

## Directors Update

Since October 1st 2015, the Insolvency Service have the power to pursue disqualified directors to compensate creditors who have lost out financially due to their misconduct. In such cases, a judge will look at past misdemeanours, and the nature and extent of the harm caused to creditors. This power is in addition to and separate from any action the Liquidator may take against a director for misfeasance. Some of the more common actions taken by Liquidators are:

### **Wrongful Trading- Section 214 Insolvency Act 1986**

Wrongful trading is when a company has entered into insolvent liquidation and prior to the commencement of the winding-up the directors knew or ought to have known that there was no reasonable prospect that the company would avoid insolvent liquidation.

Wrongful trading is a civil offence, so directors found guilty can be held personally liable for the company's debts. They may also face disqualification as a director for a period of up to 15 years.

Directors have a defence if they can demonstrate that they took every step to minimise the potential loss to creditors, once they became aware of the problem.

### **Fraudulent trading- Section 213 Insolvency Act 1986**

As opposed to wrongful trading where the directors 'ought to have known', there is a subtle difference in fraudulent trading where there has been intent to defraud creditors. It is not only limited to directors but can be brought against professional advisors and anyone who can be shown to have been involved in intentionally deceiving and defrauding creditors.

Fraudulent trading is a criminal offence which means that it is punishable by fines and/or imprisonment, depending on the severity. However, it is often hard to prove 'intent to defraud' because of the high burden of proof required.

### **Insolvent trading- Section 123 Insolvency Act 1986**

Under the Insolvency Act 1986, there are two clear definitions of insolvency; firstly, a company cannot pay its debts as and when they fall due; and secondly, its liabilities exceed its assets.

There are thousands of companies which continue to trade with a balance sheet that shows a negative figure at the bottom of its accounts, or have missed a payment due to a temporary cash-flow issue. It does not mean that those companies have to cease to trade tomorrow.

The issue which faces those directors and companies is that of 'temporary financial difficulty', but has future viable work in the pipeline. Cash-flows are produced and within 6 months the company's balance sheet is looking

much healthier and creditors are being paid on time. Based on the forecast, the company will return to solvency and thus the risk of wrongful/fraudulent trading is mitigated.

However, in situations such as that above, we would still urge directors to produce detailed file notes and compare actual figures against their estimated cash-flows to ensure that they are still on track. If at any time the figures are looking materially different, directors should consider seeking professional advice to review the risks.

Please note that should your clients require any confidential advice regarding any insolvency matter they are welcome to contact Ian, John or Robert. An initial consultation is provided free of charge and without obligation. Also, if you or any of your colleagues require any clarification regarding insolvency law or procedure, please do not hesitate to contact us.