



STATEMENT OF INSOLVENCY PRACTICE 4 DISQUALIFICATION OF DIRECTORS SCOTLAND

New legislative provisions for the reporting obligations of insolvency office holders on the conduct of those who formerly controlled a company came into effect from 6 April 2016.

Conduct reports in insolvency procedures which commenced after 6 April 2016 must be submitted within 3 months of the office holder's appointment, via the new online reporting portal. Conduct reports and returns due in respect of procedures commenced before 6 April 2016 will continue to require the submission of a D1 or D2 form.

The existing Statement of Insolvency Practice 4 - disqualification of directors, will not be relevant / appropriate for cases to which the new legislative provisions apply. It will continue to apply to cases to which the existing legislation applies.

The existing legislation and the current SIP 4 will be withdrawn on **6 October 2016**.



STATEMENT OF INSOLVENCY PRACTICE 4

SCOTLAND

DISQUALIFICATION OF DIRECTORS

1 Introduction

- 1.1 This Statement of Insolvency Practice is to be read in conjunction with the Explanatory Foreword.
- 1.2 This statement has been prepared for the guidance of insolvency practitioners on their statutory obligations under the Company Directors Disqualification Act 1986 and related legislation. It applies to Scotland only.
- 1.3 The law relating to the obligations of insolvency office holders in relation to disqualification matters is contained in the Company Directors Disqualification Act 1986 ('The Act') and associated statutory instruments, of which the most significant for practitioners is The Insolvent Companies (Reports on Conduct of Directors) (Scotland) Rules 1996 ('the Rules'). In addition to companies which may be wound up under the provisions of the Insolvency Act 1986, the Act applies to building societies and incorporated friendly societies. In this statement references to companies should be read as references to anybody to which the Act applies. The DTI issue guidance notes, which are updated from time to time, elaborating on the requirements, to which practitioners should refer.
- 1.4 By virtue of Article 16 of the Insolvent Partnerships Order 1994 certain sections of the Act also apply to insolvent partnerships where they are wound up as unregistered companies under Part V of the Insolvency Act 1986. (However, it should be noted that the Insolvent Partnerships Order 1994 does not apply to Scottish partnerships.)

2 Submission of reports and returns

- 2.1 Insolvency practitioners who are appointed to a company as receiver, administrator, or liquidator in an insolvent liquidation are required to submit information on the conduct of the directors of the company to the Disqualification Unit of the Department of Trade and Industry. The information must be submitted on the appropriate statutory form (Form D1 (Scot) or Form D2 (Scot), known colloquially as 'D Forms') appended to the Rules, or in a form which is substantially similar, together with the supporting documentation as described in 4.5, as appropriate.
- 2.2 Form D1 (Scot) (subsequently referred to as a 'report') is used to report conduct which may render the director unfit to be concerned in the management of a company. Form D2 (Scot) (subsequently referred to as a 'return') may be either an 'interim return' or a 'final return', the appropriate designation being made on the front page of the form. An interim return is used where the practitioner expects to be able to submit either a report or a final return at a later date. A final return is used where the practitioner has not become aware of any matters which would require him to submit a report.
- 2.3 The practitioner is required to submit a report forthwith to the Secretary of State where it appears that the conduct of a director makes him unfit to be concerned in the management of a company. If such a report has not been submitted before the expiry of six months from the 'relevant date' or, if he vacates office earlier than one week before the expiry of the six-month period, within 14 days of vacating office, he must submit a return (either interim or final). The 'relevant date' is:

- in a creditors' voluntary liquidation, the date of the winding-up resolution;
- in a court liquidation, the date of the winding-up order made by the court;
- in a members' voluntary liquidation, the date when the liquidator formed the view that the company was insolvent;
- the date of the appointment of a receiver; or
- the date of the administration order.

Except in the case of joint appointments, where there is more than one office holder either concurrently or consecutively, a report or return is required from each one appointed within the relevant period. The Secretary of State does not require more than one report or return from joint office holders.

- 2.4 The submission of a report or final return within the six months period will discharge the practitioner's statutory obligation (except that he may be required to provide information or otherwise assist the Secretary of State). Where this is not possible, and an interim return is submitted, the practitioner is required to indicate on the return the date by which he expects to be able to submit a report or final return. When fixing this date the practitioner should bear in mind that any proceedings against a director must be commenced within two years of the company's becoming insolvent (see paragraph 2.6 below) and that the Disqualification Unit needs time to evaluate cases and prepare papers, where action is to be taken. For this reason the Unit hopes to receive reports within nine months whenever it is not possible for them to be submitted within the six-month period. If for any reason the practitioner finds that he is not able to submit his report or final return by the date specified in the interim return, he should notify the Disqualification Unit accordingly as soon as possible.
- 2.5 Practitioners should bear in mind that the effective operation of the disqualification procedures depends on practitioners fulfilling their obligations in a timely manner and maintaining proper communication with the Disqualification Unit in cases of difficulty. Practitioners should not routinely await deadlines before submitting reports or returns where they can be submitted earlier, and should not routinely submit interim returns where a report or final return can be submitted within the initial six month period.
- 2.6 For the purposes of the two year time limits for bringing proceedings a company becomes insolvent when:
- it goes into liquidation (as defined in section 247(2) of the Insolvency Act 1986);
 - an administration order is made; or
 - a receiver is appointed.

