained from the action will be divided amongst all creditors.[71] If one creditor provides the funding then all of the other creditors will be free-riding on the former's risk and efforts.

More frequently liquidators are entering into arrangements with companies which specialise in funding actions, in exchange for either an assignment of the action or a portion of any successful claim. The problem for liquidators is that in securing funding in the manner just suggested, they are engaging in maintenance and/or champerty. The former is the assistance or encouragement of proceedings by someone who has neither an interest in the proceedings nor any motive recognised by the law

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[67] For a discussion of this point, see S Gleghorn, "Re MT Realisations Ltd ; recovering costs from an insolvent company" (2004) 20 *Insolvency Law & Practice* 105. Also, see R Gregorian and R Butler, "Liquidators' litigation expenses, funding arrangements and the amendment to rule 4.218" (2004) 20 *Insolvency Law & Practice* 151.

[68] *Re London Metallurgical Company* [1895] 1 Ch 758; *Re MT Realisations Ltd* [2003] EWHC 2895 (Ch); [2004] 1 BCLC 119; *Re Toshoku Finance (UK) plc* [2002] BCC 110.

[69] *Re Toshoku Finance (UK) plc* [2002] BCC 110.

[70] For a discussion of this, see A Keay, "Pursuing the Resolution of the Funding Problem in Insolvency Litigation" [2002] *Insolvency Lawyer* 90.

[71] Contrast this with the position in Australia, under s.564 of the Corporations Act 2001. For further discussion, see ibid.

as justifying interference in the proceedings. The latter is a form of maintenance[72] in that assistance or encouragement of proceedings is provided in exchange for a promise to provide a share of the proceeds of the action. While these doctrines may be archaic,[73] they are still relevant in several areas, such as in the assignment of causes of action. There is a well-established exception to the application of these doctrines available to a trustee in bankruptcy (and liquidators and administrators) who is able lawfully to assign any of the bare causes of action of the bankrupt (being property of the bankrupt) that have vested in the trustee on the basis that the trustee is to receive a share of any proceeds of ensuing litigation.[74] This exception (referred to here as "the insolvency exception" as it applies to other regimes besides bankruptcy, such as liquidation[75]) is based on the idea that the legislature has granted to the liquidator the power to realise the assets of the company, and the transfer of actions to an insurer in return for the financing of it has been treated as a sale in *Grovewood Holdings Plc v James Capel & Co Ltd.*[76]

Liquidators have power to sell the company's property,[77] and this includes causes of action. Notwithstanding this, according to *Re Oasis Merchandising Services Ltd*[78] it is not possible for a liquidator to assign a cause of action under s.214 to an insurer in exchange for a promise to pay the liquidator a part of the fruits of the claim.[79] This is because actions commenced under provisions like s.214 are granted to the liquidator personally and not to the company; an action under s.214 is only given to the liquidator and involves the recovery of moneys to which the company never had any right.[80] The courts are most concerned that there is no interference in the action by a third party, and that there is no loss of control of the action by the liquidator.

It is also highly debatable whether a liquidator could agree to assign only part of the fruits of a wrongful trading action to an insurer, thereby retaining control over the proceedings. This is because it was held by Lightman J in *Grovewood Holdings Plc v James Capel & Co Ltd* that a share of the proceeds of an action could not be assigned without being regarded as champertous. Unlike a bare cause of action, which can be assigned, as it comes within the insolvency exception (to the rules on champerty), a portion of the fruits of an action does not constitute property for these purposes and cannot be assigned without breaching the rules against champerty.[81]

Another method of funding actions is to instruct solicitors who are willing to operate under a conditional fee arrangement ("CFA"). However, that only means that if liquidators are not successful their own lawyers do not get paid. If, as usually occurs,

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72 Referred to as "aggravated maintenance" : *Guy v Churchill* (1888) 40 Ch D 481, 489.

73 See the comments of Oliver LJ in *Trendtex Trading v Credit Suisse* [1980] QB 629, 674.

74 *Seear v Lawson* (1880) 15 Ch D 426; *Re Park Gate Waggon Works Co* (1881) 17 Ch D 234 (CA); *Ramsey v Hartley* [1977] 1 WLR 686; *Stein v Blake* [1996] 2 AC 243; *Norglen Ltd v Reeds Rains Prudential* [1998] 1 All ER 218.

