

# Can Directors Be Personally Liable For A Company's Debts?

When the directors of a company believe that its solvency is in doubt, they are required to concentrate on minimising losses to creditors rather than maximising returns to shareholders.

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**D**irectors need to regularly monitor financial management information and to remain alert to signs of their company being insolvent. Every financial decision in relation to the company should be carefully considered to ensure the directors determine the true position.

Best practice day-to-day management will include:-

- keeping minutes of every board meeting;
- reviewing the company accounts on a regular basis;
- regular meetings with your bank.
- reviewing all of the above before entering into any new contracts or orders with creditors.

Where the directors believe the company is or is about to become insolvent they are duty bound to take professional advice and consider formal insolvency procedures. If the directors fail to take such action, they could become personally liable for the debts of the company, particularly if found guilty of liable for wrongful trading, fraudulent trading, or misfeasance/breach of duty.

Where the directors could not then meet those debts, they could find themselves being pursued into personal bankruptcy. They might also have to face disqualification proceedings and risk being prevented from acting as a company director again for a period of up to 15 years (in the most serious cases).

It is important to point out that not all instances of a company being technically insolvent require the instigation of formal insolvency proceedings. For example, a company may have an insolvent balance sheet but be perfectly able to meet its liabilities as they fall due for payment. If it is trading profitably

and can reasonably predict that its cash flows will permit it to meet its present and future debt obligations then creditors are not being put at undue risk.

If the company however is both balance sheet and cash flow insolvent then, clearly, immediate formal insolvency proceedings are likely to be required.

Taking professional advice early can help to avoid any claims against the directors personally in relation to the company's liabilities.

## **I am a director of a company and am worried about its solvency. What should I do?**

If the company is running out of money there are a number of options available including refinancing, formal insolvency procedure (such as administration or a voluntary arrangement) or a sale of some of the business or assets. Contact a solicitor, accountant or insolvency practitioner with experience of advising directors of financially troubled companies for immediate advice.

## **Should I resign?**

Generally, no. If the company is at risk of going into liquidation, your obligation as a director is to take every step which you ought reasonably to take with a view to minimising the potential loss to creditors. Failure to do so could leave you personally liable for wrongful trading. Resigning will not help creditors.

## **What is wrongful trading?**

If a company goes into insolvent liquidation and the liquidator can show that the directors allowed the company to continue trading after the 'point of no return', he may claim against the directors personally for a contribution towards the creditors' losses. The point

of no return occurs where directors realise - or ought to realise - that there is no reasonable prospect of the company avoiding insolvent liquidation.

## **How can I avoid liability for wrongful trading?**

By constantly testing whether the company has a "reasonable prospect" of avoiding insolvent liquidation. This means producing reliable cash flow forecasts, ensuring that the bank supports your continued trading and/or ensuring that the company retains the support of its investors. If at any point there is no longer a "reasonable prospect", you (and the board) need to take every step which you ought reasonably to take in order to minimise the potential loss to creditors. This will almost certainly mean invoking a formal insolvency procedure of some kind and, in the meantime, ceasing to pay creditors or place new orders. Before you get to this stage, you ought already to have approached an insolvency practitioner who will be prepared to take over the business (whether on liquidation, administration or receivership) in order to ensure a smooth transition, and avoid a period of no trading during which irreparable damage may be caused to the goodwill of the business.

## **The company owes me money. Can I repay this before the company goes into liquidation?**

No. Any such payment may constitute a "preference" under the Insolvency Order. Not only will you risk having to repay the money, but you may also risk disqualification as a director for up to fifteen years where you have been involved in actions which demonstrate "unfitness", such as preferring certain creditors, particularly yourself or those connected with you, over others.

## **The company owns assets which could be used by another company with which I am involved. Can these be transferred to protect them from the liquidator?**

No. A company which is insolvent (i.e. unable to pay its debts as they fall due, or with negative net assets) cannot lawfully transfer assets except for full market value. Other transfers of assets may be reversed by a liquidator; or the person who acquires the assets may be required to pay full value for them. Directors who approve transfers at an undervalue may be guilty of wrongful trading or breach of duty and will be exposed to the risk of disqualification.

## **Can I put the company into administration and set up a new company to buy the business from the administrator?**

It may be an option, but the new company will have to pay full value for the business. The administrator (or liquidator) has a duty to get the best price he can for the company's assets. It is not uncommon for existing management to be able to offer the best price, particularly if a quick deal is necessary in order to avoid loss of a fragile customer base or workforce, or where personal contacts are particularly important. There are, though, restrictions on the ability of the directors to carry on a new business under the existing company's name, or a similar name.

## **Eye**

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