

Company Directors Disqualification Act 1986

Guidance Notes for the Completion of Statutory Reports and Returns

These notes are important and should be read before completion
of any report or return under Section 7 of the Act.



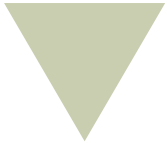
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1. Purpose of this Guide



This guide is for Practitioners who are required to report under Section 7 of the Company Directors Disqualification Act 1986 (CDDA). It updates the guidance published in March 1993.

Disqualification of directors is a rapidly evolving area. This guide:

- sets out what the Disqualification Unit ("the Unit") sees as current best practice in reporting unfit conduct;
- brings the Unit's guidance into line with the reporting changes which were made in The Insolvent Companies (Reports on Conduct of Directors) Rules 1996 and The Insolvent Companies (Reports on Conduct of Directors) (Scotland) Rules 1996; and
- reflects best practice guidance given by the Society of Practitioners of Insolvency in SIP2 ("A liquidator's investigation into the affairs of an insolvent company") and SIP4 ("Disqualification of directors").

At the time of printing, the Institute of Chartered Accountants in Scotland was drafting versions of these statements for their members who are licensed Insolvency Practitioners.

The guide does not have the force of law. Please do not regard it as a substitute for understanding the legislation itself. Moreover, you should bear in mind that it is your responsibility to exercise your independent judgement on the conduct of individual directors in individual cases. However, the Unit hopes that the guide will be a useful reference point for you, your managers and staff.

2. Introduction



2.1 What is the legislation?



The CDDA came into force on 29 December 1986. It repealed and consolidated the disqualification provisions in the Companies Act 1985 and the Insolvency Act 1985.

What are the reporting duties of Practitioners?

The guide deals with reporting requirements under Section 7 CDDA. In England and Wales, their detailed provisions are now contained in The Insolvent Companies (Reports on Conduct of Directors) Rules 1996 ("the reporting rules") which came into force on 30 September 1996. The procedure for disqualification applications is laid down in The Insolvent Companies (Disqualification of Unfit Directors) Proceedings Rules 1987 (as amended by The Insolvent Companies (Disqualification of Unfit Directors) Proceedings (Amendment) Rules 1999) ("the proceedings rules") and with the Practice Direction on Directors Disqualification Proceedings.

The procedure for bringing proceedings in respect of Scottish companies is summarised on page 18.

Section 7(3) of the CDDA places a duty on you as liquidators of companies which are being wound up voluntarily (as well as on the Official Receiver in the case of a company which is being wound up by the Court), or as administrative receivers and administrators, to send a report to the Secretary of State as soon as you think that:

- a person is or has been a director of a company which has at any time become insolvent (whether while he was a director or subsequently); and

- his conduct as a director of that company (either taken alone or taken together with his conduct as a director of any other company or companies) makes him unfit to be concerned in the management of a company.

Each office-holder must report independently (but see page 17 in respect of joint appointments). The reporting rules also require you to make a report or a return no later than six months after your appointment (or sooner in the case of earlier vacation of office), if you have not previously reported on all persons mentioned in rule 4(2) of the reporting rules. Failure to submit a report or a return or to include all the known information can lead to prosecution.

When reporting to the Secretary of State, you should have regard to the reporting rules and to Schedule 1 to the CDDA which lists certain matters to be considered by the Court in determining whether the conduct of a director in relation to the affairs of a company, or companies, makes that person unfit to be a director of companies generally. The list is not exhaustive. The decision whether to initiate disqualification proceedings is made by the Secretary of State if it appears to be in the public interest.

The Secretary of State considers the matters of unfitness reported, alongside any matters reported on previous occasions and any other relevant information available.

When forming a view of whether conduct is unfit, you are asked not to be pedantic about isolated technical failures, for example, the occasional lapse in filing annual returns etc., but to be objective about each director's conduct. Please also remember that you need only consider matters of conduct based on information you acquire in your normal duties and by reference to the books and records available; you are not obliged to make investigations which would not otherwise be necessary for the purposes of the administration.

The Council of the Society of Practitioners of Insolvency (SPI) has issued Statements of Insolvency Practice (SIP), two of which you should have particular regard to when discharging your reporting duties under the CDDA. A summary of the key points from SIP2, "A liquidator's investigation into the affairs of an insolvent company", is in Appendix 1 to this guide. You should also consider SIP4, "Disqualification of directors".

Section 7(4) of the CDDA says that you have a duty to provide the Secretary of State or the Official Receiver, with all such further information (including relevant books, papers and other records) as may reasonably be required to support an application.

If proceedings begin, you (or, if you prefer, a member of your staff with day-to-day responsibility for the insolvency) will be asked to make an affirmation or swear an affidavit, and may be called to give evidence in Court. In cases before the Scottish Courts, you (or a member of your staff) will need to attend in person unless the proceedings are unopposed.

2.2 What is the role of the Disqualification Unit?



In cases based on information from Practitioners, the claimant for a disqualification order is the Secretary of State for Trade and Industry. The Disqualification Unit of The Insolvency Service, based both in London and Edinburgh, is the administrative arm of the Secretary of State for applications under Section 6 of the CDDA. The CDDA contains other provisions which enable disqualification applications to be made, but the Unit solely deals with those applications based on unfitted conduct reports from Practitioners and Official Receivers.

On receiving your report, the Unit's Central Vetting Section considers it carefully. This Section is responsible for determining whether, on the face of things, there is sufficient unfit conduct for it to be in the public interest to seek disqualification; and if so, from reading the report and any other information which the Unit has, whether adequate evidence appears to be available. In conjunction with you and your staff, the Unit then either:

- prepares an affidavit (or draft report in respect of Scottish companies) for you to consider and eventually swear or affirm; or
- allocates the report to the local Official Receiver who carries out the same duties, although always under the general direction and final authority of the Unit.

The Unit arranges for legal input from the Treasury Solicitor or, more usually, local solicitor agents, employing Counsel when needed. An application is taken through the Courts by the Treasury Solicitor, the local solicitor agents, or the Official Receiver.

2.3 How does the Unit decide when to apply for disqualification?



Appendix 3 gives a flow chart summarising the decision-making process. The main points are:

- Every report is considered on its own merits.
- If the Unit considers that the director is unfit to be concerned with the management of a company, the Secretary of State applies for disqualification in the public interest.
- The evidence must be sound and of substance. The Courts regard disqualification as a severe restriction on the rights of the individual. So the Secretary of State must be satisfied that there is a reasonable prospect of success. It is not public policy to seek disqualification based on unsubstantiated assertions, presumptions or assumptions, or a general feeling of "unhappiness" about the conduct of the director, or the circumstances surrounding the failure of the company.