75 Causes of action are company property which can be dealt with by liquidators under Schedule 4, para 6 to the Act (Sch 2, para 6 of the Order).

76 [1995] BCC 760, 764.

77 See ss 165 and 167 and para 6 of Sch 4 (arts. 140 and 142 and Sch 2, para 6 of the Order).

78 [1995] BCC 911.

79 Ibid, 919.

80 Ibid, 918.

81 Ibid; *Grovewood Holdings* [1995] BCC 760.

costs go to the victor, the liquidator will be faced with having to pay the costs of the other party. In the past if a liquidator were successful then he or she could claim against the other party a success fee that applied under the CFA, but since the introduction of the so-called "Jackson reforms"[82] success fees will not be able to be claimed against the other party. This change does not apply to Insolvency proceedings[83] until after April 2015.[84]

A final option is for the liquidator to obtain after the event insurance (ATE). This is much easier to secure than third party funding and it will cover the legal costs of the other side (in case of losing the proceedings and the court making the usual order against the loser), disbursements and a portion of the liquidator's own legal costs.[85] But as with creditors agreeing to cover costs, it does not generate any cash flow, and so a liquidator has to ask his or her solicitors to wait for payment until the insurer pays out.[86]

V. Reform Measures[87]

The previous section of the Chapter explained some of the difficulties that a liquidator is confronted with when considering taking legal proceedings under s.214. While the requirements for succeeding in a claim should cause liquidators to engage in careful consideration of their case, and a weighing up of the basis of the action, it is submitted that hitherto liquidators, on the whole, have decided not to take action not necessarily because they have a weak case, but because of other issues. Also, the provision has come under increasing attack from academics and practitioners alike.[88] It is contended that while the intention behind s.214 is commendable, the law needs to be modified. It is submitted that some major changes to the law could provide a more effective right of action.

A. Prohibiting the Incurring of Debt

The first proposal is to amend s.214(2)(b) so that a liquidator rather than having to establish that the director/defendant knew or ought to have concluded that there was no reasonable prospect of the company avoiding going into insolvent liquidation, the liquidator has to establish that the director incurred debts or liabilities at a time when he or she knew or ought to have known that the company was unable to pay its debts as they fell due. So, if directors know or ought to know that their company is unable

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82 These were recommendations made by Lord Justice Jackson after his inquiry into legal costs. See *Review of Civil Litigation Costs*, Final Report, December 2009 and accessible at : http://www.judiciary.gov.uk/NR/rdonlyres/8EB9F3F3-9C4A-4139-8A93-56F09672EB6A/0/jacksonfinalreport140110.pdf (accessed, 16 July 2013).

83 A claim by a liquidator does constitute insolvency proceedings for this purpose. See, "insolvency related-proceedings" in Civil Procedure Rules r.48.2(2)(a)

84 Legal Aid, Sentencing and Punishment of Offenders Act 2012, c. 10.

85 Crinson and Morphet, "Funding for actions brought by insolvency officeholders" (2011) 24 *Insolvency Intelligence* 108, 111.

86 Ibid.

87 Some of the following points draw on Keay, *Company Directors' Responsibilities* n.24 above.

88 For example, see L Doyle, "Ten Years of wrongful trading" (1996) 18 I L & P 10; Godfrey and Nield, above n.34; Walters, n.14 above; Simmons, n.40 above; Fidler, n.63 above, Keay, *McPherson's Law of Company Liquidation,* n.24 above at pp747-765.

to pay its debts when they have fallen due, they should stop incurring more debt. If this is likely to mean that the business cannot continue, they should consider placing their company into administration or liquidation.