Where there are successive events in respect of the same company the two-year limit runs from the date of the first event.

3 Extent of work

- 3.1 The practitioner is expected to base his report, or decision that only a return is necessary, on information coming to light in the ordinary course of his work and is not required carrying out investigations specifically for the purpose of fulfilling his duties under the Act. The Statement of Insolvency Practice entitled 'A Liquidator's Investigation into the Affairs of an Insolvent Company' describes the extent of the investigation work that is expected in liquidation.
- 3.2 Since the submission of a report may lead to proceedings in which he may be called to act as a witness, the practitioner should take care to ensure that the basis of his opinion that a report should be submitted is properly documented. Where a practitioner has formed a preliminary view that the conduct of a director renders him unfit to be concerned in the management of a company he should normally, if he has not already interviewed him in the course of his duties, consider the advisability of seeking a

meeting with the director concerned, with a view to confirming his understanding of the facts upon which he based his preliminary view that the submission of a report was appropriate.

4 Contents of report

4.1 Schedule 1 to the Act lists matters to which the courts shall have regard when considering a disqualification case and practitioners should have regard to the matters listed there when considering whether a report is appropriate. However, these matters are not exhaustive and the practitioner should include in his report other matters, which he believes to be relevant. The Disqualification Unit attaches particular importance to the following:

- attempted concealment of assets or cases where assets have disappeared or a deficiency is unexplained;
- appropriation of assets to other companies for no consideration, at an undervalue, or on the basis of unreasonable charges for services;
- preferences;
- personal benefits obtained by directors;
- overvaluing assets in accounts for the purpose of obtaining loans or other financial accommodation, or to mislead creditors;
- loans to directors in making share purchases;
- dishonoured cheques;
- use of delaying tactics;
- non-payment of Crown debts to finance trading;
- phoenix operations;
- misconduct in relation to operation of a factoring account;
- taking of deposits for goods or services ultimately not supplied; and
- cases where criminal convictions have resulted.

4.2 Practitioners should not take a pedantic view of isolated minor compliance failures, but should form an overall view of a director's conduct when deciding whether a report is appropriate.

4.3 Details of the conduct giving rise to the decision to submit a report should be included, and specific examples of alleged failings should be given wherever possible. It is recognised that in some cases substantive information may not be available, but the report, in the light of other information already held by the Disqualification Unit, may reveal a course or pattern of unfit conduct. Accordingly in these cases the practitioner should report on the basis of such evidence as does exist. This may help the Disqualification Unit in deciding whether to recommend to the Secretary of State that it is in the public interest for an action to be brought in the event of the director being involved in other insolvencies.

4.4 The following matters should be dealt with within the body of the report:

- the position on any civil recovery actions;
- the adequacy of the accounting records;
- evidence available in support of insolvent trading;
- professional advice taken by the directors, and specific correspondence which sheds light on directors' conduct, for example with banks, solicitors, accountants or creditors.

Where the practitioner has been unable to quantify, or otherwise comment on the amounts involved in the alleged conduct due to cost or other considerations then an explanation to that effect should be included in the report.

4.5 The following items should be appended to every report, where the information is available:

- a copy of the statement of affairs: where none has been submitted the report

should include an estimate of the financial position of the company by listing known assets and liabilities;

- notes issued for purposes of the creditors' meeting (liquidations only), any original notes signed by directors from which the final issued note was prepared and any record of the proceedings at the meeting;
- section 67 report to creditors (receivership);
- copy accounts as available - last statutory accounts and any other draft, management, or interim accounts;
- a summary of asset realisations, unrealised assets yet to be dealt with and claims notified;
- dividend prospects;
- aged creditor analysis - if readily available from the company's records.

- 4.6 When fulfilling his reporting duties, a practitioner should have regard to the laws of defamation and should ensure that he has followed the procedures set out in paragraph 3.2 above. A defamation action, even if it has no prospect of success, can be time-consuming to deal with. He should bear in mind that if disqualification proceedings are brought the report will form the basis of the Unit Report and eventual Petition or Summary Application and may be subject to disclosure to the respondent director in the proceedings. -
- 4.7 Dictation of the report to, or its discussion with, members of the practitioner's staff is protected by qualified privilege. Practitioners should stress to staff the need to maintain strict confidentiality and not to discuss the contents of reports with people not involved in their preparation. Certain forms of communication within the practitioner's own office (such as e-mail) may also amount to 'publication' which might lead a director to consider a defamation claim.
- 4.8 The Disqualification Unit encourages approaches from practitioners who require assistance or clarification regarding their investigations or the completion of a report or return. However, such contact is informal and does not diminish the practitioner's responsibility for preparing the return or report in accordance with his own judgement.
- 4.9 In certain circumstances, the Court is entitled to have regard to the conduct of a director in relation to companies other than the company to which the practitioner had been appointed. Accordingly, if the practitioner has information about the conduct of a director in relation to other companies which, in his opinion, might support the view that the director's conduct had rendered him unfit in the sense required by the Act, reference to that conduct, identifying the company concerned and the relevant material supporting that view, should be included.

