

# Fraudulent trading as a creditor's remedy - time for a rethink?

by Henry Skudra

## INTRODUCTION

The Business Secretary's recent succinct but important discussion paper *Transparency & Trust: Enhancing the Transparency of UK Company Ownership and Increasing Trust in UK Business* raises several issues over which no doubt much ink will be spilt.

One of the key aims of the proposals is to improve financial redress for creditors and, within that, the proposed radical disruption of the *Re Oasis Merchandising Services Ltd* [1998] Ch 170 orthodoxy whereby liquidators are presently prevented from selling or assigning civil actions for fraudulent or wrongful trading. Such actions are undertaken pursuant to sections 213 and 214 of the Insolvency Act 1986 respectively.

This paper compares the current options creditors enjoy against delinquent directors. It engages in detailed comparisons and delves especially into criminal fraudulent trading since there is a startling omission in both the discussion paper and in academic literature generally of fraudulent trading prosecutions under section 993 of the Companies Act 2006 and its statutory predecessors. This is even more surprising given the recent case of *Bilta (UK) Ltd (in liquidation) and others v Nazir and others (No 2)* [2012] EWHC 2163 (Ch); [2013] 2 WLR 825 as well as post-conviction developments in recent time. These include the Proceeds of Crime Act 2002 and courts being compelled to consider the issue of compensation pursuant to the Powers of Criminal Courts (Sentencing) Act 2000, section 130 (as amended by the Legal Aid, Sentencing and Punishment of Offenders Act 2012, s 63).

It concludes that criminal fraudulent trading should not be overlooked- either in pursuing the government's laudable aim of improving financial redress for creditors (at paragraphs [11.1]-[11.17] of the above discussion paper), or as an option for creditors. It is hoped that this article can at least attempt to fill this lacuna in academic literature.

## CURRENT OPTIONS FOR CREDITORS

When a company has been wound up, creditors (defined in *Halsbury's Laws of England* as natural or legal persons with a pecuniary claim, whether actual or contingent, against a company) will seek to get their money back. Very often there are insufficient remaining assets for the company, even when

liquidated, to fully repay its creditors and so they will try and recover their losses by extracting funds from the company's directors; almost always through the medium of an insolvency professional. To illustrate the scale of corporate insolvencies, Goode in his most recent corporate insolvency textbook identifies a stark rise from 12, 507 liquidations in 2007 up to 15, 535 in 2008 and 19, 077 in 2009 as the Recession/Credit Crunch hit home. The most recent figures from the Insolvency Service (taken from <http://www.insolvencydirect.bis.gov.uk/otherinformation/statistics/201308/index.htm>) suggest that we are over the worst (with around 15, 356 liquidations for the last 12 months up to and including the second quarter of 2013), but we are far from being back to pre-Recession levels.

There are chiefly three methods by which directors are held personally liable for mis- or malfeasance when a company is in its last death throes, commonly known as the "twilight zone":

- fraudulent trading under the Insolvency Act 1986, section 213 (civil liability);
- wrongful trading under the Insolvency Act 1986, section 214 (civil liability);
- fraudulent trading under the Companies Act 2006, section 993 (criminal liability).

Each of these options must tread a fine line which is perhaps best outlined by Buckley J in *Re White and Osmond (Parkstone) Ltd*:

*"What is manifestly wrong is if directors allow a company to incur credit at a time when the business is being carried on in such circumstances that it is clear the company will never be able to satisfy its creditors. However, there is nothing to say that directors who genuinely believe that the clouds will roll away and the sunshine of prosperity will shine upon them again and disperse the fog of their depression are not entitled to incur credit to help them to get over the bad time."* (Unreported, cited at A Keay, *McPherson's Law of Company Liquidation* (2nd edn, Sweet & Maxwell 2009), [16.020]).