This proposal is similar to what was proposed by the Cork Committee.[89] The proposal is made on the basis that the main requirement that has to be established by the liquidator, namely that at some time prior to the commencement of winding up the defendant director knew or ought to have concluded that there was no reasonable prospect of the company avoiding going into insolvent liquidation, is fraught with problems. First, I have already considered the fact that it is arguable that the liquidator must plead an exact point of time from which wrongful trading commenced. This is often an onerous requirement. Second, the phrase "reasonable prospect" is elusive.[90] According to the court in *Re Kudos Business Solutions Ltd*,[91] whether directors had a reasonable prospect depends on rational expectations of what the future might hold.[92] In determining whether there was no reasonable prospect of a company avoiding insolvent liquidation, courts may take into account a broad range of factors which may be presented to them through evidence, including pressure from creditors owed debts, the withdrawal of support from banks, the loss of contracts, the fact that fresh contracts cannot be obtained, the failure to pay the revenue,[93] and the loss of a major supplier.[94] But it is difficult for directors in many situations, leaving aside those cases where their company is clearly hopelessly insolvent and cannot possibly recover, or the slide into insolvency appears to be inexorable, to gaze into the future and determine whether insolvent liquidation is the fate of the company.[95]

It is argued that directors should be able to ascertain whether their company is in effect cash flow insolvent; they will know or can easily discover that their company is not able to pay its way. While an inability to pay debts as they fall due is not a precisely defined expression,[96] although arguably it is a little more so since the decision of Briggs J in *Re Cheyne Finance plc,*[97] and it is certainly more certain than considering whether a director ought to have known that the company was not going to be able to avoid insolvent liquidation (a future occurrence). For the most part directors should be able to detect insolvency before they could be expected to conclude that there was no reasonable prospect of the company avoiding insolvent liquidation.[98] It is easier for a director, and perhaps fairer, to ascertain whether his or

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[89] Cork Report, [1783].

[90] Oditah, n.24 above at p208; J Payne and D Prentice, "Civil Liability of Directors for Company Debts Under English Law" in I Ramsay (ed), *Company Directors' Liability for Insolvent Trading* (CCH and University of Melbourne, Melbourne, 2001), 206.

[91] [2011] EWHC 1436 (Ch).

[92] Ibid, [61].

[93] S Griffin, *Personal Liability and Disqualification of Company Directors* (Hart Publishing, Oxford, 1999), 66.

[94] *Re DKG Contractors Ltd* [1990] BCC 903.

[95] See M Mumford and A Katz, *Making Creditor Protection Effective* (ICAEW, London, 2010), 52, who consider some of the accounting problems that exist with this element of the section.

[96] A Keay and P Walton, *Insolvency Law : Corporate and Personal* 3rd ed, (Bristol, Jordans, 2012), 16-21.

[97] [2007] EWHC 2402 (Ch), [2008] 1 BCLC 741, [2008] BCC 182.

[98] But note the criticism of the Australian criteria of insolvency in D Morrison, "The Australian Insolvent Trading Prohibition - Why Does It Exist?" (2002) 11 *International Insolvency Review* 153, 166-169.

her company is solvent or not than to be expected to look into a crystal ball and determine whether the company will recover and avoid insolvent liquidation. Directors would only be liable, on the above proposal, if they knew or ought to have known that the company is insolvent when they incur further debts. As a consequence if directors could not have reasonably known that their company was unable to pay its debts then they would not be liable.

The Australians have employed this approach for some time,[99] and found it to be workable and appropriate, even though there has been, admittedly, some concern over the meaning of "incurring a debt" and the timing of this occurrence.[100] Nevertheless "Australian law in effect is definite as to when liability will arise; it is expected that directors will take heed of this potential liability in their conduct."[101]

Some might say that what is proposed is unfair on non-executive directors as they will not always be aware of a company's exact financial position. There are three things to be noted in this respect. First, it is clear from the case law that the vast majority of problems with wrongful trading are to be found in small private companies where it is rare to have non-executive directors in the classic sense. All of the directors are more often than not the shareholders and managers of the company. Second, courts have more and more over the past 20 years, emphasised the fact that all directors need to be aware of a company's financial position. No longer can directors plead passivity or ignorance as a defence. They must keep themselves informed concerning the affairs of the company.[102] The recent Australian case of *ASIC v Healey*[103] has made it clear that directors must keep apprised of a company's financial position. Third, even with the amendment being suggested directors can still extricate themselves from liability if they can establish that they did not know and ought not to have known about the company's inability to pay its debts. For instance, a director might prove that he or she made inquiries or did what was reasonable, but the executive directors kept from him or her the information that would indicate the insolvency of the company.

