

# The Interpretation of Directors Duties during Administration and Liquidation of Company by the English Courts

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## Abstract

The company's directors owe all the general duties when the company is in the phase of liquidation or administration is held in System Building Services Group Ltd. However, after the meticulous and critical analysis of English courts jurisprudence, it has been pinpointed that directors are obliged to perform very limited duties when a company is passing from liquidation or administration.

**Keywords:** Director • Duties • Administration • Liquidation • Administrator • Liquidator

## Introduction

When a company is in the phase of administration or liquidation, the question arises what will be the duties of the directors of the company at that time. Whether the company's directors are obliged to perform their general duties or not. This issue has great significance, affecting how a willing company's directors can purchase the assets of the company from a liquidator or an administrator and what are possible ways of doing so. This issue was framed in the landmark case System Building Services Group Ltd. It was held in the case by Judge Barber that if the company is in the phase of liquidation or administration, the director of the company owes all of his general duties. The basic purpose of this study is the critical analysis of System Building Services Group Ltd to highlight that the director of the company is obliged to perform very limited duties in the circumstances when the company is in the phase of liquidation or administration. To this end, the general duties of directors enshrined in the Companies Act 2006 are also scrutinised.

## General directors duties

Companies Act 2006 (hereinafter 2006 Act) assigns duties to the director of the company. The general duties of the company's director are preserved in sections 171 to 177 of the 2006 Act. The purpose of assigning the duties to the director is the protection of the company by limiting or defining the scope of duties of the director so that the director must not perform any action beyond this scope or he must not misuse his power. Madoff Securities International Ltd can be cited [1].

Section 171 of the 2006 Act forms a domain of the directors' duties and says that the director of the company should not surpass its powers. Section 171 states that "A director of a company must-(a) act in accordance with the company's constitution, and (b) only exercise powers for the purposes for which they are conferred." Section 174 of the 2006 Act imposes the duty of reasonable care on the director. Moreover, sections 173 to 177 have great significance as they protect the director of the company from inappropriate influence. It is submitted that the duties of the directors protect the company

and stop the director from misusing his power. Hence, there is a very close link between the extent of directors' duties and powers [2,3].

It is generally expected that when the director leaves his company as well as his office, in such cases, he will be relieved from all of his duties. Furthermore, the duties enshrined in section 170 of the 2006 Act are the only duties that are lingered in such circumstances. Section 175 of the 2006 Act describes that the director has to avoid conflicts of interest related to the misuse or abuse of any kind of information, opportunity, or property. This duty is imposed on the director as long as he is working as the director of the company. Section 175 of the 2006 Act also imposes duties on the ex-director that he must not misuse his office privileges after leaving his post or job [3,4].

Section 176 of the 2006 Act elucidates that the director is not obliged to get any benefit from the stranger or third party. It is the duty of the director that he must not obtain undue benefits for doing or abstaining from doing any action until he is the director of the company. Section 176 of the 2006 Act ensures that the director of the company must have to perform his function reasonably and properly and he must not sway himself from it, with the thought that he will be benefited from a third party after he leaves the company. After the performance of these certain duties, the ex-director is free and he is not obliged to perform further duties. He is independent and can act to save and prefer his interest [5,6].

In *Hilton v Barker Booth and Eastwood*, the court held that when the director is working in a company, the degree of his power is tied to the degree of his duties. Additionally, the court has recognized that "for fiduciaries generally scope of a fiduciary duty must be moulded according to the nature of the relationship between fiduciary and principal." This position is also sustained in the *University of Nottingham V Fishel* [7,8].

*Plus Group Ltd v Pyke* describes the tie between the company's directors' duties and powers. In *Plus Group Ltd*, the claimant was disqualified by the shareholder director from the management of various companies at once. The court held that the claimant has been released from his duty. Because he was unable to set up a competing commercial business. It was held by Brooke LJ that the claimant had been released from his duty. He stated the claimant was expelled effectively from all the corporations. Moreover, the reason given by Jonathan LJ was that the claimant resigned, "his resignation would have done no more than reflect what had in practice already happened." However, Sedley LJ stated that "his role as a director of the claimants was throughout the relevant period entirely nominal, in the concrete sense that he was entirely excluded from all decision-making and all participation in the claimant company's affairs. In the circumstances, his duties had been reduced to vanishing point." [9,10].

## Powers of the directors during administration and liquidation

The duties protected under section 170 of the 2006 Act lingered on the ex-directors in the circumstances when the company faces compulsory liquidation.

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In *Measures Brothers Ltd v Measures*, the court held that the appointments of the company's directors are ended spontaneously and automatically when the company goes into compulsory liquidation [11].