To fully appreciate the forthcoming discussion, it must be pointed out that prior to 1985 there was only **one** form of fraudulent trading- (both civil and criminal) in the form of section 332 of the Companies Act 1948. In the Companies Act 1985 the criminal and civil provisions were split and

the civil subsection was hived off to become section 213 of the Insolvency Act 1986. Wrongful trading only arrived as a cause of action in the form of section 214 of the Insolvency Act 1986 (see further: Henry Mikolaj Skudra, “An Analysis of

the Statutory Regulation of Fraudulent Trading” (M Jur thesis, University of Durham 2012), ch 2).

The following table best presents the three different causes of action and allows for the simplest comparison:

Option:	fraudulent trading (civil)	wrongful trading	fraudulent trading (criminal)
Legal basis:	s 213 of the Insolvency Act 1986	s 214 of the Insolvency Act 1986	s 993 of the Companies Act 2006
Elements:	(Based on <i>McPherson’s Law of Company Liquidation</i> , [16.018]-taken from <i>Morris v Bank of India</i> [2004] 2 BCLC 236, 243).  1. <i>the company was in liquidation;</i>	(See P Totty, G Moss and N Segal (eds), <i>Totty, Moss &amp; Segal: Insolvency</i> (Looseleaf, Sweet & Maxwell), [B1-32]).  1. <i>that the relevant company had gone into insolvent liquidation;</i>	(Based on J Richardson QC (ed), <i>Archibold: Criminal Pleading, Evidence and Practice 2013</i> (59th edn, Sweet & Maxwell 2013), [30-118]-[30-122]).  1. <i>the business has been carried on with intent to defraud creditors or for any other fraudulent purpose;</i>
	2. <i>such business has been carried on with intent to defraud creditors or for any other fraudulent purpose;</i>	2. <i>that at some point before the commencement of the winding up of the company, that person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation; and</i>	
	3. <i>the defendant participated in the carrying of business; and</i>	3. <i>that at the time the person reached his conclusion or ought to have reached his conclusion about the company’s fate (and for convenience that time is called “the relevant time”) that person was a director of the company.</i>	2. <i>the defendant participated in the carrying of business; and</i>
	4. <i>the defendant did so knowingly.</i>	<b><i>BUT The foregoing is subject to a caveat contained in s.214(3) which provides a statutory defence in that no declaration will be made is the court is satisfied that the (ex)director took every step he ought to have taken to minimise creditors’ potential loss.</i></b>	3. <i>the defendant did so knowingly.</i>

Remedy(ies):	<i>Liability to make such contributions (if any) to the company’s assets as the court thinks proper.</i>	<i>Liability to make such contributions (if any) to the company’s assets as the court thinks proper.</i>	<i>Ten years’ imprisonment and/or a fine, compensation orders made and</i>
	<i>(if the defendant is a director, disqualification will almost inevitably follow if it has not been done already).</i>	<i>(disqualification will almost inevitably follow if it has not been done already - and wrongful trading actions can be pursued against directors <b>only</b>)</i>	<i>post-conviction proceedings under Proceeds of Crime Act 2002 legislation to recover creditors’ monies/assets.</i>
	<b>NB - It is also worth noting that options 1 and 2 are specifically <u>not</u> mutually exclusive by virtue of s 214(8).</b>		

## DIFFERENCES BETWEEN THE THREE OPTIONS – A CONTRAST

The following provides an analysis of the differences between the three pieces of legislation mentioned above. From that, key differences as to the efficacy of each provision will emerge.

### “In the course of the winding up of a company” – in ss 213 and 214 only

This phrase is not problematic *per se* given that part IV of the Insolvency Act 1986 clearly delineates what is meant by this as well as outlining the various procedures by which this can occur.

However under section 993 of the Companies Act 2006, section 213’s sister criminal law provision, the proscribed behaviour may be penalised whilst the company is still in normal full legal existence and not being subjected to insolvency procedures (s 993(2)).

