McCann FitzGerald

Briefing

Directors' Declarations of Solvency:

Proceed with Care

This briefing was produced by the Institute of Directors in association with McCann FitzGerald for use in Ireland. McCann FitzGerald is one of Ireland's premier law firms, providing a full range of legal services to many of Ireland's leading businesses. Clients include international organisations, major domestic concerns, emerging Irish companies and clients in the State and semi-State sectors.

A 2018 judgment by the UK High Court[1] highlighted the potential risks for directors in making a solvency statement about a company without having made a full inquiry into its affairs. This briefing looks at issues a director should consider before making the equivalent Irish-law declaration of solvency as part of the summary approval procedure.

The Case

The company (LRH), acting by its liquidators, sued three of its former directors. The directors had formulated and implemented a group reorganisation whereby the company's share capital had been reduced and a dividend of £21 million paid to the company's sole shareholder.

UK company law required that, prior to the capital reduction, the directors should make a solvency statement that each director had formed the opinion that (a) there was no ground on which the company could be found to be unable to pay its debts; and (b) if it was intended to commence its winding up within 12 months, that the company would be able to pay its debts in full within 12 months of the winding up or, in any other case, be able to pay its debts as they fall due during the following year. In forming these opinions the directors had to take into account all of the company's liabilities (including any contingent or prospective liabilities).

The court held that:

- the reorganisation had been implemented in a way that made the company's insolvency unavoidable so the directors had breached their duty to act in the best interests of the company, which by that stage (because of the company's financial predicament) had become a duty to act in the best interests of the creditors;

- the solvency statement had been made invalidly because one director (Mr Trew) had not properly formed the required opinion of solvency: he had not made any enquiries about, or considered, the company's actual liabilities or how they were being met at the time of the reorganisation;
- the capital reduction that had been made on the basis of the solvency statement was unlawful and each director was responsible to the company for the divided paid out as a consequence; and
- Mr Trew assumed that the parent company would meet the company's liabilities, despite there being no binding agreement to this effect and that such informal assistance could not be considered an asset that was properly available to the company to support a solvency opinion.

Companies Act

Certain Irish companies use the summary approval procedure under the Companies Act 2014 (the "**Act**") to authorise activities which would otherwise be prohibited or in some cases could otherwise only be engaged in with court consent. These "restricted activities" include a reduction of capital, variation of company capital on a reorganisation or approval of certain transactions involving directors and, as part of the approval process, use a declaration of solvency in writing made by the directors (or by a majority of directors where there are more than two).

The content of the declaration varies depending on the particular restricted activity although in every case it includes confirmation by the directors that a full inquiry has been made into the affairs of the company and that having done so, they have formed the opinion that the company is able to discharge its debts and liabilities in full as they fall due for a period of 12 months after the restricted activity is carried out.

Personal Liability for Directors

Where a company director makes such a declaration without having reasonable grounds for the opinion that it expresses, the court may[2] declare that the director is (without limitation of liability) personally responsible for all of the debts or other liabilities of the company.

If the company is wound up within 12 months of the making of the declaration and its debts are not paid or provided for in full within 12 months after the commencement of the winding up, it will be presumed, unless the contrary is shown, that each director of the company who made the declaration did not have reasonable grounds for expressing the opinion referred to above. Therefore the onus is on the director to prove that he or she had reasonable grounds for expressing the opinion.

1 *LRH Services Limited (in liquidation) v Trew* [2018] EWHC 600 (Ch).

2 The court would be acting on the application of a liquidator, creditor, member or contributory of the company or the Director of Corporate Enforcement.

Considerations for Directors

Facts and Reasonable Grounds

A director's view of the year following the making of the declaration is only an assessment to be made on the facts and circumstances known to the director at the time of making the declaration (having made a full inquiry into the affairs of the company) and a director is not required to speculate as to what might happen in the future other than by reference to the facts known to the director at that time.

In making the declaration, a director is not required to ensure that the company will be able to pay or discharge its debts and other liabilities in full as they fall due in the 12 months after the date of the relevant act or that the cash-flow projections for the company will be met. A director risks incurring liability only if, having regard to the position of the company at the time the declaration is given, he or she does not have reasonable grounds for believing that the company, having carried out the transactions, will be able to pay or discharge its debts and other liabilities in full as they fall due in the 12 months after the date of the relevant activity or transaction.

Directors' Duties

An important question that arises in some corporate restructurings is the extent to which directors owe duties to the members or to the creditors of the company (or to both). In a recent judgment[3] the UK Court of Appeal confirmed that the duty to have regard to the interests of the creditors arises when the directors know or should know that the company is, or is likely to become, insolvent. In that case, the court confirmed that payment of a dividend can be challenged under UK law as a transaction defrauding creditors and confirmed the possibility that payment of a dividend could be considered to be an attempt to put assets beyond the reach of actual or potential claimants.

Decision to make a Solvency Declaration

When deciding whether he or she can properly make the declaration, a director should look at various factors including working capital figures, the contents of the cash-flow for the group and the company and relevant management accounts.

Although, for certain restricted activities, the summary approval procedure requires an independent report from an expert (qualified to be the statutory auditor of the company) setting out an opinion as to whether the declaration is not unreasonable, the Act does not require directors of the company to involve the auditors in the process whereby directors make the declarations. However, in some cases it may be appropriate to do so.

---

3 *BTI 2014 LLC v Sequana SA* [2019] EWCA Civ 112.

It is for the directors to determine what information they ought to rely on to get comfortable that the company will be able to pay its debts as they fall due for the purposes of the requisite declaration. Relevant board minutes should then describe this information and any documents as well as note any other relevant considerations (such as discussions with the financial director). Board minutes should also note specific details of the assets and liabilities that have been considered. The company should document any group company financial support upon which it depends so that it can be properly considered as an asset.

Conclusion

While the summary approval procedure is a valuable, efficient and cost-effective way of permitting a restricted activity by a company, directors should inform themselves fully and carefully when making the declaration of solvency.

Further information is available from

Garreth O'Brien
Partner
+353 1 607 1489
garreth.obrien
@mccannfitzgerald.com

Peter Osborne
Consultant
+353 1 611 9159
peter.osborne
@mccannfitzgerald.com

Frances Bleahene
Senior Associate
+353 1 607 1466
frances.bleahene
@mccannfitzgerald.com

Alternatively, your usual contact in McCann FitzGerald will be happy to help you further.

© McCann FitzGerald and Institute of Directors in Ireland 2020. All rights reserved.

Institute of Directors in Ireland, Europa House, Harcourt Street, Dublin 2
01 411 0010 | info@iodireland.ie | www.iodireland.ie

This document is for general guidance only and should not be regarded as a substitute for professional advice. Such advice should always be taken before acting on any of the matters discussed.

© McCann FitzGerald, September 2020