



## **Business Law Briefing No: 2**

### **Companies facing insolvency – Directors must be aware of their responsibilities**

#### **Background**

There are potential personal liabilities that can be attributed to Directors (and, in certain circumstances others) in the event of the insolvency of the Company. These personal liabilities do not only arise on the insolvency, they can materialise as the Company approaches insolvency.

#### **Duties of Directors**

The general duties of Directors has been codified in the Companies Act 2006 (the "Act") and have been covered in our Business Law Briefing No: 1. As can be seen from that Briefing all Directors have, amongst other obligations, a duty to promote the success of the Company. This duty is qualified and is subject to any enactment or rule of law requiring the Directors, in certain circumstances, ***to consider or act in the interests of the creditors of the Company***. This duty is, therefore, widened to include the provisions of the Insolvency Act 1986.

#### **Insolvency Act 1986**

Once a director or directors conclude (or should have concluded) that there is no reasonable prospect of the company avoiding an insolvent liquidation, directors have a duty to take every step which a reasonably diligent person would take to minimise potential loss to the company's creditors. If, after the company has gone into insolvent liquidation, it appears to the court that a director has failed to comply with this duty, then such a director will be liable for ***wrongful trading***. The court can order the director to make a ***personal contribution*** to the company's assets as it thinks proper.

When a company is being wound up and it appears that any business of the company has been carried on with the intent to defraud creditors or for any fraudulent purpose, the liquidator can apply to the court to declare that any persons (directors and others) who were knowingly parties to the carrying on of the business in such a manner be liable to make a personal contribution to the company's assets.

This is known as **fraudulent trading**. Not only is this civil liability imposed, fraudulent trading is also a **criminal offence**.

A finding of either **wrongful trading** or **fraudulent trading** is almost certain to lead to a **disqualification** of a guilty party from acting as a director of any company. Disqualification of directors is dealt with in Business Law Briefing No: 3.

If it appears during a liquidation that a director has misapplied or retained, or become accountable, for any money or other property of the company, or been guilty of any **misfeasance or breach of any fiduciary or other duty**, the liquidator (or any creditor, shareholder or contributory) can apply for such an order that a court thinks just to compel that the director (or any other guilty party) to repay, restore or account for money or property with interest or contribute to the company's assets by way of compensation as. The expression "director" includes any person occupying the position of director, by whatever name called.

### **What happens next?**

If a director thinks that their company is or may be facing insolvency then it is imperative that they quickly take advice so that the risk of a successful claim being made against them personally is minimised.

### **Author – Martin Hall**

This Business Law Briefing has been prepared by Martin Hall who is a solicitor and consultant with Cleggs Solicitors. He is both a graduate of Nottingham Law School and a Fellow of the Institute of Chartered Accountants in England and Wales.

Martin specialises in Company and Commercial Law, with strong emphasis in share sales, business sales, joint ventures, management buy-outs & shareholder agreements, company reconstructions, partnerships, franchising, IT agreements and all aspects of Business Law.

Qualifying as both a Solicitor and Chartered Accountant gives Martin the broad range of skills necessary to assist in the successful, timely and cost effective completion of his client's transactions.

### **Copyright ©Cleggs Solicitors 2009**

Cleggs Solicitors is a legal practice regulated by the Solicitors Regulation Authority.

### **Disclaimer**

This publication is provided for general information purposes only and does not constitute legal or other professional advice. If you require specific advice on a legal problem then please contact either:

Martin Hall Tel: 0115 977 8510 Email: martinh@cleggssolicitors.com  
Ian Torr Tel: 0115 977 8577 Email: it@cleggssolicitors.com

It is worth reminding you that it is our policy that we charge neither clients nor prospective clients for the time it takes us to understand the nature of their business. We only charge for the giving of advice.