2.4 Late reporting



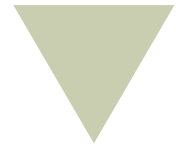
The CDDA says that the Court may allow the Secretary of State to make applications outside the statutory two-year period. But several judicial decisions have made it clear that such leave will not be readily granted and that the Secretary of State must show good reason for leave to be granted. In assessing whether there are good grounds for granting leave, the Court will consider the length of delay, the reasons for it, the strength of the case and the degree of prejudice to the defendants.

Experience shows that the late submission of an unfit conduct report will not itself be a "good ground", so it is vital to send your reports as soon as the information is available, as required by section 7(3) of the CDDA. An interim return must be sent within six months of the relevant date laid down in rule 4(4) of the reporting rules if you have not made a report under section 7(3) within that period covering all the persons mentioned in rule 4(2). If you send an interim return, you are strongly encouraged to send a report or final return within a further three months. If you need longer than this, please contact the Unit to discuss the matter.

If you are not sure what kind of report to send, please contact the Unit's Central Vetting Section for advice and technical guidance. In exceptional circumstances, where urgency seems paramount, the Unit may agree that an "outline" report is acceptable so that enquiries can begin as soon as possible.

The two-year period within which proceedings must be issued under section 6 of the CDDA runs from the earliest insolvency event affecting the company. If there has been such an earlier insolvency event, you should send your reports as soon as reasonably possible or contact the Central Vetting Section if there is likely to be any delay.

3. Completing the report or return



Your conduct report must be the D1 report or D2 return contained in the schedule to the reporting rules, or in a form which is substantially similar to the relevant form in the schedule and with any necessary variations.

- Send a D1 report if you have unfit conduct to report, and enclose supporting papers.
- Send a D2 return, if you do not have unfit conduct to report. There is no need to add enclosures.

The flowchart at Appendix 4 may help you decide the appropriate form of report. All reports or returns on companies registered in Scotland must be sent to Disqualification Unit (Edinburgh). The statutory forms to use in such cases are D1(SCOT) and D2(SCOT), as appropriate.

As soon as you think there is no unfit conduct to report, please send a D2 return. Every office-holder must send a return or report (but see page 17 in respect of joint appointments).

Insolvency Practitioners Compliance Unit ("IPCU") in Birmingham monitors the submission of reports and returns and, if necessary, sends reminders to Practitioners. Practitioners will be referred to their recognised professional bodies if they fail to send returns on time; to respond to correspondence; or to contact IPCU or the Disqualification Unit.

Practitioners authorised by the Secretary of State who do not comply, will face appropriate action. The Unit may refer a case of non-compliance to be considered for prosecution under Rule 4(7) of the reporting rules.

3.1 The 'D2' interim return



If you have not reported under section 7(3) in relation to all the persons mentioned in rule 4(2) of the reporting rules and you cannot yet send a final return - for example, because you are still examining the company's affairs - then you must:

- send an interim return (also in form D2) within 6 months of the relevant date; and
- provide an estimate of when a report or final return can be expected.

If you can, please send a report or final return within nine months of the relevant date. If you need more time or are having other difficulties, please contact the Central Vetting Section for advice and to agree the best way forward.

The information in your return is input to a computer database and kept for future reference.

3.2 Completing the 'D1' conduct report



The following comments aim to help you complete the D1 conduct report. You should send a D1 as soon as you think that:

- a person is or has been a director of a company which has at any time become insolvent (whether while he was a director or subsequently); and
- his conduct as a director of that company (either taken alone or taken together with his conduct as a director of any other company or companies) makes him unfit to be concerned in the management of a company.

General considerations

You should ask yourself three questions:

- What allegations of unfit conduct am I making?
- What evidence is available to support them?
- What were the roles of the directors and their various levels of responsibility for the unfit conduct?

At the initial vetting stage the Unit need not see all the evidence. However, if you do not send the evidence with the report, you should summarise its main points and say where it is.

Directors' details (section 3 of the D1)

Here you should list all the directors, including shadow and de facto directors of the company, and any other person who appears to you to have been a director or shadow director in the three years before the relevant date in rule 4(4) of the reporting rules. You should also state which of them are responsible for the matters of unfit conduct. Please state each director's full name (including aliases), address and date of birth, and provide the other information required by section 3 of the D1.

If you think that a director is no longer at the address provided, please say so and provide all the information available which will help in tracing the director. The fact that a director is living abroad does not preclude the Secretary of State from seeking disqualification and should not stop you filing a report. If a director cannot be traced, this may prevent proceedings being brought, but we often trace directors by using agents.

Shadow or de facto directors

In section 3 of the D1, please clearly list any people who acted as directors without being formally appointed. The term "de facto" director includes any person occupying the position of director, by whatever name called, if that person has not been formally appointed.

In several cases the Courts have shown that proceedings against such people will only succeed if a very good standard of evidence is produced to show that they acted as directors. It will therefore be useful if you can supply comprehensive evidence of their role. It will probably need to be documentary, in the form of information from third parties such as creditors, auditors, banks, employees, other directors. The Court will need to be convinced that the "de facto" director acted essentially at the same level as the duly appointed directors.

In relation to a company, "shadow director" means "a person in accordance with whose directions or instructions the directors of the company are accustomed to act". However, a person is not treated as a shadow director merely because the directors act on advice he gives in a professional capacity (section 22(5) CDDA). The fact that one member of a board acts on the instructions of a third party does not necessarily mean that the third party is a shadow director; the capacity to influence the whole board (or at least a majority) is the key issue.

The inactive director

In recent years the Courts have addressed the issue of those directors who are not engaged full-time in the company's day-to-day business. In one case, the Court ruled that non-executive directors can be found unfit if they have failed properly to inform themselves of what is happening to a company and thereby failed to take appropriate action, particularly in financial matters. In another case, the Court held that all directors have statutory and fiduciary duties. In the absence of special circumstances, and even though they may not have received payment, directors may make themselves unfit "by virtue of sheer inactivity over the period of their respective directorships".

Connected companies (section 4 of the D1)

Connected companies are those with which the director whose conduct you are considering had an involvement which is relevant in your consideration of the conduct. These include companies in which the company's directors or shareholders have also held directorships or shares. The information the Unit needs is the name of each connected company, the relationship to the company reported on (subsidiary, parent, common directors, common shareholders) and in broad terms the scale and nature of inter-company transactions. If the connected company is in liquidation, administration or in receivership, please

provide any known information.

Unfit conduct (section 5 of the D1)

Here, please give details of the conduct of each director who you regard as unfit, together with a summary of the supporting evidence. If you are attaching these details in a separate report, please at least list here the conduct which causes you to consider that the director is unfit.

Chapter 4 gives detailed consideration of the more usual types of unfit conduct and how you should report them.

Statement of Affairs, Accounts and Report to Creditors (section 6 of the D1)

Please always attach to the D1 a copy of any Statement of Affairs which has been submitted. If it has not been submitted, you should include all details of the known assets and liabilities, explain why the Statement of Affairs is not available, and say how you have tried to obtain it.