Williams condemns the fact that fraudulent trading civil provisions are only engaged when companies are being wound up (R C Williams, “Fraudulent Trading”, (1986) 4 *Company & Securities Law Journal* 14, 17). Indeed, he contends that a company’s, “viability may be testament to its success in fraudulent trading endeavours”, and so he submits that the remit of section 213 ought to be widened so that creditors do not have to wait for the company to be in liquidation in order to halt the errant behaviour (ultimately via a liquidator). This, he argues, would make the fraudulent trading provision, “far more sensible” if it were unrestrictedly applied to all companies. This submission is perhaps exaggerated in that creditors can themselves force a company to be wound up as and when the fraudulent trading is discovered. Therefore to argue that section 213 is severely hamstrung by narrowing its application only to companies “in the course of being wound up” is perhaps overstating the case.

However, the removal of this restriction in the context of the criminal law section 993 fraudulent trading provisions has two chief advantages. Firstly, there is a practical one that enables charges to be laid and Proceeds of Crime Act 2002 proceedings to be invoked much earlier before the company is wound up which enables assets to be restrained at an earlier stage (see further: T Millington and M Sutherland Williams, *Millington and Sutherland Williams on the Proceeds of Crime* (4th edn, OUP 2013). This is especially important given that a creditor may be a party to the fraudulent trading itself- as in *Morris v Bank of India* [2004] 2 BCLC 236; [2005] 2 BCLC 328. Secondly, this has a much greater prophylactic effect in that it will prevent corporate misfeasance as potential defendants cannot hide behind a technical defence of the company not being “in the course of winding up”. It must also be borne in mind that the liberal overuse of section 993 (and thereby overly easy criminalisation) is prevented by the criminal standard of proof – that of beyond reasonable doubt.

### “Intent to defraud”- in ss 213 and 993 only

The phrase, “with intent to defraud” is the most problematic element of fraudulent trading of both types and has troubled both commentators and the courts for some time (as pointed out in A Keay, *Company Directors’ Responsibilities to Creditors* (Routledge-Cavendish 2007), p 122). It is important to highlight that this same test is applied to *both* civil and criminal proceedings.

This oddity, whereby a criminal test is also applied to a civil wrong, was brought about by *DPP v Schildkamp* [1971] AC 1 where it was decided that both civil and criminal wrongs were contained in section 332 of the Companies Act 1948. A bare majority of the House of Lords held that the whole of section 332 of that Act should be read together and that, “the civil liabilities under subsection (1) and the criminal liability under subsection (3) were in *pari materia*.”

The great difficulty of making out this key element in the context of the civil wrong has meant that section 213 is perhaps much more infrequently used than it should be. Fletcher aptly highlights that: “there has been a lack of consistency over the years regarding the judicial approach to formulating the test of fraudulent conduct...which is to be applied in cases falling under s.213 and its statutory antecedents” (I F Fletcher, *The Law of Insolvency* (4th edn, Sweet & Maxwell 2009), p 851).

The general proposition from the seminal case of *Morphitis v Bernasconi* [2001] 2 BCLC 1; [2003] Ch 552 is that for behaviour to fall under section 213(1) of the Insolvency Act, there must be dishonesty in the form of incurring company debts by those in charge when either they know that they will not be repaid or there is a substantial and unreasonable risk that they will not be. Indeed, Chadwick LJ accepted counsel for the directors’ submission that: “There is a distinction between a fraud on a person that gives rise to a claim in damages against the company and the carrying on of the business of the company with intent to defraud.”

However, the notion of the immorality or “anti-social” nature of fraudulent trading (as Williams puts it) raises questions with regards to whether the current civil procedures under section 213 of the Insolvency Act for fraudulent trading are appropriate or effective. I suggest that a criminal provision serves the law and creditors’ interests best since its purpose is primarily one of deterrence and stigmatisation. In stark contrast is Keay’s observation (at p 432 of *Company Directors’ Responsibilities to Creditors*) that:

“s 214 does not use the words ‘wrongful trading;’ it is a description that is only employed in the title to the section. The trading that offends against s 214 is, perhaps, better referred to as ‘irresponsible.’”

