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Liability of a holding company for an insolvent subsidiary

Directors must be careful not to leave themselves open to possible claims by liquidators and administrators, says David Foster, Partner at Barlow Robbins Solicitors and a member of professional services network IR Global.

by David Foster (https://www.financialdirector.co.uk/author/davidfoster/) | Barlow Robbins Solicitors - August 16, 2018

This is a poignant question in the light of the wave of recent administrations and liquidations on the High Street.

The general position is that a holding company is only liable to pay any amount not paid up on its shares in the subsidiary company. However, there are some situations where a holding company or its directors may be held liable upon the insolvency of a subsidiary. Some examples are:

- Where there is a contractual liability, such as a guarantee or an indemnity.
- Where a subsidiary is merely acting as its holding company's agent in dealing with a third party.

- Where a person or company is under an existing legal obligation or liability, or subject to an existing legal restriction, which he/she/it deliberately frustrates by interposing a company that is under his control such as to avoid paying debts on a liquidation. This is known as piercing the corporate veil.
- Where a holding company has assumed responsibility or the law imposes responsibility for the actions of a subsidiary. This principle is set out in the case of *Chandler v Cape Plc 2012 EWCA* and can occur when the parent company has greater knowledge of health and safety issues.
- If a distribution from a subsidiary company is unlawful, the holding company would have repay monies received.

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The three main ways a company's directors can be held liable to contribute to the company's assets

Where the following examples talk of a director, this can be the holding company as a *de facto* director and a director of the holding company as a shadow or *de facto* director.

- **Misfeasance Claims**

This type of claim relates to a director not acting in line with directors' fiduciary duties. A liquidator, creditor or contributory to the company's capital and Official Receiver can bring a misfeasance claim. A director may be held liable even for simple negligence.

A good example of this is *d'Jan of London* in which the company premises were destroyed by fire. As a result of the director's negligence in the completion of certain insurance forms, the company was uninsured causing it to become insolvent. The liquidator brought an action against the director based on the director's duty of care to the company when completing the forms.

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- **Fraudulent trading**

Any person who is or was knowingly a party to the carrying on of business with intent to defraud creditors may be liable to contribute to the company's assets. Criminal penalties may be imposed for fraudulent trading even if a company is not insolvent.

- **Wrongful trading**

A successful wrongful trading action imposes personal liability on directors if they allow a company to continue trading after they knew, or ought reasonably to have known, that there wa no reasonable prospect of avoiding insolvent liquidation or insolvent administration.

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Defence Strategies

Each situation will have its own legal complexities but there are some useful general points to make:

- Under **wrongful trading,** it is a defence if the directors can show that, from the relevant time, they took every step to minimise the potential loss to the company's creditors.
- Under a **misfeasance** claim, a director can seek relief if he acted honestly and reasonably and the circumstances of the case mean that it is fair to excuse him from liability. In *d'Jan of London*, the director got relief in part because the judge noted that he held 99% of the company shares (1% being held by his wife) and at the time of the negligent act the company was solvent. Therefore the only people he put at risk were himself and his wife.
- The *Duomatic Principle* from *Duomatic Limited 1969 to Ch365* may provide a defence to liability under a **misfeasance** For this to apply, it must be shown that all shareholders who have a right to attend and vote at a general meeting of the company assent to ratify the misfeasance or breach of duty, providing this is a matter which could be passed at a general meeting. It must be shown that the shareholders did assent and not just that they would have done.
- Know the law in the jurisdiction of any foreign subsidiary. The law in this area is not uniform and it is important not to make assumptions that may be wrong. To take one example in Italy – financing within one year of declaration of insolvency of a subsidiary must be paid back by the parent company.

All this serves to underline the importance to directors of not leaving themselves open to possible claims by liquidators and administrators by careful governance in both the holding company and subsidiary and wise decision-making with minutes kept showing why decisions are being made. If you suspect that a subsidiary may be heading towards insolvency, take detailed advice from a lawyer and accountant.

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