With the D1, you should also send:

- a copy of the last two sets of audited or statutory accounts;
- copies of any management or draft accounts for periods thereafter;
- a copy of your report to creditors; and
- a copy of any questionnaires which have been completed by the directors at your request.

Other proceedings (section 7 of the D1)

If you have begun asset recovery proceedings, you should enclose copies of the Statement of Claim and any defence. Please also tell us of the present state of the action. If you have identified a cause of action but have not begun proceedings or made a decision to abandon them, you should give the reasons. Please provide details of any settlements entered into and copies of any Court orders.

If you have begun civil recovery proceedings or are considering them, this is not an adequate reason to delay sending the D1; disqualification proceedings are separate from any recovery actions arising out of

the insolvency.

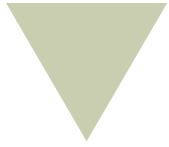
It is particularly important to give details of civil recovery proceedings if your application is for fraudulent or wrongful trading. This is because section 10 of the CDDA allows a disqualification order to be made after a finding of fraudulent or wrongful trading by the Court. If you are considering proceedings for fraudulent or wrongful trading, please give brief details of the evidence that would support such an application.

If you are aware that the police or any other prosecuting authority are taking criminal proceedings in respect of the company, or are investigating its affairs, you should give all known details. Where possible, please include a contact name, address and telephone number of the person dealing with the investigation so that the Unit can ascertain the up-to-date position. Section 2 of the CDDA allows a disqualification order to be made following a conviction for an indictable offence in connection with a company.

If criminal offences are suspected, please remember that sending a D1 does not relieve a voluntary liquidator from the responsibility to send a report to the Director of Public Prosecutions (or, in Scotland, the Lord Advocate) under section 218(4) of the Insolvency Act 1986. If such a report has been sent, or is likely to be, please note this on the D1.

You should also report any other proceedings being taken against the director(s), for example by HM Customs and Excise or the Inland Revenue.

4. Unfit conduct



This section discusses the types of unfit conduct described in Schedule 1 of the CDDA 1986 and states the types of evidence which are needed to support an allegation if put before the Court. This evidence should be viewed in the context of the duties of all directors, which may be summarised as:

- a fiduciary duty to act honestly and for the benefit of the company;
- a duty to act with such a degree of skill as may reasonably be expected of a person with their knowledge and experience; and
- a duty to comply with statutory obligations imposed by the Companies Acts and other relevant legislation.

All matters of unfit conduct fall within one of the following more general categories. You may therefore find it easier to use them when identifying unfit conduct:

- Taking unwarranted risks with creditors' or shareholders' money.
- Taking unfair advantage of the position of director.
- Serious failures to comply with statutory duties and company law.

The following information will be required whatever the nature of the unfit conduct:

- Who was responsible?
- When did it happen?
- What are the sums involved?

The more frequently encountered matters laid down in Schedule 1 to the CDDA are now discussed. They are not exhaustive, and you must report any other matters which demonstrate unfitness on the part of the directors, bearing in mind, among other matters, Part X of the Companies Act 1985 concerning fair dealing by directors of all companies.

However, you should always consider the “materiality” of matters of unfitness. In particular, you should ask:

- How much damage has been done to creditors', shareholders' or employees' interests?
- How much did the unfit conduct affect the directors' ability to manage the company?

4.1 Schedule 1 CDDA - Matters for determining unfitness of directors



Part I - Matters that apply in all cases

Misfeasance or breach of duty

- (a) In your opinion, have the directors received any money or other consideration from the company (except their proper remuneration) for services provided, which has resulted in a material loss to the company? When did this take place and what was the company's financial position at the time?
- (b) Has the director authorised any payments or other dispositions of property to himself (or to connected persons) as in (a) above, including any amounts paid to the directors for personal expenses?
- (c) Has the director been responsible for the non-disclosure to the company of any contracts, dealings or other transactions in which the company's assets or property (including goodwill) were used and which resulted in a material loss to the company?

- (d) Has the director been responsible for any material loss to the company through the sale, assignment, transfer or other disposal of any company assets or property, except in the normal course of business?

If the answer is yes to any of the above questions, please quantify the loss, supply details of evidence available, and provide any explanations given by the director for their actions. If proceedings for recovery have been, or are to be, taken against the director(s), then you should give details in answer to question 20 at section 7 of the D1 (see "Other proceedings" on page 8).

Breach of duty can cover many matters of unfit conduct. Examples might be failing to pay over pension contributions deducted from employees, or allowing the company to make loans for which it received no benefit. The allegation effectively covers any conduct by a director which you consider was not in the proper interests of the company or generally worked to the detriment of creditors, employees or members.

Misapplication or retention of company money or property

Has the director retained or misapplied (or been responsible for the retention or misapplication of) any money or other company property resulting in:

- an obligation to account which has not been fulfilled?

or

- a trading, capital or other loss?

If so, please provide full details.

Transactions defrauding creditors

Matters which you should consider under this heading include:

- Disposal of any of the company's property, assets or undertaking by transfer, gift or at a significant undervalue for the purpose of placing such assets beyond the reach of the company, its members or creditors.

The director's responsibility for this and explanations given should be set out.

- Selling goods which are the property of third parties. Matters for consideration include:
 - ◆ Who was responsible, and what was the value of goods disposed of? Is the original agreement available?
 - ◆ When were the goods sold and what happened to the sale proceeds? Is the sale recorded in the accounting records?
 - ◆ Has the owner of the assets complained; is a separate action for recovery being taken?
 - ◆ Did the company continue to make lease or hire purchase payments after the disposal?

Transactions which give you cause to make allegations of misfeasance/breach of duty, misapplication/retention of company money or property, and transactions defrauding creditors are fairly similar to each other and could collectively be described as comprising "breaches of commercial morality". More usually, you will be reporting in respect of companies which are insolvent, so such transactions will come under the heading of "preferences and transactions at an undervalue". The type of evidence needed in relation to such an allegation is discussed in more detail on page 14.

In either event, you need not overly concern yourself at the reporting stage with defining the allegation by reference to Schedule 1, Part I or II. Rather, you should describe the transaction and show its adverse effect on the company or its creditors or both.

Failure to comply with the Companies Acts 1985 and 1989

Accounting records

Please confirm that you have formally required the delivery of all accounting records to you and state whether you believe you have all records which were kept. If not, please state why others may still be holding the company's records and what steps you have taken to obtain the remaining records. If the accounting records are not produced or are inadequate, and the deficiency cannot properly be explained (except by a balancing trading losses figure), you should always ask the directors for explanations. For example:

- Did the company keep accounting records regularly recording its transactions, dealings, assets and liabilities (section 221 CA 1985)?

- If no accounting records were kept, what was the director's responsibility for the default? What explanation has the director given? Was any accountant or bookkeeper employed?

