Beat: Business

Hold free ticket to fraud by law or hold costly ticket to protect creditors?

Company liquidation kill or cure by law

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USPA NEWS - Companies Bankrupt and Liquidation Fraud; when a company goes bankrupt or liquidation, a second company can start up overnight with the same management directors but without any obligation to pay for the failed company´s losses. Fraud happens when directors abuse the company arrangement by transferring the assets of the failing company below their market value before insolvency.

It´s perfectly legal to form a new company from the remains of a failed company. Any director of a failed company can become a director of a new company, unless he or she is: subject to a disqualification order, or undertaking personally bankrupt subject to a bankruptcy restrictions order or undertaking. By doing this, the fraudulent directors reduce the funds available to creditors when the original company becomes insolvent. As a result, the creditors are left out of pocket for the goods or services they supplied. Once a company enters insolvency or liquidation proceedings, the creditors will be paid in order of priority from whatever remaining company funds are made available.

The cost of fraud within companies can be costly to shareholders, to employees and sometimes the public at large.The stories around these companies failures by examining the fraudulent activities in light of the auditors role, and by considering how auditor could have enabled a better quality of information to be distributed about them in timely manner.

It is not the responsibility of the external auditor to prevent fraud from occurring within companies, and therefore, auditor could not reasonably be expected to prevent this situation from occurring. External Auditors role shall be investigated when companies collapse; they may have played a part in this collapse or at least in its costly delay. Auditors simply came with wrong conclusion in annual audited report, therefore, the liquidator could not find the documents outlining the reason for establishing new company as a going concern.

Directors as the fiduciaries of a company bear many duties and responsibilities. These duties do not end when a company starts to run into trouble. In fact, directors should be conscious that they have moved into new territory with new rules. In their efforts to rescue the company, they should ensure that they do not run foul of these rules.In addition, it should be noted that the creditor may rely on the company´s contingent and prospective liabilities in order to show that the company is unable to pay its debts.

Where a company´s circumstances are such that either of these two tests are satisfied, or where there is a probability that either of these tests may, in the near future, be satisfied, this should act as a red flag for directors. Under these circumstances, directors should be conscious that a different regime has or will be about to kick in, and this regime will impose certain specific duties and liabilities that they should take special care not to breach.

These provisions embody a regime designed to protect creditors´ interests. Accordingly, once a director becomes aware that a company is insolvent or on the verge of insolvency, it behaves him to ensure that care is taken not to run foul of any of the provisions cited above.

The principle that creditors´ interest become pertinent on the onset of insolvency has also been increasingly recognized in case law. The general rule is that directors´ duties are owed to the company and not to individual shareholders nor to the company´s creditors. Some creditors who are owed money by a failed company are often outraged to find that the directors of these companies may suffer little personal loss and are often able to start up a new business in the same field. To a certain extent this is an inevitable consequence of corporate "˜limited liability´. For the purposes of the law, a company is a separate legal entity and if it trades with limited liability its directors and shareholders do not usually retain liability for the company´s debts should it become insolvent.

Legally, there is nothing in law to prevent a director of a failed company from starting a new business 'overnight' provided that he has acted 'properly' in managing the first company both before and during its insolvency. However, if the director of an insolvent company has deliberately acted to the detriment of creditors, action may be taken against him under both insolvency and company legislation. In certain circumstances, directors may incur personal liability for their acts or omissions in managing the company.

For the purposes of the law, a company is a separate legal entity and if it trades with limited liability its directors and shareholders do not usually retain liability for the company´s debts should it become insolvent. It is not illegal for directors of an insolvent company to form a new company from the remnants of the failed company, and they can become new directors except in circumstances
where he or she is:

“¢ subject to a disqualification order or undertaking;
“¢ personally adjudged bankrupt; or
“¢ subject to a bankruptcy restrictions order or undertaking

The new company arrangement allows a business to start again and for the profitable elements of the failed business to survive, offering some continuity for both suppliers and employees.
It is not illegal to start up a new company following the liquidation of the original company, but there are rules to be followed. The rules are designed to prevent directors deliberately running a company into liquidation, leaving unpaid creditors, only to set up “˜over-night´ a new business trading under a similar name to that of the liquidated company. The rules outlined below apply to anyone who was a director or shadow director of a company in the 12 months ending with the day before it went into insolvent liquidation.

The directors responsibilities of a company are generally responsible for the management of the company and they may exercise all the powers of the company. However, the extent of their power may be constrained by the company´s own “˜Articles of Association´ or by company law.
For example, Articles of Association often include provisions and restrictions on borrowing by the company.

The power of appoint provisional liquidator; As an insolvency procedure, provisional liquidation is usually an emergency measure, directed to recovery in the sense of preservation of assets rather than as a means of business rescue or asset realization.The appointment of a provisional liquidator as the “˜caretaker of assets´ can (and usually does) bring an end to the business of the company (a fact that the applicant for appointment must draw to the court´s attention and explain why it is not considered appropriate to seek an injunction or to give the company notice of the application.

There are, however, an increasing number of instances in which the court has used the appointment of a provisional liquidator as an alternative to administration. Although this approach is not perhaps as novel as it first appears, recent cases emanating from the auditors reports in particular, show that provisional liquidation may be used for the purpose of achieving a more favorable realization of a company´s business or assets than might be achieved in either administration or liquidation.

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