However, section 91 of the Insolvency Act 1986 (hereinafter 1986 Act) describes the domain of powers of the directors in case of voluntary liquidation of the company. Section 91 of the 1986 Act says that the director of the company loses his power when the company is in the phase of voluntary liquidation. Moreover, the office of the director is maintained. The director in case of voluntary liquidation does not lose his office. The director loses various powers except "except so far as the company in general meeting or the liquidator sanctions their continuance." In case when the company is passing the phase of administration, the director does not lose his office. Furthermore, the director during that phase loses his powers. Even during the phase of administration, the company's director is not competent in exercising his management powers. The director with only the consent of the administrator can exercise his management powers [12,13].

Hence, the company's director owes very minimal duties, when the companies go into administration, compulsory or voluntary liquidation. In *Plus Group Ltd v Pyke*, Brooke LJ stated that the claimant was companies' director in the name only. Similarly, when the company is in administration or voluntary liquidation, its director is in name only. When the director lacks or loses all his management powers, then he has very negligible or minimal powers like the claimant had in *Plus Group Ltd* [14].

In case, when the company's director is authorised to utilise his management powers, of course, in such circumstances, he will be entertaining his general duties. Hence, he will only owe the duties given in section 172 of the 2006 Act. To this end, he has to work in the best interest of the company reasonably and honestly. However, he will not be obliged to act beyond his power as well as when he loses his office then he will not be able to perform the duties mentioned in sections 173 to 177 of the 2006 Act. *CMS Dolphin Ltd v Simonet* describes in such circumstances the company's director will be independent to take the decision of giving resignation. In this way, he will be independent to make any decision in his interests [15].

## System building services group case

This segment of the piece describes the facts and the decision of the case *System Building Services Group Ltd* and meticulously and critically analyses the verdict of the case.

### Facts

The case is about selling the property of the company by the officeholder to the director of the company. The appointment of an administrator was done by the company when it was passing through the phase of administration. Misfeasance was done by the appointed administrator. The administrator relied on an irrelevant authority that was *Mama Milla Ltd*. The property of the company comprises a house that was for the residency of the subcontractors and the company's director. The value of the house was near about £195,000 and that worth was told to the administrator. The director of the company wanted to buy this house at its proper value. Over time, the administrator did not initialize the formalities of the sale.

The company went into the phase of creditors' voluntary liquidation from the administration. The mortgage lender was demanding its sale again and again. The administrator at that time accepted the offer of the company's director who was willing to buy the house. The amount offered by the director was £120,000. When the company's director paid the total price, then the house was transferred to the director. After creditors' voluntary liquidation, the company was dissolved.

After the dissolution of the company, another fact arose that the misfeasance had been committed by the appointed administrator. Hence, the corporation was restored to the register. Moreover, the appointment of another insolvency practitioner as liquidator was made by the company. After investigation of the sale of the property of the company, the director was sued only as the administrator was bankrupt and an order of unwinding the sale of the company's property was pleaded by the liquidator.

The liquidator argued about the conduct of the administrator and his claim was based on it. Because the administrator had to work in the best interest of the company and the administrator owed a fiduciary duty to act honestly and in good faith. The administrator was obliged to work reasonably and honestly as held in *Brewer v Iqbal*. It was alleged that the administrator had breached the duty by selling the property of the company for an unreasonable amount that was £120,000 knowingly the expected value of the property was £195,000. If the infringement of the duty was done by the administrator, and the director was thinking "to make it unconscionable for him to retain the benefit of the receipt," then undoubtedly, in the light of *Bank of Credit and Commerce International (Overseas) Ltd V Akindele*, the liability will be imposed on the director for knowing receipt [16,17].

The company's director knew the fact that he was purchasing the property of the company at a very low and unreasonable price. The director knew for buying the property at that price, he had a lot to do with the administrator. The administrator might have alleged the "primary liability" while the director might have alleged "secondary liability." The liquidator could have done so without making the director of the company a party to the suit.

The liquidator sued the director for infringement of his duties rather than for knowing receipt. It was asserted by the liquidator that there are duties imposed on the company's directors in light of sections 171 to 177 of the 2006 Act. Furthermore, if the company is in the phase of administration or voluntary liquidation, the director has certain duties to perform. Consequently, as in the case in hand, the company was passing the phase of administration and voluntary liquidation, however, the duties were not performed by its director and even the director breached the duties more specifically under section 172 of the 2006 Act to promote the company's success [18].

The director agreed that various duties have been imposed on the director of the company under sections 171 to 177 of the 2006 Act even though the company was passing through the phase of liquidation or administration. Many statements were given in defense regarding the scope and extent of duties owed by the company's director. To this end, the defense concluded that "once a company enters administration or liquidation, the duties under sections 171 to 177 of the 2006 Act apply only to an exercise of a director's powers qua director." [19].