If records were kept:

- ◆ were any accounts produced and, if so, were qualifications made in auditors' or accountants' reports regarding the adequacy of the records?
- ◆ to what date were the accounting records written up?
- ◆ are there any material omissions, having regard to the size and nature of the business?
- ◆ have the inadequacies hindered your administration, for example, collection of book debts, verification of creditors' claims, identification of assets belonging to the company, and benefits received by the directors?
- ◆ would the lack of proper financial information have caused the directors to be unable to inform themselves of the company's financial position, and to manage the company properly?
- ◆ have the creditors lost because of the inadequacies?

If accounting records have been maintained in a computerised form, you should ensure that you recover both the hard-copy printouts and the relevant source documents from which the accounts have been prepared.

Preservation of accounting records

- For what period did the company preserve its accounting records and where were they kept (section 222 CA85)?
- Were accounting records kept outside Great Britain? If so, were accounts and returns prepared from them and were they regularly sent to Great Britain (section 222 CA 1985)?
- Can you identify any of the accounting records which are missing and give any information as to the circumstances?

Keeping of statutory registers

- Did the company keep the registers required by sections 288, 352 and 353 of the CA 1985?
- If not, what was the director's responsibility for the failures or omissions? The size and nature of the company's business should be taken into account, especially if it is owner-managed.
- Has the lack of any of these records hindered the administration of the company's estate? If so, please give details.

Minute books

Although not specifically referred to within the schedule, the company's minute book can be an important source of information. Often it provides clear evidence of what information was available to the directors and what action they took at various points in time.

- Has the minute book been kept and written up?
- Has it been delivered up to you?

Annual returns

- Please provide details of any (material) omissions or deficiencies in respect of the annual returns (sections 363 and 364 CA 1985).
- What was the director's responsibility for any default, omission or delay in the annual returns, and what explanation has he given?

Accounts

- (a) To what date were audited or statutory accounts last prepared? Or has the company taken advantage of the exemption from audit provisions available to certain small companies?
- (b) Were any accounts prepared for any period subsequent to the accounts referred to in (a) above?
- (c) Have the balance sheets to the accounts referred to in (a) above been signed by the company's officers, and were all required

documents annexed to them (section 238 CA 1985)? If there was any default, omission or delay in preparation, signing or filing the audited or statutory accounts, what was the director's responsibility for this?

- (d) Has any failure to file accounts caused particular prejudice to creditors or third parties or both?
- (e) Concerning the accounts referred to in (a) above, were any auditors' or accountants' reports qualified in relation to matters other than the quality of records, e.g. reference to fundamental uncertainty concerning the company's financial position.
- (f) Were the reports to any earlier accounts qualified? If so, please supply copies and state the extent of the director's responsibility for any of the deficiencies disclosed in the auditor's qualification and what explanation the director has given.

Part II - Relevant matters if the company has become insolvent

Causes of failure and insolvency

You should report on the extent of the directors' responsibility for the causes of the company becoming insolvent.

Conduct which can be put before the Court under this heading can be categorised in terms of:

- trading without regard to the interests of creditors (and shareholders) through incompetence or negligence to a marked degree; or
- trading without reasonable prospect of paying creditors' claims. These are both dealt with in detail below.

As descriptions of types of conduct they are, to an extent, interchangeable. The Courts are reluctant to place responsibility on directors for events leading to a company's failure which could not be foreseen or whose effects could not be mitigated; nor are they prepared to penalise directors for commercial misjudgement.

Trading without regard to the interests of creditors

- What events caused the company's insolvency?
- In promoting the company, was sufficient regard given to the potential viability of its business?
- Was capital available, except as credit from suppliers, to finance the purchase of necessary plant and equipment and to see the company through its setting-up period?
- In accepting contracts, was proper consideration given to the costs involved or did the customers effectively dictate the price? Were the directors aware whether prices charged covered costs?
- Having regard to the size and nature of its business and their own professional qualification and experience, did the directors have available enough financial information, management accounts, feasibility studies or professional advice, to make effective policy decisions?
- Were audited accounts prepared, and filed, by due dates?
- Was information provided to investors, providers of working capital and creditors? Did they rely on that information and was it accurate?

Trading without reasonable prospect of paying creditors' claims

In addition to those matters set out under the preceding sub-heading, the following are relevant considerations:

- (a) When did the company first become insolvent?
- (b) Is that evidenced by accounting information, judgements/claims, threatening letters, dishonoured cheques, distrains, execution, PAYE/VAT/DSS arrears?
- (c) Could the directors have had any valid reason to believe that the company's fortunes would change sufficiently for it to return to solvency?

- (d) Was any capital/cash injection expected to be forthcoming and if so was that expectation reasonable? Would it have been adequate?
- (e) Was professional advice to continue trading (or not to do so) ever received? If so, what was the advice given, when, and by whom, and was it based on accurate information?
- (f) By what amount did the company's deficiency or debts to various categories of creditors increase after the date identified at (a) above?
- (g) To what extent was the continuation of the company's trading facilitated by the withholding of Crown money? By its forbearance, has the Crown suffered disproportionately to the creditors generally? Over what period, compared with other creditors, has the Crown debt accrued?
- (h) With regard to (f) above, what money was introduced directly or indirectly by the directors in the relevant period? If debts have been guaranteed, will those guarantees be honoured? What is the extent of collateral security?
- (i) Did the directors moderate their remuneration/benefits in the relevant period? Did the amounts drawn remain reasonable in all the circumstances? Indeed, was there any increase?

Crown debts

The Courts have held that debts due to the Crown, for example, VAT or PAYE & NIC not paid over, are not, of themselves, evidence of unfit conduct. The existence of Crown debt can provide evidence of a company's inability to pay its debts as and when due, in addition to money owed to trade creditors, as mentioned above.

To make a specific allegation in relation to Crown debts, it is necessary to demonstrate that:

- the Crown has been treated worse than the general body of trade creditors; or
- that the forbearance of the Crown departments has been abused when, for example, deferred collection arrangements have been agreed but not complied with, to the detriment of the Crown.

It is important to report significant failure to comply with statutory schemes where, for a prolonged period, there has been a failure to submit returns and/or pay over money for which the company is accountable to the Crown. Such conduct may, of itself, give rise to a separate allegation.

The Crown is an involuntary creditor. It relies on compliance to be in a position to assess its debt due from the company. Therefore, the absence of Crown pressure should not be regarded as a mitigating factor because the duty is on the company to comply.

It is important, where possible, for Practitioners to identify those claims which are quantified as opposed to those estimated. You should send copies of any claims you receive, when relevant.

Phoenix companies

You should consider how far the business of the company under consideration was the successor of an earlier failed company. The overriding considerations are the time elapsed between two (or more) failures and how far the same people were responsible for managing each company. Clearly you may be restricted as to how far you can enquire into relevant matters. However, listed below are some of the more important the Unit would like to see.

- What assets were acquired from a previous company or business and in what circumstances? How much was paid (if anything) and what was the source of the money used?
- How similar is any business acquired and continued? For instance, did the successor company continue the same contracts or deal with similar customers? Was the workforce substantially unchanged? Did the successor company use the same or similar trading style (section 216 IA 1986), advertising material etc?