An argument against the introduction of this requirement is likely to be that companies go in and out of insolvency all of the time, so can one ever say that the present insolvency being experienced is likely to be terminal? It is undoubtedly true that many companies do go in and out of insolvency. So, if actions were permitted, would the proposed change be unfair on directors? Under the proposal we are only going to see action being taken against those companies that became insolvent and then ended up in liquidation. If a company was insolvent, but then traded out of that

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[99] The present provisions are ss.588G-588Z of the Corporations Act 2001. For a discussion of them, see, R Austin, H Ford, IM Ramsay, *Company Directors : Principles of Law and Corporate Governance* (Sydney, LexisNexis, 2005), 412-420; M Murray and J Harris, *Keay's Insolvency Law* 7th ed, (Sydney, Law Book Co, 2010), 473-479.

[100] See J Mosley, "Insolvent Trading : What is a Debt and When is One Incurred?" (1996) 4 *Insolvency Law Journal* 156; Austin et al, ibid.

[101] A Keay and M Murray, "Making Company Directors Liable : A Comparative Analysis of Wrongful Trading in the United Kingdom and Insolvent Trading in Australia" (2005) 14 *International Insolvency Review* 27, 37.

[102] *Re Westmid Packing Services Ltd (No 3)* [1998] 2 All ER 124; [1998] BCC 836 at 842; [1998] 2 BCLC 646 at 653. A similar view was taken in the disqualification case of *Re Galeforce Pleating Co Ltd* [1999] 2 BCLC 704.

[103] [2011] FCA 717.

position it would not be subject to liquidation, and no action under s.214 would eventuate. But if the company did end up in insolvent liquidation that indicates that the company was in significant difficulties and not just experiencing some temporary cash flow problems.

It might be said that the use of this test might mean that more companies prematurely enter administration, as directors would be fearful of breaching s.214 and they will used administration as a safe haven. If this were to occur this is not a major problem as administration would provide a moratorium against claims and would offer a chance for the company to look for ways to get itself back on its feet, under the professional guidance of an independent insolvency practitioner. This seems to accord with the Government's desire to foster realistic corporate rescue.[104]

It is submitted that the approach being advocated here would address the overriding concern that the Cork Committee and the Government had 30 years ago, namely that a company could slide into insolvent liquidation and prejudice the creditors. The only negative elements, if administration occurred and was not strictly necessary, would be the incurring of extra costs and a possible effect on the company's reputation. Now while the running up of any unnecessary cost and harm to reputation is not optimal, it is submitted that it is preferable to companies continuing to trade, incurring more and more debts, and prejudicing creditors and others, such as customers, in the long run. It has been suggested that :

> Intuitively, one would say that creditors would rather see their dividend reduced in a small way in relation to a few companies who did not need to go into administration if they were to see their losses because of wrongful trading reduced significantly.[105]

In any event, having insolvency as the trigger point for directors to do something to arrest the problems of the company rather that what is provided for presently in s.214, could give the directors more time to turn around the company, because it might be said that under the present section the directors might have concluded that their company could not have avoided insolvent liquidation before the company actually becomes insolvent.[106]

One of the ideas behind this reform proposal is, as the Cork Committee advocated,[107] if the directors at any time consider the company to be insolvent, they should take immediate steps for the company to be placed in administration (or liquidation). This is not altogether radical or overly severe, as it is something that is akin to what is required in some jurisdictions, such as France, Belgium and Germany. Given the fact that administration may now be commenced extra-judicially, and without a lot of formality and cost, this approach has attractions. It is certainly the approach taken in

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[104] See, Review Group, "A Review of Company Rescue and Business Reconstruction Mechanisms," Insolvency Service, May 2000, [17]; "Productivity and Enterprise : A World Class Competition Regime," 2001, Cm 5233, [5.10].

[105] Keay, *Company Directors' Responsibilities* n.24 above at p144.

[106] This is something acknowledged by Paul Davies ("Directors' creditor-regarding duties in respect of trading decisions taken in the vicinity of insolvency" [2006] EBOR 302, 319).

[107] Cork Report, [1786].