This aptly highlights a point which is not readily made in that the label which is added to a particular cause of action should be seen as part of the punishment or resultant action taken against the transgressing actor (see further: D Matza, *Becoming*

*Deviant* (Prentice Hall 1969); G Williams, “Convictions and Fair Labelling” (1983) 42 CLR 85 and D Downes and P Rock, *Understanding Deviance: A Guide to the Sociology of Crime and Rule Breaking* (6th edn, OUP 2011).

This is perhaps best illustrated with an example. A person convicted of murder will be known as a “murderer”. This stigma will be with that person for ever, long after they are perhaps released on licence. Relating this same principle back to mischief conducted when a company is in the “twilight zone”, fraudulent trading (either civil or criminal) contains in both its title and under the description of proscribed behaviour the term “fraud.” Thus, anyone held liable under either section will be a “fraudster.” It is argued that being labelled or described as a “fraudster” will stigmatise any person within the corporate sphere where trustworthiness is extremely important – with clear detrimental effects.

Parry *et al* highlight the very wide framing of fraudulent trading which is potentially on the verge of engaging the ECHR on the grounds of a lack of legal certainty (J Parry *et al*, *Arlidge and Parry On Fraud* (3rd edn, Sweet & Maxwell, London 2007), pp 200-08). This is hardly surprising given, for example, the dicta of Marshall J in *R v Inman* [1967] 1 QB 140, 148. He held that the section’s (s 332 of the Companies Act 1948) terms can be split as it “dealt with two different types of offence, fraudulent trading with intent and fraudulent trading for the purpose of achieving certain things.”

However, in *Re White and Osmond (Parkstone) Ltd* Buckley J’s dicta (set out above) clarified and attempted to reconcile two diverging fraudulent trading decisions of Maugham J from the 1930s – those of *Re William C. Leitch Brothers Ltd* [1932] 2 Ch 71 and *Re Patrick and Lyon Ltd* [1933] Ch 786. Whilst directors and managers may incur credit which, given their company’s financial situation, *prima facie* appears dishonest or verging on reckless, this must not impugn genuine business optimism. It must be recalled however that all entrepreneurship involves a degree of risk-taking and business optimism.

*R v Cox* (1982) 75 Cr App R 291 is a vitally important case which is perhaps overlooked on occasion for it evidences what has become a key feature of fraudulent trading and the manner in which it is dealt with in criminal courts. The defendant was charged under section 332 of the Companies Act 1948 of which subsection (1) was what we recognise today as civil fraudulent trading, and subsection (3) of which became section 993 of the Companies Act 2006. It was held that the trial judge had seriously misdirected the jury in telling them that dishonesty was not essential in the “intent to defraud” element. Indeed, it was recommended by Watkins LJ at 296 that the authoritative criminal practitioners’ work *Archbold* be reviewed, “so as to make it clear that dishonesty is an essential ingredient of the offence created by section 332.”

It is important to note two things. Firstly, the case related solely to criminal fraudulent trading, and secondly the words used by the Court of Appeal should be more closely re-

examined in that the phrase “offence created by section 332” is used. This therefore strongly suggests that dishonesty applies only to criminal and not civil proceedings. Indeed, the fact that in this case fraudulent trading is so very closely associated with fraud in general, and especially the common law crime of conspiracy to defraud in the case law, strongly adds to the argument that fraudulent trading is perhaps better left to the criminal rather than civil jurisdiction.

Following both *R v Cox* and *R v Grantham* [1984] QB 675, the *Ghosh* test of dishonesty (from *R v Ghosh* [1982] QB 1053) was brought in by *R v Lockwood* (1986) 2 BCC 99333; something well-known and recognised in deception offences under the Theft Act 1968 (though such offences are now repealed by the Fraud Act 2006) as well as other dishonesty-based crimes. This incorporation has stood the test of time; it has been cited with approval by the House of Lords in *Powdrill v Watson* [1995] 2 AC 394, 407-08 and *Re Leyland Daf Ltd* [1994] BCC 658, 668 which were section 213 cases.