In summary, the central question is how far the directors of the new company could reasonably expect it to be viable. In this context, the length of time between the two failures is crucial, as is your consideration of matters listed under "Trading without reasonable prospect of paying creditors' claims" on page 12.

You are also asked to provide details of any 'new' business being managed by the directors in apparent contravention of section 216 of The Insolvency Act 1986.

Consumer prepayments/deposits

The mere fact that a company has taken customer deposits and has then failed to deliver goods or services does not automatically constitute unfit conduct. Neither does the Secretary of State necessarily have to prove that the deposits were taken at a time when the company was insolvent in order to allege unfit conduct.

For the allegation to stand up, there must be some evidence that the failure was not excusable. Although not an exhaustive list, the following factors are relevant:

- Was the company using deposits for its general trading purposes at a time when orders were not being met on time, so that the company was jeopardising deposits without realistic prospect of delivering the goods or services, or being able to repay deposits?
- If it can be shown that a company had neither the intention nor the ability to deliver the goods or services, then the taking of deposits would constitute unfit conduct even if the company is, or was, fully solvent at the time the deposit was taken.
- If the company's treatment of deposit money is in breach of the express terms of a contract, the receipt and handling of such deposits may amount to unfit conduct, even in the absence of fraud or insolvency.

When reporting, you are asked to state, in addition to the above:

- What is the number and aggregate amount of deposits?
- Over what period were the deposits received?
- Were any misleading statements made to customers, and, if so, when and by whom?
- Have depositors been reimbursed under any kind of compensation scheme, or by a credit card issuer?

- Have you received complaints? (Please forward examples.)
- Did the company ever maintain a separate bank account into which deposits were, or should have been, paid?
- What, if any, explanation has been offered by the directors for the failure to supply goods or services, or to give refunds?

Transactions at an undervalue, preferences and dispositions of property

Matters that can be put before the Court are those for which an application has been, or could reasonably be made, for an order of the Court to set aside the transaction under sections 127 or 238 to 240 (in Scotland, section 242 or 243) IA 1986. If the full tests set out in those sections cannot be met, it may still be possible to make out an allegation along these lines. You should highlight any benefit to the director or connected persons, at a time when the company was insolvent or which exacerbated the failure of the company.

Preference/transaction at an undervalue

- When did the transaction take place and who has benefited from it?
- How much was the benefit and what was the full value of the asset transferred?
- Is the transaction recorded in the accounting records?
- Was there a liability in the last accounts to a director or connected person or company where that liability apparently no longer exists?
- What action/decision has been taken over recovery?

Duty to assist the Practitioner and to deliver property

- Has the director failed to deliver to you, when required, any property, books, papers or records of the company (section 234 IA 1986)? If so, please give details.

- Has the director failed to co-operate with you as office-holder, in providing information about the company's affairs (section 235 IA 1986)? If so, provide brief details, including any proceedings taken.
- What explanations have been provided for these defaults?
- What steps have you taken to enforce compliance? Have you verified that the director is at the address where requests for information have gone?
- What actual problems have these defaults caused in the administration of the company's affairs? Can a loss to the creditors be identified?

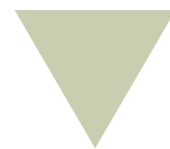
Showing that the company was insolvent

With many of the matters under Part II of the schedule, it is also necessary to show that at the time of the events to which the allegation relates, the company was insolvent. If so, it is important that you tell the Unit what evidence is available to show that the directors ought to have been aware of the insolvent position.

"Balance sheet" insolvency is not necessarily enough. To prove the allegations, it must be shown that the directors were aware, or should have been aware, of the insolvent position (for example, by creditor pressure or warnings from advisers), that steps were not taken to remedy the situation, and that continued trading was detrimental to creditors and others.

You should also consider whether there is any evidence, particularly in any records delivered up, which provides justification for the company continuing to trade, even if the directors were aware of the insolvent position. Such evidence might include the existence of potential investors or evidence that the company was currently trading profitably. However, the mere fact that there has been professional advice does not preclude allegations of unfitness. Much depends on the assumptions on which that advice was based, and whether it was acted upon.

5. Other matters



5.1 Disclosure of material obtained under section 235 and 236 of the Insolvency Act 1986



The Secretary of State is advised that you can lawfully disclose to him any relevant information and documents which you have obtained by using the powers under section 235 and 236 of the Insolvency Act 1986. The power by which the Secretary of State can request, and is entitled to receive, such documents and information is in section 7(4) of the CDDA.

The basis of that advice is that the powers in sections 235 and 236 under which you obtain information and documents are to help in your administration of the affairs of the insolvent company. One of the duties placed on you arising from your appointment is to report to the Secretary of State under section 7 of the CDDA and as a result provide information. You are therefore fulfilling one of the purposes of the administration, and thus one of the purposes for which the material was obtained.

Despite the duty of confidence that you may owe, the public interest requires appropriate disclosure and use of such material, and you should therefore disclose it to the Secretary of State.

This is why you should not give any undertaking to any person providing information or documents that implicitly or explicitly prevents its disclosure to the Secretary of State. If you did so, you might not be able to properly discharge your statutory duties. And the Secretary of State might then have to apply to Court to enforce your co-operation.

Similarly, you are asked to have regard to your duties under section 7 of the CDDA, and draw them to the attention of the Court when it considers any restrictions to be imposed on you over the disclosure of information and documents which become available in litigation brought in the administration.

Furthermore Part 31.8(2)(c) of the Civil Procedure Rules 1998 confirm that the Secretary of State has to disclose to defendants documents over which he has or has had a right to inspect or take copies. Therefore the Secretary of State has a duty to disclose any documents to which he is entitled under Section 7 of the CDDA. If the Secretary of State is not in a position to provide documents which are requested, then the Practitioner could be subject to a third party disclosure application.

5.2 Availability of accounting records

It is published best practice (SIP 1 and 2) for administrative receivers and liquidators to list all company books and records produced to them at the outset of the insolvency. Similar considerations also apply when taking appointment as administrator. You are also advised to list those records not taken into custody, with a note as to their whereabouts.

The accounting records are a very important source of information to the Unit. If proceedings are issued, defendants must be given the opportunity to inspect the records so they can prepare their defences. You need to recover all accounting records from the directors. If these have not been delivered, you must detail what steps you have taken to obtain them. You must notify the Unit at the outset of any discrepancies in the records. You should also identify any records held by others. In cases where the Unit has stated that further enquiries will be made, you must keep the Unit fully informed as to:

- any further records which become available;
- any records which may have to be passed to the company's directors or others; and
- any records which, being held by you or others, become lost, stolen or destroyed.

If you take office as administrative receiver or administrator, you are especially asked to notify the Unit of:

- any records due to be passed to a third party purchaser of the business of the company; and
- any records which are to be passed back to the directors at the completion of the receivership or administration.