### Decision and reasons

Very inadequate arguments were listened to by the court as the court acknowledged that fact. However, the court rejected such arguments. Furthermore, Judge Barber stated that when the company is in the phase of administration or liquidation, the general duties of the company's director continue to apply. The judge gave many reasons to support that point of view. Firstly, the judge stated that if the company's directors retire from their office then the directors are obliged to perform duties under sections 170, 175, and 176. It is necessary to note that "they must apply beyond the point at which a given individual is exercising any powers as a director." The judge further noted that the 2006 Act is a clear document and it has never stated that in the cases when the company goes into administration or voluntary liquidation the duties of the director ended. The judge stated that sections 171 to 177 of the 2006 Act are based on common law as well as equitable principles hence these are not rigid, and they are flexible enough so that they are validly applicable when the company is facing the administration or liquidation. The judge held that none of any authority has been referred to that evince that the duties of directors ended in the case when the company is in liquidation or administration. Furthermore, it was noted that the director of a company is not spontaneously removed from the job in circumstances when the company is in administration or voluntary liquidation. The judge concluded that in the present the director had breached his duty as the company was in the phase of liquidation but still the director was obliged to promote the success of the company. Buying property of the company at an insufficient price showed that the director acted to save self-interest rather than considering and promoting the interest of the company or creditors.

### Comment

The court had acknowledged that it had heard very limited arguments

during the proceedings of the System Building Service's case. The result and the verdict of this case would be quite different if the court would listen to the complete and comprehensive arguments on the similar points that are discussed and considered by the court in Plus Group. If System Building Service would be considered as a benchmark then impracticable duties would be imposed on the company's director. In this way, the English courts' attitude will be affected and they will start treating the director of the company that will be in the phase of compulsory liquidation or the director who leaves his job or has been effectively expelled from the company very differently than a director of a company which will be in the phase of administration or voluntary liquidation.

In the System Building case, it is presumed that the director of the company before negotiating to purchase the property of the company had resigned. This presumption will not affect the outcome. The resignation of the company's director would have done no more than reflect what already had actually occurred. However, the resignation could change the fate of the case. Due to it, the company's director in System Building Services would not be liable for infringing any of his duty. CMS Dolphin Ltd states that the director can resign and leave his office at any time and by giving any justification. Hence, by resigning from his job, the director of the company would not infringe any of his duties.

It is impossible and impractical to follow the verdict of the System Building Services. Following this decision will place the directors of the companies in an unrealistic conflicting status. However, ignoring the decision of System Building Services will be the cause of inconsistency. That inconsistency will be far better than following a subjective decision.

The director of the company negotiated to purchase the company's property from the liquidator or administrator in System Building Services. If this case would be followed, then the administrator, liquidator, and director of the company would owe a duty to work for the better interest of the corporation and they were obliged to work in good faith. The directors owe a duty to sell the objects or assets at their reasonable and best price. The director of the company would have to offer the highest reasonable price. However, such duty cannot be imposed on the company's director as if such duty is imposed on the director then only a few directors of the company would countenance purchasing the property of the company from the liquidator or administrator. If the duty of paying a fair amount would be imposed on the director then they would be more suspicious about whether or not the price paid by them was fair enough.

If it is assumed that a company that is in the phase of liquidation or administration, incorporates another corporation to purchase the first company's assets and business. In this scenario, if the System Building Service is applied then the company's director owes a duty to the first company to seek a sale at the possible, reasonable, and highest price or reasonable fair price, and it owes a duty to the second company to seek the sale at the possible lowest price. In this circumstance, the director cannot maintain his conflicting duties.

If it is presumed that the administrator or the liquidator invokes the corporation to sue its director for past misfeasance. While negotiations, would the company's director be obliged to perform a duty to promote the company's success. If the answer to this question is "No", why not? The answer to this question cannot be that the director and the company's interests are different or opposite or the interest of the corporation are preserved by the insolvency practitioner, meanwhile, these are the things in common with the System Building case.

The imposition of the duties on the company's director in name only is subjective, unreasonable, and unnecessary as noted in the System Building case by Judge Barber. Licensed insolvency practitioners are the guardians and protectors of the companies' assets to which they are appointed. It is submitted that the insolvency practitioner should be sued for the infringement of the fiduciary duty or negligence, in the cases, when he remains unsuccessful in protecting the assets of the company.

## Conclusion

The director of the company that is in the phase of compulsory liquidation or the director who leaves his job or has been effectively expelled from the company is treated very differently than a director of a company that is in the phase of administration or voluntary liquidation. Consequently, this difference in treating the directors should be eradicated. Unless they are authorized to utilize the management powers, they should perform the duties that are enshrined in section 170 of the 2006 Act, and otherwise, they are independent to protect their interest.

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