*R v Grantham*, a criminal case under the old section 332 of the Companies Act 1948 is of great import in the development of “intent to defraud” as it is seen as a central authority on this critical phrase. At 683-85 Lord Lane CJ reviewed the preceding case law (crucially both civil and criminal in nature) under section 332 and distilled their rationes of the case into the proposition that “deliberate dishonesty” (a phrase he borrowed from *R v Sinclair* [1968] 1 WLR 1246, 1249) was a central plank of “intent to defraud.”

Overall therefore, a precise list of determinants of “intent to defraud” is difficult to pin down, but with a very good degree of certainty it can be gleaned that the “dishonesty” element of the phrase is that of the criminal law and is subjective- as evidenced by Keay at p 134 of *Company Directors’ Responsibilities to Creditors*.

#### **Liquidators’ locus standi – in ss 213 and 214 only**

Actions under sections 213 and 214 may only be commenced by liquidators – what I term the “liquidator only” clause. This is something which the government proposals seek to address (at paras [11.5]-[11.12]) and so it is worthwhile examining this in more than superficial detail.

This clause was introduced in the 1986 Act following the Cork Committee’s recommendations. Prior to that there was a much wider class of those with *locus standi* since, under Companies Act 1948 section 332(1), “the official receiver, or the liquidator or any creditor or contributory of the company” could apply for relief.”

However, in the Committee’s extensive review of insolvency law, it did not even mention other potential litigants besides liquidators. From this, one might logically infer that the previous fraudulent trading actions were brought by liquidators only. This is certainly not the case. Indeed the summonses in the seminal fraudulent trading cases of *Re Patrick and Lyon Ltd* [1933] Ch 786 and *Re Gerald Cooper Chemicals Ltd* [1978] Ch

262 were sought by creditors, not liquidators.

It is suggested there may be two different reasons for the Committee omitting references to any parties apart from liquidators. Firstly, to reinforce the *pari passu* rule of distribution of assets amongst creditors; which may rightly be regarded as being both equitable and fair. For instance, a large creditor with a proportionally small amount of assets to recover in relation to the total it lends, may well have a great deal of resources (such as a bank). Such a creditor would *prima facie* be extremely well placed to begin their own hypothetical section 332 Companies Act 1948 or section 213 Insolvency Act 1986 action whereas a much smaller creditor would not. This could result in the larger creditor recovering all their losses and leaving no assets left for smaller, less powerful creditors to recover. The smaller creditors may also waste time and money on litigation only to then find there are no assets left in the liquidated firm. This is an example of the problem which theorist T H Jackson identifies as the “common pool problem” in *The Logic and Limits of Bankruptcy Law* (Beard Books 2001), pp 11-19. The *pari passu* distribution rule ensures an even division of the assets according to the amount lent.

A second reason could be to do with the regulation of those pursuing such actions (suggested in A Keay, ‘The Supervision and Control of Liquidators’ [2000] *The Conveyancer and Property Lawyer* 295). Liquidators are subject to fairly strict supervision from both industry regulators and provisions within statute law which govern their behaviour. Creditors and other contributories are naturally not subject to these stringent rules and regulations, although they are required to adhere to regulations and statute law regarding their actual lending practices. Therefore, by prohibiting this far more nebulous body of potential litigants who are more loosely regulated (if at all – as in the case of trade creditors for example) from taking civil fraudulent trading actions themselves, a certain degree of control can be exercised over actually when and in what circumstances the civil fraudulent trading provision is litigated. This may be through professional guidelines or industry advice to liquidators – for example only pursuing actions if losses are above a certain threshold to prevent too many cases clogging up the court system and so on. Indeed, one industry observer noted in 2002 that liquidators were subjected to the scrutiny of eight different regulators and this is still the case today (see J Verrill, “The Insolvency Gremlins” (2002) 16 *The Lawyer* 29).