In appropriate cases, and where this applies, the Unit may ask you to photocopy relevant company records.

5.3 Payment to Practitioners

- No payment will be made to Practitioners for time taken in discharging their statutory duty to report. The work which constitutes the discharge of that duty, undertaken at the time of reporting or subsequently at the request of the Unit, is set out in Appendix 2.
- Practitioners will be paid for any work undertaken at the request of the Unit beyond that set out in Appendix 2. The rate of hourly charge of all staff involved must be agreed in advance along with an estimate of the number of hours the Practitioner and/or each member of his staff will take to do the work required. All Practitioners must notify the Unit when that time estimate is reached and agree any necessary extension. The Unit will not pay for work which was not formally authorised in advance.
- Practitioners will be paid for time taken considering draft affidavits. In relatively straightforward or simple cases, Practitioners can expect to be allocated up to four hours for considering and swearing an affidavit, with more complex cases taking up to eight hours. Where necessary time is expected to exceed four hours, the time to be taken in excess must be specifically agreed with the Unit. The rate payable will be that normally charged out for the deponent's time. If, for example, a manager is better placed than the office-holder to give evidence, then the deponent need not necessarily be the

office-holder.

- The cost of any legal advice taken, separate from that given to the Unit by the Treasury Solicitor or local agent, is a matter for the Practitioner and will not be paid by the Unit.
- All work after the start of the proceedings (that is, the issue of the claim form), including witness costs, will be paid for subject to advance agreement of time and rate. It is open to the defendant(s) to seek cross-examination of a Practitioner on his affidavit. If this is to happen, it will become apparent well before the substantive hearing of the application. Practitioners will be notified of the dates of the substantive hearing and will need to ensure they are available.

5.4 More than one office-holder



The rules on reporting duties when a company has two or more office-holders (for example, an administrative receiver and a liquidator), were amended in September 1996. Now, every office-holder must make a return (under rule 4(5) of the reporting rules) to the Secretary of State, except where he has made a report in respect of all the persons mentioned in rule 4(2).

The duty to report arises when it appears to the office-holder that the conditions in section 6(1) are satisfied, and the duty is to report forthwith. That duty is not affected by the fact that another office-holder has been appointed.

The expression "office-holder" can be read as "liquidator", "administrative receiver" or "administrator". "Relevant date" differs for each type of office-holder. This is because, under rule 4(5)(a) of the reporting rules, the office-holder must send a return to the Secretary of State if he is in office on the day one week before the expiry of the period of 6-months from the relevant date.

So the rule is based on there being separate regimes for the different offices. Hence the obligations arising under one regime and thus on the holders of a particular office, operate, arise, and should be assessed and discharged independently. There are

clear difficulties where the second appointment occurs much later than the first and particularly towards the end of the "first" two-year period. In any event, the office-holder appointed second must report as soon as he becomes aware of unfit conduct. The conduct of which he becomes aware, or the evidence, might differ from that discovered by the other office-holder. However, the Unit wants to avoid a Practitioner undertaking unnecessary work in completing a report which, because of the timing difficulties, might not be of practical use. Where this situation arises, Practitioners should contact the Unit for guidance on the appropriate approach.

Rule 4(5)(b) of the reporting rules says that an office-holder who leaves office before the day one week before the expiry of the 6-month period must send a return within 14 days of leaving office unless he has already reported.

A company that is put into compulsory liquidation after it has been in voluntary liquidation, will have passed a resolution for voluntary liquidation. The voluntary liquidator is therefore an office-holder.

A voluntary liquidator of a company which becomes the subject of a compulsory winding-up order must still make a report or return as appropriate. However, in a compulsory liquidation, the duty to make the return or report remains with the Official Receiver, whether or not he is replaced as liquidator by a Practitioner.

If there are joint appointees to one office, only one joint report is required in respect of that appointment. It is for the joint appointees to determine which of them should draft the report, having regard to the division of duties between them. Unless there is a clear intention from the outset that one of the joint appointees will be responsible for all aspects of submitting the report, both appointees should ensure that they are fully satisfied with its content. If proceedings are taken and the author of the report is unavailable to swear any affidavit in support of those proceedings, the other appointee will be expected to swear it and, if necessary, give evidence. Such cases are rare; when they occur, they will be considered on their merits.

5.5 Scotland



The primary legislation, namely the Insolvency Act 1986 and the CDDA, are Great Britain Acts. This means they apply to Scotland as well as England and Wales. The secondary legislation differs. Reporting provisions are set out in The Insolvent Companies (Reports on Conduct of Directors) (Scotland) Rules 1996.

All reports and returns in respect of companies registered in Scotland must be sent to Disqualification Unit (Edinburgh). The statutory forms to use in such cases are the D1(SCOT) and D2(SCOT) forms in the schedule to The Insolvent Companies (Reports on Conduct of Directors) (Scotland) Rules 1996.

The procedure for making applications to the Sheriff Court is set out in the Act of Sederunt (Company Directors Disqualification) 1986 and the Rules 74.33 and 74.34 of the Rules of the Court of Session. The detailed provisions of the Insolvent Companies (Disqualification of Unfit Directors) Proceedings Rules 1987 (as amended by The Insolvent Companies (Disqualification of Unfit Directors) Proceedings (Amendment) Rules 1999) do not apply in Scotland.

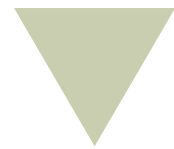
In Scotland, cases are taken into Court by the Scottish Office Solicitor or solicitor agents who issue the "10 day" letter and begin the proceedings, acting on the instructions of the Unit.

Court proceedings in Scotland differ from those in England and Wales. The cases regularly call in Court for motion to be made. The proceedings for Court of Session cases are structured as follows:

Petition	Sets out the Secretary of State's case.
Answers	Sets out the defendant's case in answer to the petition.
Adjustments	For both parties until agreement on content or entrenched dispute is reached.

Debate	To dispose of preliminary pleas in law.
Proof before Answer	Proof but pleas in law are outstanding.
Proof	The final hearing of the case; each side calls witnesses to prove the facts of the case.
Sheriff Court cases are similar but proceed by way of summary application rather than petition.	