5 Further assistance

- 5.1 The Disqualification Unit aims to let practitioners know within two months of the submission of a report whether the case has been targeted for further investigation and, if not, the reason why. If a case is selected the Unit will give the practitioner the name of the case officer dealing with it, who will act as a contact point once the case is allocated (typically within two months of selection). Upon receipt of this notification, practitioners must ensure that all the company books, records and papers, together with all their working files, are maintained and preserved for inspection by the Unit's staff.
- 5.2 Having completed its enquiries, the Unit will prepare a report supported by productions which shall be sent to the practitioner for his consideration. The practitioner will be asked to confirm:
- that the matters contained within the report are factually correct, to the best of his knowledge;
 - that the persons under consideration for disqualification are considered unfit by the practitioner and/or his case manager and he/they will be prepared to attest to

- the same in court, if required;
 - that each of the allegations have been made out against each of the individual directors; and
 - that each of the allegations are satisfactorily supported by sufficient evidence.
- 5.3 Where proceedings are instituted, the evidence will be by Petition or Summary Application supported by productions. The practitioner and/or his case manager will be the most suitable witness (as) as to facts.
- 5.4 The practitioner is not an expert witness. It is for the Disqualification Unit to draw inferences as to a director's conduct from the practitioner's evidence as to the facts.
- 5.5 The case of *Re Pinemoor Limited* ([1997] BCC 708) contained judicial comment on the purpose of the practitioner's evidence. The judge noted that the purpose of the practitioner's evidence is, first, to place before the court the facts which the practitioner had established as a result of holding his office; and, secondly, to draw to the attention both of the court and of the respondent those matters upon which the Secretary of State relied in support of his allegation of unfitness. He went on to observe that in the course of that exercise it was not unusual for the Secretary of State, through his witnesses, to invite the court to draw inferences of secondary fact from the primary facts established by the practitioner's evidence. He added that it would be preferable if in disqualification proceedings the witnesses were careful to distinguish between the facts which they were able to establish by direct evidence, the inferences which they invited the court to draw from those facts, and the matters which were said to amount to unfitness on the part of the respondent.
- 5.6 The contents of the practitioner's evidence should be confined to matters of fact and simple conclusions drawn therefrom. The practitioner should ensure that he only refers to matters within his knowledge and belief. Where the Petition or Summary Application includes matters which have come to light as a result of the Unit's investigations, the practitioner should satisfy himself that the matters stated therein are within his own knowledge and are consistent with the other matters stated. It is important that the practitioner should deal with all evidence which he considers to be relevant to the court's consideration of the director's conduct, and should not omit matters which might favour the director. If he is dissatisfied with any aspect of the Unit's report he should discuss his concerns with the Unit as soon as possible.
- 5.7 There is no requirement for the evidence to be given by the office holder himself if there is another member of his staff with the appropriate knowledge to do so, who may be called upon to give oral evidence in the proceedings.
- 5.8 Practitioners should bear in mind that under section 7(4) of the Act the Secretary of State has power to require office holders, or former office holders, to furnish him with such information, and produce and permit inspection of such records, as he may reasonably require. In receivership cases, where the practitioner is proposing to return the company's records to the directors, he should notify the Disqualification Unit accordingly.
- 5.9 Practitioners should confine any evidence given by them in Court Proceedings for disqualification of a director to matters of fact. It is not appropriate for a practitioner to express an opinion in such Court Proceedings on whether the directors concerned are unfit to hold office as directors. It is also inappropriate for a practitioner to express an opinion on whether any allegations against directors are satisfactorily supported by sufficient evidence. These are matters for the court to decide after hearing the evidence.

6 Costs

- 6.1 The submission of reports or returns is one of many statutory duties that automatically fall upon the practitioner accepting an appointment in one of the categories to which the

requirement applies. As such it does not attract any specific entitlement to remuneration.

- 6.2 However, payment will be made to the practitioner for work done by him and his staff for perusal of the Unit's report. He may, in exceptional circumstances, be paid for work done by way of further investigation over and above the normal standard of reporting set out in paragraph 4 above. The likely extent of the work and level of costs should be discussed with the Disqualification Unit before the work is undertaken in accordance with "Dear IP" notices. Solicitors acting for the Unit can be contacted to provide assistance to the practitioner on points of difficulty or concern which he may have in relation to the Unit's report. All work after the commencement of disqualification proceedings will be authorised in advance and paid for at the agreed rate.
- 6.3 The Unit will not pay for any additional work required to address any omissions from the report of the matters referred to in paragraph 4 above.

Effective date: 1 January 2005

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