Australia, where voluntary administration has been embraced frequently, and is posited as the reason for a reasonably low number of reported insolvent trading cases.[108]

If this proposal were initiated it would be preferable to change the heading to the section to "insolvent trading" in place of "wrongful trading" as that would eliminate any connotation of blameworthiness or moral wrong that might emanate from the idea of "wrongful" and it would enable the focus to be on the catalyst for the operation of the provision, namely insolvency.

If this alternative element for liability were introduced the defence currently found in s.214(3), which is not very precise in any event, and widely criticised, would need to be replaced with a new defence, namely the director had reasonable grounds to expect the company was solvent when a debt was incurred, or the director took all reasonable steps (contrast with s.214(3) and the reference to "every step") to prevent the incurring of the debt or at the time of the incurring of the debt the director had reasonable grounds for not being involved in the management of the company, or the director had reasonable grounds to believe that any debt incurred would be able to be repaid.[109]

B. Extending the Scope of Permissible Claimants

At the moment s.214 only permits proceedings to be initiated by a liquidator. It is submitted that this is too narrow. In other common law jurisdictions various persons and bodies are able to initiate actions in relation to their equivalent of wrongful trading. It is contended that two other persons should be entitled to bring proceedings.

1. Administrators

It is submitted that administrators should be empowered to commence proceedings.[110] This will reflect the fact that administration has become very popular and frequently invoked, and it has been favoured by government policy. Also, it is being used in place of liquidation in some cases, namely where there is no possibility of the company being rescued. The administrator essentially winds up the company, and may seek court approval to distribute to the unsecured creditors.[111]

The Cork Report[112] actually advocated that administrators and administrative receivers as well as liquidators be given the right to take proceedings, and it is not

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[108] A Herzberg, "Why Are There So Few Insolvent Trading Cases?" (1998) 6 *Insolvency Law Journal* 77.

[109] Parts of this defence are similar to that in the Australian legislation (Corporations Act 2001, s.588H).

[110] This issue has been recently raised in a Discussion Paper of the Department of Business Innovation and Skills, *Transparency and Trust*, Discussion Paper, July 2013 at para 11.6 and accessible at : https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/212079/bis-13-959-transparency-and-trust-enhancing-the-transparency-of-uk-company-ownership-and-increaing-trust-in-uk-business.pdf (accessed 16 July 2013).

[111] Para 65 of Schedule B1 of the Act.

[112] Cmnd 858, HMSO (1982), [1791],[1792].

clear why this recommendation was not taken up. In Ireland examiners, who fulfil a similar role to administrators in the UK, are given the right to bring proceedings. Also, it is somewhat strange that administrators in the UK are given the power to bring proceedings under the adjustment provisions, e.g. for a preference, and they are not able to do so with respect to wrongful trading.

Keeping administrators from bringing proceedings has three possible drawbacks. First, if an administrator believes that directors of the company have been engaged in wrongful trading, he or she has to recommend that the company move from administration to liquidation. This is time-consuming and adds costs. Second, any creditor who is concerned that wrongful trading has occurred or is occurring might push for liquidation rather than administration so as to obtain a share of an award made under s.214. Yet, conceivably if an administrator could take proceedings the company could be placed in administration, take action against the directors and the company might still be rescued. Third, a company could go from administration to dissolution without any consideration being given to a possible action against the directors for a breach of s.214.[113] Admittedly, allowing administrators to initiate wrongful trading actions might be said to discourage some directors from embracing administration.[114] Yet today the appointment of an administrator can be done quickly and if they do so the directors can gain assurance that they will not be liable for any future trading in which the company might engage. Also, it is unlikely that many directors would be moved to refrain from appointing an administrator because of fear of wrongful trading having occurred. Most directors will not have contemplated it.

2. *The Secretary of State*

For a couple of reasons, it is submitted that it would be preferable if s.214 also permitted the Secretary of State for Business, Innovation and Skills to be able to instigate proceedings. First, we have noted already that one of the major difficulties facing liquidators is obtaining the necessary funding to bring proceedings. Whilst the government is obviously not able to expend large amounts, it could determine, in a number of situations, to bring proceedings where a liquidator might not be able to do so, or to do so might place him or her in a potentially embarrassing situation. Where the Secretary of State does take action he or she is likely to have more resources, in terms of investigation, at his or her disposal than a private liquidator. Second, the Secretary of State could take proceedings where the liquidator cannot be persuaded by creditors to initiate proceedings.