6. Contact Points



6.1 England and Wales



All conduct reports and returns and requests for supplies of forms should be made to:

Insolvency Practitioners Compliance Unit
5th Floor
Ladywood House
45/46 Stephenson Street
Birmingham B2 4UZ
(DX 713897 BIRMINGHAM 37DX)

Tel: 0121 698 4000
Fax: 0121 698 4095

Unit Manager: Gareth Limb
Tel: 0121 698 4105

All enquiries about operational matters and technical queries about conduct matters should be made to:

Disqualification Unit (London)
PO Box 203
21 Bloomsbury Street
London WC1B 3QW
(DX 120875 BLOOMSBURY 6DX)

Tel: 020 7291 6807
Fax: 020 7291 6810
020 7637 6428

Director of Enforcement: Patrick Chillery
Tel: 020 7291 6787

Management Support Officer: Mark Bruce
Tel: 020 7637 6392

Central Vetting Section

Chief Examiner: Allan Baxendale
Tel: 020 7637 6402

Senior Case Officer: Tom Phillips
Tel: 020 7291 6832

Unit-produced Practitioner Cases

Chief Examiners:
Allan Baxendale
Tel: 020 7637 6402

John Beckett
Tel: 020 7637 6532

Ceri Bradley-Jones
Tel: 020 7637 6592

Elliott Burns
Tel: 020 7291 6819

Stephen Leinster
Tel: 020 7291 6818

Official Receiver-produced Practitioner Cases

Chief Examiner: Stephen Leinster
Tel: 020 7291 6818

Disqualification Unit (Manchester)

The Service has recently set up an office in Manchester to deal with many of the cases in the North West of England. Practitioners will be notified of those cases which are to be pursued by that office. All enquiries on those cases should be made to:

Disqualification Unit (Manchester)
1st Floor
Boulton House
17-21 Chorlton Street
Manchester M1 3HY
(DX 715638 MANCHESTER 2DX)

Tel: 0161 934 5471

Senior Case Officer: Stuart Hyde
Tel: 0161 934 5469

6.2 Scotland



In all Scottish cases, even where the office-holder is based in England and Wales, the office-holder should send returns and reports, and make enquiries about operational matters, to:

Disqualification Unit (Scotland)

J Floor

B Block

Argyle House

3 Lady Lawson Street

Edinburgh EH3 9SA

Tel: 0131 222 6531

Fax: 0131 222 6565

Senior Case Officer: Tone Hannon

Tel: 0131 222 6529

6.3 Insolvency Service Hotline: 0845 601 3546



This hotline was set up by the Minister in January 1998 to enable members of the public to provide details of the activities of disqualified directors or bankrupts who are apparently taking part in the management of limited liability companies without having obtained the leave of the Court. Practitioners may use the hotline when they feel it is appropriate and should encourage complainants to do so.

Appendix 1

Key points of Statement of Insolvency Practice 2 - A liquidator's investigation into the affairs of an insolvent company



This is a summary of the key points from SIP2 which will affect the discharge of the liquidator's duty to report under the CDDA.

Report to creditors

At the initial creditors' meeting, and in the subsequent report to creditors, the liquidator should invite creditors to bring to his notice any particular matters which they consider require investigation.

Liquidation committee

The liquidator should also specifically invite members of the liquidation committee to bring to his attention any matters requiring investigation.

Questioning directors and other key personnel

At the outset of the winding-up, the liquidator should arrange to make enquiries of company officers and other senior officials, as to the company's affairs, including the reasons for failure and the location of its records and property. The liquidator should consider carefully which individuals are relevant to his investigation, having regard to the information which he believes they may have. The individuals who may be relevant will normally include all directors (by whatever name called), the company secretary, and other senior officials and employees, but may also include others from among those persons listed in section 235(3) of the Insolvency Act 1986.

Records

At the outset of his appointment, the liquidator should ascertain the location of and safeguard and list the books, records and other accounting information belonging to the company. He should examine the records of the company covering the period since the date of the last audited or filed accounts to ensure that changes in the financial position of the company can be accounted for.

Trading

The liquidator should consider preparing trading and profit and loss accounts if there is a material difference between the deficiency disclosed in the Statement of Affairs and the last audited or filed accounts, after taking into account matters such as writing down asset values. However, the liquidator should have regard to the likely costs which would be incurred and the benefits which might accrue to creditors from carrying out such an exercise.

Comparison of assets with last audited or filed accounts

For the purpose of discovering company property, the liquidator should compare the Statement of Affairs with the last audited or filed accounts. The liquidator should satisfy himself that material movements in fixed and current assets can be properly explained.

Transactions with associated companies or connected persons

The liquidator should examine the books and records of the company to ensure that any transactions with associated companies or connected persons were carried out at arm's length. Material transactions should be examined in detail. Particular attention should be paid to transactions involving directors, including any reduction in loan accounts, overdrafts, or other debts supported by personal guarantee.

Criminal offences

During a voluntary winding-up, if the liquidator finds that any past or present officer (or member) of the company may have been guilty of any offence in relation to the company for which he is criminally liable, he must report the matter to the Director of Public Prosecutions or, in Scotland to the Lord Advocate (section 218, Insolvency Act 1986).

Appendix 2

Documents and information to be included with a report



This list shows items of information which should be submitted with every report. Producing one or more of these after submitting a report - and following a specific request to do so by the Unit - will not be considered additional work for which a Practitioner would expect to receive payment.