It is strongly contended that the formerly wider field of potential litigants, as under section 332 of the Companies Act 1948, would be undesirable. It may seem artificial and indeed contrary to the original intended aims of the fraudulent trading provisions to restrict the class of plaintiffs. Yet better-placed litigants will, it is argued, more often than not recover their assets and leave virtually nothing for other creditors. Moreover there was not, as there is now, a large industry of thoroughly regulated and professionally qualified insolvency practitioners.

It is conceded that the Cork Committee seems to have

gravely overlooked providing a full and proper explanation for their narrowing of those with *locus standi* under fraudulent and wrongful trading, yet a review of the facts surrounding this position demonstrates plausible and creditable rationales for doing so.

Turning briefly to the government’s proposal to partially re-widen the *locus standi* and permit administrators to bring fraudulent and wrongful trading actions themselves (at paragraph [11.6]), at first blush this seems to be a workable proposal which achieves the aim of both widening the collection of insolvency professionals who can seek assets on behalf of creditors as well as saving costs. The saving would be the costs of putting a company into liquidation, but naturally costs vary since they involve work done by administrators. However, using the fixed costs of presenting a winding-up petition for compulsory liquidation (ie those which all compulsory liquidations must involve), it is easy to see how costs would be saved. The fixed costs of a compulsory liquidation are as follows: a deposit of £1,165.00 paid to the court; a £220.00 court fee; and a minimum of £66.00 which is the cost of advertising the petition in the *London Gazette*.

This author queries whether this conflicts with an important phrase in both sections 213 and 214. Subsection (1) of both sections mandates that the misfeasance has to be discovered “in the course of the winding up of a company” – albeit that the actual activity constituting fraudulent or wrongful trading can in practice occur before or during the period of winding up. Therefore, in order to realise the proposals as drafted, Parliament would have to amend the Insolvency Act 1986, which may seem radical and contrary to the original intentions of legislators. Indeed, this restriction as to when trading proceedings can be issued can be traced right back to the inception of fraudulent trading in section 75 of the Companies Act 1928 (wrongful trading was only introduced by the Insolvency Act 1986; see further Henry Mikolaj Skudra, “An Analysis of the Statutory Regulation of Fraudulent Trading”, (M Jur thesis, University of Durham 2012), ch 2.)

However, this proposal does have its merits and also support. It must be noted that this barrier does not exist as far as section 993 Companies Act 2006 fraudulent trading is concerned – a restriction removed by section 96 of the Companies Act 1981.

### **Section 993 remedies**

This requires particular attention given the dearth of academic commentary on this matter. The compensation order and Proceeds of Crime Act 2002 form a key part of section 993’s role in attempting to recover assets as well as protecting creditors in a prophylaxis-type role as well.

In 2011 (and therefore before it became mandatory for courts to consider the issue of compensation) several men were convicted of fraudulent trading involving a tickets scam whereby tickets and hospitality packages were sold and then the tickets or promised services were never provided. They

were caught as part a joint Serious Fraud Office (SFO) and Metropolitan Police operation (see: <http://www.sfo.gov.uk/our-work/our-cases/case-progress/xclusive.aspx>). They each had confiscation orders made against them under the Proceeds of Crime Act 2002 to the tune of £1,750,000 in total and compensation orders were made, which were to be paid out of the confiscated funds.

One of the government's proposals is to allow courts to make compensation orders during disqualification proceedings. However, again highlighting the startling omission of section 993, since December 3, 2012 criminal courts have been under a duty to consider a compensation order during sentencing. After a conviction for fraudulent trading such an order is used to give creditors back some of their assets. This idea of compensation is however distinct from recovering assets which are rightfully the creditors' – compensation is about both trying to give back an injured party the value of what they have lost in terms of monetised value, but also for an intangible loss. Such a loss could be things like inconvenience, loss of business reputation etc. Again, this shows the utility of section 993 and of fraudulent trading in a criminal setting.