Third, the introduction of such a change would allow the Secretary of State to obtain a declaration in relation to wrongful trading and then seek a disqualification order all in the one action. It is arguable whether the Secretary of State could in fact pursue disqualification proceedings against a director under s.6 of the Company Directors' Disqualification Act 1985 ("CDDA") (unfitness) on the basis that he or she has engaged in wrongful trading where no declaration is made that the director has actually so engaged. In fact Richard Schulte has submitted that the Secretary of State

[113] Para 84 of Schedule B1 of the Act.

[114] See, P Davies, "Directors' creditor-regarding duties in respect of trading decisions taken in the vicinity of insolvency" [2006] EBOR 302, 323-324.

cannot do so.[115] In *Official Receiver v Doshi*[116] it was held that an application under s.214 may be consolidated with disqualification proceedings, but the application under s.214, in that case, had been commenced by the liquidator of the director's company.

If the Secretary of State were entitled to bring proceedings then s.7(2) of the CDDA would need to be amended, for at the moment it requires a disqualification action to be commenced within two years of the commencement of a company entering insolvency and that might be too soon for a wrongful action to be initiated. This change has been recently mooted in a Department of Business Innovation and Skills Discussion Paper, *Transparency and Trust*.[117]

In both Ireland and Australia, a government agency is entitled to initiate equivalent proceedings against directors. In Ireland action may be taken by the Director of Corporate Enforcement,[118] and in Australia action is able to be initiated by the Australian Securities and Investment Commission.[119]

Why should the Secretary of State be involved in an action that is taken for the benefit of creditors? After all is said and done, an award against directors in favour of the company can be seen as a private matter. The main thrust of s.214 is to compensate creditors of companies in insolvent liquidation, but it also plays a public role. If a person is guilty of wrongful trading there is no criminal sanction to be imposed. But the fact that wrongful trading does not lead to criminal liability should not be seen as an indication that s.214 is without a public role to play. The public element in s.214 proceedings was adverted to by Robert Walker J in *Re Oasis Merchandising Services Ltd.*[120]

It is not in the public interest to permit directors to get away scot free when they have engaged in wrongful trading, because it is likely to have wide-ranging consequences, such as the creditors of the company might not be able to pay their creditors and so on, thereby causing a chain reaction of insolvency.[121] A second reason is that the section involves an attempt to prescribe a minimum standard of conduct of directors in managing the affairs of companies. Third, the public is interested in companies being managed properly for a number of reasons, such as to instil confidence in the market, provide protection for stakeholders, enhance commercial morality etc. The public has legitimate expectations that those involved in managing companies will act

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[115] R Schulte, "Enforcing wrongful trading as a standard of conduct for directors and a remedy for creditors : the special case of corporate insolvency" (1999) 20 *Company Lawyer* 80, 82. Compare A. Mithani (ed), *Mithani : Director Disqualification*, Lexis, Div IV, Chap 1A, [5].

[116] [2001] 2 BCLC 235.

[117] July 2013 at para 59 and 60 (at p18) and accessible at : https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/212079/bis-13-959-transparency-and-trust-enhancing-the-transparency-of-uk-company-ownership-and-increaing-trust-in-uk-business.pdf (accessed 16 July 2013).

[118] Company Law Enforcement Act 2001.

[119] Australian Securities and Investments Commission Act 2001.

[120] [1995] BCC 911, 918.

