

Article

Tread with Care: Directors' Declaration of Solvency

Authors: Ben Hobden, Partner | Róisín Liddy-Murphy, Attorney

A recent case from the English High Court, *LRH Services Limited (in liquidation) -v- Trew and others* [2018] EWHC 600 (Ch) ("*LRH Services Limited*") provided a cautionary reminder to directors of the consequences that can arise in signing declarations of solvency, without having carried out the necessary inquiries as to the company's affairs.

Application process

In this case, the liquidator of LRH brought a claim against three former LRH directors. The directors had formulated and implemented a group reorganisation whereby LRH's share capital had been reduced pursuant to section 643 of the UK Companies Act 2006 ("CA 2006"). Under section 643 of CA 2006 a company can reduce its share capital if each company director makes a solvency statement. In order to avail of the section 643 procedure, a solvency statement was therefore made by the directors of LRH. The reorganisation resulted in a £21 million dividend being paid to the parent company after LRH went into liquidation.

Declaration of Solvency

Similar to the Cayman declaration of solvency as set out in Section 124(2) of the *Cayman Islands Companies Law (2018 Revision)*, Section 643 of the CA 2006 provides that it is a statement that each of the directors of the company have formed the opinion that there is no ground on which the company could be found to be unable to pay its debts on the date of the statement, and also formed the opinion that the company will be in a position to pay its debts in full within 12 months of the commencement of winding-up. In forming this opinion, the onus is on the director to prove that he or she had reasonable grounds for expressing that opinion. *LRH Services Limited* confirmed the position set out in *BTI 2014 LLC -v- Sequana* [2016] EWHC 1686 (Ch) that a solvency statement is valid so long as the director honestly and genuinely formed the required opinion, even if the director did not have reasonable grounds for holding it. In forming this opinion, directors are required by the legislation to take into account all the company's liabilities.

Personal Liability for Director

In *LRH Services Limited*, it was held that the solvency statement made by the directors was invalidly made on the basis that the opinion of solvency had not been properly formed. The Court held that the directors had failed to make any enquiry or to give any consideration to LRH's actual liabilities as required by the legislation. It transpired that Mr. Trew, one of the directors, was relying on the parent company of LRH to discharge its liabilities (even though there was no binding agreement to do so) in order to support the opinion that LRH was solvent. The Court held that the solvency statement was invalid and that capital reduction on the basis of the statement was thereby unlawful. The court found that each director was personally liable for the invalid solvency statement and responsible to LRH for a £21 million dividend paid out in consequence.

Conclusion

LRH Services Limited would be persuasive authority in the Cayman Islands. It is an important reminder that the consequences can be severe if directors are not diligent when reviewing a company's financial statements prior to signing a declaration of solvency. Where a company director makes such a declaration of solvency without having carried out the necessary inquiries to form the basis for the opinion, the Court may declare that the insolvency statement is invalid and that the directors could be held personally liable.

A copy of the judgment is available [here](#).

Authors:

Ben Hobden

Partner

ben.hobden@conyers.com

+1 345 814 7366

Róisín Liddy-Murphy

Attorney

roisin.liddy-murphy@conyers.com.

+1 345 814 7371

This article is not intended to be a substitute for legal advice or a legal opinion. It deals in broad terms only and is intended to merely provide a brief overview and give general information.

For further information please contact: media@conyers.com