

## **NEW RULES ON DISQUALIFICATION OF COMPANY DIRECTORS**

### **The New Rules**

On 23 April 2013, the Danish Parliament adopted a new act on disqualification of company directors. The Act is implemented as part of the current Bankruptcy Act.

In their essence, the new rules on disqualification of company directors make it possible to ban persons who speculate in corporate bankruptcies for their own profit to the detriment of creditors, businesses and consumers from managing the affairs of any business for three years. The new legislation will also apply to front men and anyone operating through front men.

The legislation implies that any disqualified company director may not participate in the management of a business without being personally and unlimitedly liable for the company's obligations. This means that any disqualified company director cannot participate in the management of e.g. limited liability companies, but may in principle participate in personally run businesses with personal liability. In general, disqualification is made for a period of 3 years.

In order to disqualify a company director, the person concerned must be deemed unfit to participate in the management of a commercial enterprise due to their grossly irresponsible business conduct. The Bankruptcy Court makes this judgment based on the substantiated recommendation of the liquidator.

The conduct of the person concerned, as well as the circumstances, are taken into careful consideration when judging whether it is fair to disqualify the person.

In its judgment, the Bankruptcy Court attaches great importance to whether the bankruptcy has led to any significant losses for the creditors and whether the bankruptcy is likely to have been caused by management, e.g. for having run unacceptable risks, or whether the bankruptcy is materially attributable to external factors, such as the general economic development or any sudden major changes in the company's profitability, for instance as a result of new legislation or a significantly changed competitive situation.

A typical example of grossly irresponsible business practices with regard to the company's equity capital includes major purchases on credit or advance payments from customers combined with a lack of accounting for a long period and/or entirely inadequate financial management. Another example is the continuation of the company's operations despite the fact that the person concerned reasonably should have realized that the continuation of operations would lead to substantial losses. Yet another example is the sale of company assets at an undervalue, or without real payment of the purchase price, at a time when the person concerned reasonably should have realized that the company was insolvent, or that the sale would cause the company to become insolvent.

Business incompetence alone does in principle not trigger disqualification.

Any disqualified company director will be registered in a new register of disqualified company directors set up by the Danish Business Authority. The registration aims to ensure that any disqualified company director is not registered in the agency's IT system as a member of management of a commercial company. Likewise, any disqualified company director may not be VAT registered or registered with the tax authorities as an employer. Registration also means that any person who is registered as a member of management in another company that is not in bankruptcy will be obliterated from the management of said company.

In the event of contravention of the disqualification, and the subsequent bankruptcy of the new company, the contravening company director will be personally liable on an objective basis for any part of the company's debt which is not covered by the estate if the estate deadline falls within the disqualification period.

Further, contravention of the disqualification may also lead to a new disqualification order being issued which means that it will be expanded so as to include a ban against participating in the management of any business, including the relevant person's personally owned and run business.

The liquidator's remuneration for conducting cases on the disqualification of company directors is borne by the state treasury and consequently, the creditors will not suffer any losses in this respect.

The Danish Minister of Justice sets the date for when the rules will enter into force which they have not yet at this point.

The register of disqualified company directors will not be made publicly available seeing as this might lead to a number of unintended effects, including the fact that in practice, a person who has been disqualified would be unable to ever run a business again, even after the expiry of the disqualification, because, for instance, any information on ordered disqualifications, if made publicly available, would be available on the internet in perpetuity.

## **Our Assessment**

Practice has shown that it is difficult to deal effectively with company directors showing evidence of phoenix practices, and the new rules are a step towards preventing the continued abuse of bankruptcy to the detriment of creditors.

It is not likely that the rules will be used directly by any future partners of a phoenix company, such as banks, to assess whether or not to enter into a partnership seeing as the information in the register of disqualified company directors is not publicly available.

It is difficult to predict the effect of the rules since it is up to the liquidator in future bankruptcy estates to consider whether to initiate proceedings for disqualification of those who have managed the company in question. Furthermore, the development in case law will impact the effect of the new rules.

It is, however, expected that the new rules will prevent the more serious cases of phoenix practices.

Moalem Weitemeyer Bendtsen will follow the development in practice as well as the rules' entry into force.

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