[121] See the Australian case of *Woodgate v Davis* (2002) 42 ACSR 286, 294, where Barrett J of the Supreme Court of New South Wales discussed the fact that the Australian equivalent served a social purpose.

properly and if they do not then they should be penalised.[122] Finally, the provision is linked to disqualification of directors, for if wrongful trading is found to have occurred, the court is at liberty, of its own volition, to disqualify the director from being involved in the management of companies for a period of up to 15 years.[123]

C. Funding

Funding of actions was identified earlier as a real difficulty facing liquidators. A way of alleviating this concern would be to establish a central fund, administered by the Insolvency Service, on which liquidators could draw, if they could establish a good case. This was a process that was used in Australia in relation to bankruptcies for many years and appeared to work well, particularly where bankruptcy trustees did not have sufficient funds to institute recovery proceedings or seek the examination of the bankrupt and others. Such a fund could be financed by government or, given the stringencies of public financing today, a levy on companies in general, with repayment to the fund if a liquidator were successful in the proceedings issued.

Another possible approach is to give the courts discretion to give to any creditor who funds an action a prescribed amount out of the award pursuant to the s.214 proceedings, before the creditors are paid out, as well as any costs that they have expended, in order to give them an advantage and to reward them for the risk that has been adopted.[124]

D. Corporate Rescue

Besides opening up the use of s.214 more, it is possible that the changes proposed here could contribute to a greater amount of corporate rescue. Rescue is often impossible for companies because the seeking of professional advice and/or the taking of action such as appointing an administrator does not occur early enough. The fact is that the earlier that a company realises its predicament, the more likely it is that it can be saved and rehabilitated. It is acknowledged that the directors of small private companies often commence the business carried on by the company and are sentimentally attached to their firms, often having sunk their life savings into them as well as a lot of effort. As a result they are often ready to try anything to keep their enterprise going.[125] But directors might be ready to embrace administration earlier than they have hitherto, because of fear of being liable for wrongful trading. In Australia it has been found that the existence of a provision similar to what is proposed here has led to directors placing their companies into voluntary administration [126]at a point where rescue might be a possibility.[127]

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[122] See, *Commonwealth Bank of Australia v Friedrich* (1991) 5 ACSR 115 at 126.

[123] Company Directors Disqualification Act 1986, s.10(2)). For an example, see *Re Brian D. Pierson (Contractors) Ltd* [1999] BCC 26 at 55.

[124] This is discussed in detail in Keay, n.70 above.

[125] R Mokal, "An Agency Cost Analysis of the Wrongful Trading Provisions : Redistribution, Perverse Incentives and the Creditors' Bargain" (2000) 59 CLJ 335, 353-354.

[126] For a discussion of this in comparison with the UK regime of administration, see A Keay, "A Comparative Analysis of the Administration Regimes in Australia and the United Kingdom," in P Omar (ed), *International Insolvency Law: Themes and Perspectives,* (Aldershot, Ashgate, 2008), 105.

[127] Herzberg, n.108 above.

VI. Conclusion

It would seem that wrongful trading has not made a great impact in its 25 years plus existence. Arguably, it is easier for liquidators to make out cases under the adjustment provisions, such as preferences (especially against connected persons) and transactions at an undervalue, than under s.214. One reason for this, and it is a critical one, is that "wrongful trading rarely occurs in a vacuum but usually in a context of other managerial shortcomings."[128] It has been submitted here that the present state of affairs is not palatable. In this regard, the article has identified some of the problems that liquidators encounter when considering a wrongful trading action, and that might well account for the low number of proceedings, and the perception that the wrongful trading provision has not been successful. These involve : the difficulty in establishing the critical element in wrongful trading, namely that the director knew or ought to have concluded that there was no reasonable prospect of the company avoiding going into insolvent liquidation; emphasis in some cases on the need for directors to be regarded as blameworthy in some way rather than just being regarded as someone who knew or ought to have concluded that there was no reasonable prospect of the company avoiding going into insolvent liquidation; a problem in obtaining funding; concerns as to what elements of s.214 actually mean; and what liquidators must establish.

The article proposed some reforms that might improve the usefulness of s.214 in fulfilling what its introduction was intended to achieve, as well as contributing to an increase in the incidence of corporate rescue. It was advocated that : s.214 should be changed so that directors are required not to incur further liabilities when they know or ought to conclude that their company is insolvent; administrators and the Secretary of State for Business Innovation and Skills should be permitted to initiate proceedings against directors; and some state funding should be available to liquidators and administrators where it is appropriate.

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[128] D. Milman, "Improper Trading : Can it be Effectively Regulated?" (2004) 4 *Company Law Newsletter* 3.