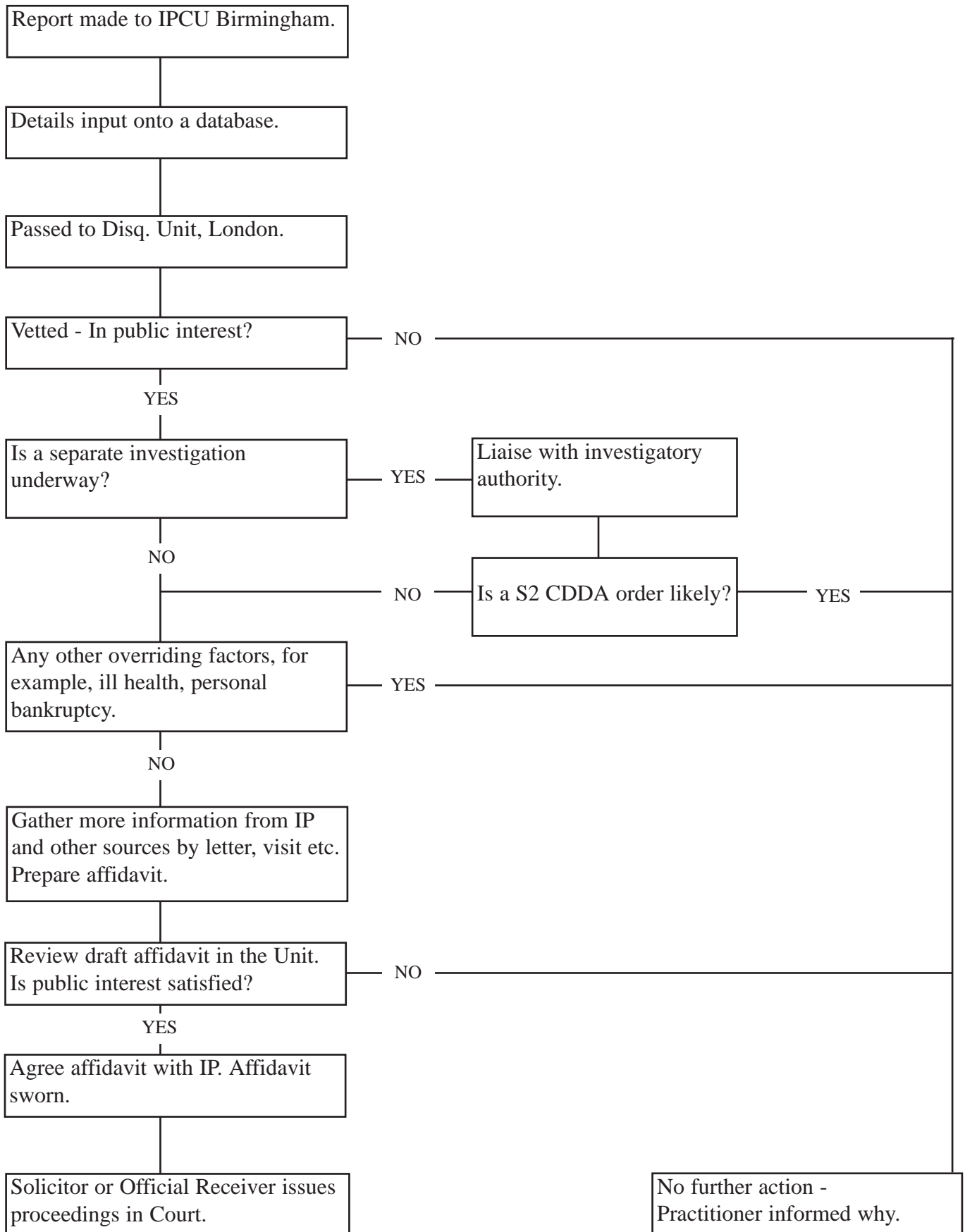
- (a) Copy Statement of Affairs. Where none is submitted, the report should include an estimate of the financial position of the company by listing known assets and liabilities.
- (b) A copy of the office-holder's report to creditors. If this is not available, please attach a report detailing the company's history.
- (c) A copy of any notes issued to creditors for the purposes of the meeting and of any record taken of the proceedings at the meeting.
- (d) Copy accounts as available - last two sets of audited accounts and any draft or management accounts for periods thereafter.
- (e) Copies of any questionnaires which have been completed by the directors.
- (f) The present position of the insolvency and dividend prospects.
- (g) Copies of specific documents referred to which provide evidence of the unfit conduct reported. If there are many documents they need not all be provided at the time of reporting. But you should give full details of what is available and where it is.
- (h) Aged creditors' analysis - if readily available from the company's records.

Within the body of a report, you should fully cover the following matters:

- (i) Position on any civil recovery actions, including statement of claim, legal advice etc.
- (j) Details of the nature of evidence available in support of insolvent trading - not, for example, detailed schedules of claims at this stage.
- (k) References to professional advice taken by the directors, and to specific correspondence which sheds light on directors' conduct, for example with banks, solicitors, accountants, creditors.

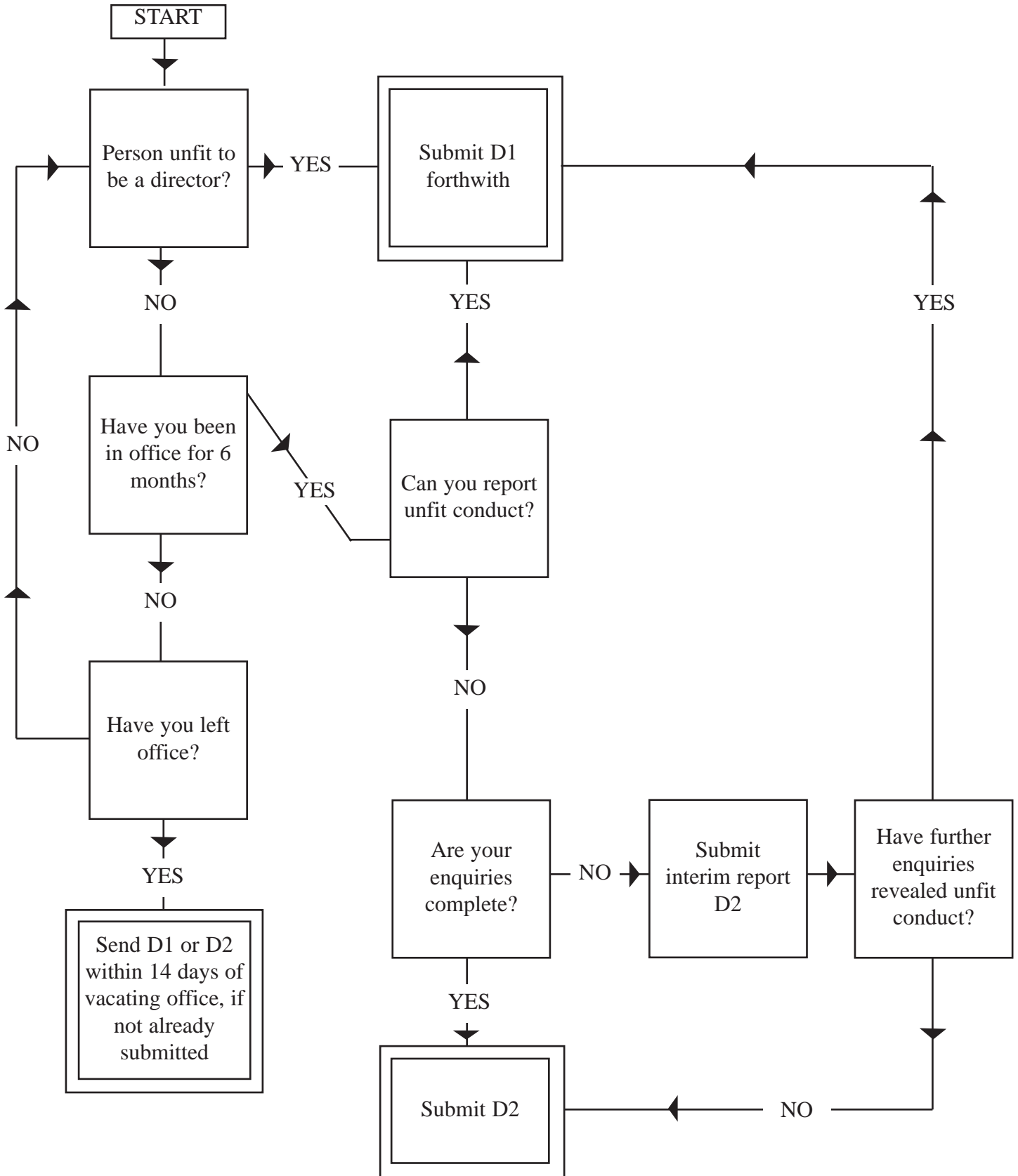
Appendix 3

How a practitioner's report is processed



Appendix 4

The reporting decision



To obtain further copies of this guide, please contact the Disqualification Unit telephone 020 7291 6837. This guide can also be found on The Service's Internet website at <http://www.insolvency.gov.uk>

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