However, there has been, even in the recent past, a conflict between public bodies such as the SFO and creditors as a matter of insolvency law. A prosecutor in section 993 Companies Act cases may well open proceedings by asking a court to make a restraint order (*Millington and Sutherland Williams on the Proceeds of Crime*, p 15). This is pursuant to section 41 of the Proceeds of Crime Act and it prevents a defendant from ferreting away their ill-gotten gains. However, there is a tension between public bodies and creditors as to who has access to these restrained funds.

This is perhaps most starkly highlighted in *Director of the Serious Fraud Office v Lexi Holdings PLC (In Administration)* [2009] QB 376. The Court of Appeal held that creditors may, but in very restricted circumstances, be permitted to recover assets owed to them when the assets are subject to a restraint order. This is by removing them from those subject to a restraint order before the public body (in that case the SFO) takes their share for public funds. This can occur only when "there is no conflict with the object of satisfying any confiscation order that has been or *may* be made" (at 404, my emphasis) or where a proprietary claim can be made.

It is noted that this second part could lead one to mistakenly think that this allows secured creditors (who, by virtue of their security, have a proprietary interest) to recover assets. However, unless it is a creditor who has secured their debt against a *personal* guarantee from the defendant, then this cannot occur. Also, it is highly likely that these types of loans would have been recalled by this stage anyway. The proprietary interest of secured creditors in the context dealt with here lies in the company or vehicle used for fraudulent trading.

Therefore, the bottom line is that secured creditors, by virtue of their security *per se*, cannot establish proprietary interests against the defendant and so cannot remove their assets from those under a restraint order. One extremely difficult method which is open to both secured and unsecured creditors is that of establishing a constructive trust, but this is almost always too costly and too complex. This therefore leaves creditors, especially those which are unsecured in a rather difficult position at the bottom of the pile. However, this is not particularly unexpected given that they are also at the bottom of the pile when it comes to distributing assets in a normal liquidation process.

Yet the harshness of the court's ruling in *Lexi Holdings* is tempered somewhat by Keene LJ who opined that compensation orders serve to soften the blow for creditors (at 402-03). Furthermore, Millington and Sutherland Williams make it abundantly clear that, "prosecuting authorities are very conscious of the difficulties that restraint orders can cause to innocent third parties and, in so far as the legislation allows, endeavour to deal with them fairly and in a way which takes account of their property rights" (*Millington and Sutherland Williams on the Proceeds of Crime*, p 463).

Secondly, under section 84(2)-(2)(d) of the Proceeds of Crime Act, property which may be realised includes the property vested in a bankrupt's trustee. Therefore if a defendant is a person who has been made bankrupt – as may very well be the case if they have defrauded creditors of very large sums – even after they are made bankrupt the property now in the hands of the bankrupt's trustee is taken into account for determining the amount available to be taken away.

This therefore potentially allows money/assets to be recoverable even when the perpetrator is bankrupt – such a situation would never arise in a recovery action under section 213 of the Insolvency Act 1986. It is admitted that this is fairly radical and draconian, yet the ability to pursue a defendant even after he or she is bankrupt has an important prophylactic effect as it firmly discourages the casual and/or malicious placing of assets beyond recovery by defendants when they know that "the game is up".

Very recent case law developments ensure the avoidance of over-punishment of those against whom compensation and confiscation orders have been made. They prevent double punishment of a defendant through the issue of each order for similar amounts for the same mischief which would thereby require payment of an amount twice over (*R v Jawad* [2013] EWCA Crim 644).

It is hoped that the above analysis has gone some way to fill a lacuna in academic literature on the section 993 fraudulent trading offence, and to enlighten creditors and those interested in the area of misfeasance before and during insolvency.

## FINDINGS FROM THE COMPARISON

There are several conclusions that can be drawn from the foregoing detailed comparison. Firstly, it is clear that the requisite criminal “intent to defraud” and the lack of any intra-section defence in section 213 means that it is a higher hurdle to surmount than wrongful trading which is only tempered by the fact that wrongful trading applies to directors only. However they both have the same remedy at the end. This therefore seriously calls the utility of section 213 civil fraudulent trading into question. This is further exaggerated by the criminal nature *per se* of “intent to defraud.”

