

Director Duties

Once a Company is insolvent a Director must be stringent and pro-active in their actions. Many Directors end up creating personal liability in situations where they should have known the Company has no future due to its debts but carry on trading. This can create the risk of potential courses of action against the Director at a later date by a Liquidator or Administrator. Here we will look at some of those courses of actions that can be taken against a Director.

Transaction at an Undervalue

A transaction at an undervalue is where a transaction is entered into, up to two years before liquidation or administration to connected parties or 6 months to unconnected parties, that is for significantly less than the consideration supplied by the Company.

A good example would be where a Director knows that a Company is insolvent and has sold Company assets for less than they are worth or transferred for no consideration to a connected Company so that the connected Company can have the benefit of the assets. In this situation, the Company has suffered a loss because its assets have been sold for less than their value. In a Liquidation or Administration, the officeholder would look to the Director to reimburse the company for the loss.

If a Director is looking to enter into the transaction and they know the Company is insolvent they should ask themselves two questions – 1. Should they be entering into such a transaction if the Company is insolvent? and 2. Is the Company receiving market value?

Preference Payments

A preference payment is where a Company pays a creditor, up to two years before liquidation or administration to connected parties or 6 months to unconnected parties, with the desire to put them in a better position than the other creditors.

The problem with such a payment is that the Director is deliberately putting the remaining creditors into a worse position by using the Company's assets (cash) to pay select creditors rather than each of them equally.

One common payment Directors make when they know their Company is insolvent and facing closure is to repay the money they have paid on behalf of the Company or put into the Company. However, these repayments to the Director are being made at a time when there are other creditors outstanding and the Director knows they won't be paid. These payments are preference payments and will need to be repaid to the Company. If the Director does not repay the amounts on request, then the Liquidator or Administrator may be required to take legal action.

Once a Director realises a Company is insolvent and needs to take proactive steps to close it, they should pause payments to creditors to ensure they do not fall foul of this. There are some payments that may be justified, however, any payment should be discussed with an Insolvency Practitioner so that the Director has proper advice.

Wrongful Trading

Wrongful trading is where a Company continues to trade even though the Company is insolvent and unable to pay its creditors. As in many cases, the Director may not have

intended to have done anything wrong and is continuing in the hope that things will turn around. However, once it becomes clear that there is no chance for the Company to continue, any additional debt incurred past that point will be a result of the Director's wrongful trading. It is therefore imperative, once a Director believes their Company may be in financial difficulty, that they consult an Insolvency Practitioner who can provide advice and guide them through the difficult time. If it can be established that there has been wrongful trading, then the Director may be made personally liable for those additional debts created.

Fraudulent Trading

Fraudulent Trading is where a Director, knowing that a Company cannot pay back its debts, continues to accrue creditors without the hope of repayment, thereby defrauding them. The difference between wrongful trading and fraudulent trading is that with fraudulent trading there must be intent to defraud creditors. Intent can be quite hard to establish in a court of law unless it has been explicitly stated.

If it can be established that a Director is guilty of fraudulent trading, then it is up to the court to decide what contributions the Director must make to rectify the position to the Company.

Reuse of Liquidated Company Name

The only automatic restriction on a Director once a Company is placed into liquidation is that they cannot reuse the Liquidated Company's name in a business going forward.

The law is written as such to ensure that Directors cannot continually accrue debts in Companies and then liquidate them in a continuous cycle and appear to be the same Company to creditors and leave a trail of debt behind them. If a Director is found guilty of breaching this restriction, they can be made personally liable for the debts of the successor Company.

However, there are exceptions to this. The exceptions have been created with a practical sense but also to support large employers should they be subject to liquidation, however not at the expense of protecting the public.

Therefore, those exceptions apply to all Companies, they are:

1. The Director purchases the whole or majority of the business from the liquidation and advertises this in the London Gazette and by writing to all creditors of the liquidated company within 28 days of completion;
2. The Director applies to court within 7 days of the liquidation for permission, and;
3. If the other Company known by the prohibited name has been known by that name for 12 months before the liquidation.

How can Directors protect themselves?

The simplest way that a Director can ensure that they do not fall foul of any of the above is to take advice at the earliest stage when financial difficulty is being experienced. A good Insolvency Practitioner will be able to explain to the Director what options there are for the Company and whether the Director needs to take action.