

WRONGFUL TRADING



Directors must act with great care if their company appears to be getting into financial difficulty. Failure to do so could result in a claim for wrongful trading and personal liability.

WHAT IS WRONGFUL TRADING?

Wrongful trading can occur when a director knew, or ought to have concluded, there was no reasonable prospect of the company avoiding insolvent liquidation or (in relation to business conducted on or after 1 October 2015) insolvent administration, and the company subsequently goes into either process. A director may become liable if they continue trading during this period and don't take every reasonable step to minimise the potential loss to creditors in these circumstances.

WHAT ARE THE CONSEQUENCES?

If found liable for wrongful trading, the court may order a director to make a personal contribution to the company's assets. Disqualification proceedings may also be brought against them and they could be disqualified from acting as director or from being involved in the setting up or management of a company for a period of up to 15 years.

WHAT CAN DIRECTORS DO TO PROTECT THEMSELVES?

To avoid liability, directors must show they took every step possible to minimise the potential loss to creditors. They will be judged by reference to:

- what a competent director in his or her position should have known and the actions they should have taken (objective test);
- the individual director's actual knowledge and actions – particular skills or knowledge will be taken into account (subjective test).

This means that a finance director, for example, will be assumed to have a higher level of specialist finance skill and experience than a sales director. Managing directors will also be expected to have a high level of general skill, experience and responsibility.

“ If found liable for wrongful trading, the Court may order a director to make a personal contribution to the company's assets”

IF A COMPANY APPEARS TO BE INSOLVENT, MUST IT STOP TRADING?

Case law indicates that liability for wrongful trading will only arise if, on a net basis, it is shown that the company is worse off as a result of the continuation of trading. Taking expert financial and legal advice when making the decision to continue trading or not will make it easier to prove you acted reasonably should you be faced with a claim for wrongful trading.

WHAT STEPS SHOULD I TAKE IF I BECOME CONCERNED ABOUT MY COMPANY'S SITUATION?

Directors of a company showing signs of financial difficulty should:

- analyse the company's financial position in detail on a daily basis;
- monitor compliance with banking covenants;
- hold regular board meetings to discuss business performance and keep comprehensive minutes of commercial decisions taken and the consideration given to creditors' interests;
- seek specialist advice from an insolvency practitioner;
- consider initiating a formal insolvency procedure if there is no reasonable prospect of the company avoiding insolvent liquidation or administration. Otherwise, document any decision to continue to trade;
- maintain and preserve the company's accounting records;
- avoid taking additional credit from suppliers;
- avoid dissipating assets and avoid preferences;
- overall, act in the best interests of the creditors.

WHAT IS FRAUDULENT TRADING?

Fraudulent trading is a separate offence and is where a person or entity knowingly carries on a business with the intention of defrauding creditors or for any other fraudulent purpose. Successfully prosecuted directors can face prison, as well as liability for company debts.

For further information, please contact us.



www.mooresouth.co.uk