Secondly, the section 993 offence is *not* restricted to instances where a company is “in the course of winding up” which, as pointed out already, means that authorities can quickly seize and restrain assets without the sometimes time-consuming need for the company to be wound up. It also further removes a barrier behind which putative defendants may try to hide.

Thirdly, unlike section 214 which is restricted to directors only, both section 213 and the section 993 fraudulent trading offence can be enforced against sole traders, partnerships and trusts – the main reasoning being, according to the Law Commission’s Report (with reference to criminal fraudulent trading) is that it would “be a logical and [procedurally] useful step” that whatever the vehicle used, the perpetrator could still be prosecuted (Law Commission, *The Effective Prosecution of Multiple Offending* (Law Com No 277, 2002), p 79).

Furthermore, it has also been pointed out (S Farrell, N.Yeo and G Ladenburg, *Blackstone’s Guide To The Fraud Act 2006* (OUP 2007), pp 75-76) that scams and certain types of complicated frauds were also the target of a widened section 993 as they previously only came under the remit of “conspiracy to defraud” – which naturally as a conspiracy required more than one perpetrator to be useable. This highlights the utility of both forms of fraudulent trading but also, less obviously, highlights the strong need for prophylaxis and prosecution of this wrong – something it is emphatically submitted only the criminal law section 993 of the Companies Act can do. Indeed, section 993 is said to “provide a valuable weapon in countering crime” (The Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: Final Report* (vol I, 2001), para [15.7]). This is evinced by the increase in the maximum term of imprisonment up to 10 years in 2006, placing it on an equivalent level to very serious offences indeed, such as indecent assault, making threats to kill, or child cruelty.

It is suggested that the government, instead of advocating a reversal of the orthodoxy of *Re Oasis Merchandising Services* (at paras [11.5]-[11.12] of the proposals), which is a radical and controversial step, should perhaps consider the re-examination

or repeal of section 213. Yet given their purported ignorance of section 993 criminal fraudulent trading, this is understandable.

Indeed, and perhaps at the danger or invoking the ire of insolvency practitioners, the reason that they have had a stay of execution from the Jackson Reforms until April 2015 is that in the view of the government “insolvency cases bring substantial revenue to the taxpayer, as well as other creditors, and encourage good business practice” (Parliamentary Under-Secretary of State, Ministry of Justice (Jonathan Djanogly), Written Ministerial Statement, May 24, 2012). Therefore what better way to save money than by cutting out insolvency practitioners altogether in cases of fraudulent trading? It would be the State (via the SFO or Crown Prosecution Service) who would bring prosecutions.

## CONCLUSION

This article has examined the current options for creditors under both sections 213 and 214 of the Insolvency Act 1986, as well as prosecutions under section 993 of the Companies Act 2006. What has been espoused is that section 993 offers a real alternative to section 213 fraudulent trading and is an effective tool in terms of discouraging directorial mischief when a company is in its “twilight zone”. It is submitted that the current aims of sections 213 and 214 of the Insolvency Act – succinctly summarised by S Preetha, ‘The Fraudulent Trading Offence: Need For A Relook’ (2011) 4 *National University of Juridical Sciences Law Review* 231, 232 in that they are “intended to engender in directors of companies experiencing financial stress a proper sense of attentiveness and responsible conduct directed towards the avoidance of any increase in the company’s debt burden” – would be better (if not best) served by section 993 of the Companies Act 2006.

The government is keen on improving the lot of creditors and one way of ensuring this, it is strongly contended, is by paying greater attention to section 993 of the Companies Act 2006, which was not even mentioned once in the proposals. It is hoped that this article goes at least some way in addressing the lack of engagement with the criminal justice side of fraudulent trading under section 993 of the Companies Act 2006, and this is an issue which needs addressing urgently.

- The views expressed in this article are the author’s own.

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