

Title:

Potential Implications of Insolvency for Directors

Word Count:

1380

Summary:

An article about the liabilities directors may face personally in the event of corporate insolvency.

Keywords:

director responsibilities, director liabilities, insolvency, liquidation, insolvent, shadow director

Article Body:

Here is a note of the issues that a director of an insolvent company or potentially insolvent company may face.

Definition of Insolvency - Section 123 of the Act states that a company is "unable to pay its debts as they fall due" if the amount of the company's liabilities (including its actual and contingent liabilities) exceeds its assets. Where a company is or is about to become insolvent its directors must act in the best interests of the company.

The Corporate Consequences of Insolvency

Preference claim - A preference is a transaction which has the effect of placing a creditor in a better position than it would be in if the company had gone into liquidation at the time the transaction was entered into.

Transactions at an undervalue

A transaction at an undervalue occurs when a company disposes of its assets for significantly less than their market value.

Personal Consequences of Insolvent Liquidation

Wrongful Trading - Section 214 of the Act states that, if the directors (including any shadow directors) of a company have traded when the company was insolvent, they may be liable for wrongful trading.

The directors may be able to justify trading for a short period of time if they are:

Trying to sell the whole or part of the company's business and/or assets as a going concern; awaiting a decision regarding further funding (for example by the shareholders or by a venture capitalist); In these circumstances the directors should: investigate whether the company's overheads and costs can be reduced; postpone all other payments; not incur any new liabilities (except for immediate payment in cash); document their decisions (usually in suitably detailed minutes). Please note that such a minute must be passed by the directors.

Fraudulent trading

Any director or shadow director who knowingly allows a company to continue trading with the intention of defrauding creditors may be liable for fraudulent trading.

Disqualification

If, following liquidation, administration or administrative receivership, the DTI is able to prove that a director has committed an offence under section 214, the DTI may disqualify the director from acting as a director of any company.

A director also faces disqualification if:

He breaches any fiduciary or other duty he owes to the company (this may include a situation where he fails to comply with any of the duties imposed by the Companies Acts (for example the obligation to act in the best interests of the company).

Options

Where the directors believe that there is a serious risk that the company may not be able to pay its debts as they fall due, they should consider the following options:

1. Continuing trading under the guidance of the IP;
2. Requesting further funds from the company's shareholders;

3. Obtaining additional funds from a venture capitalist factoring or trade asset based finance
4. A sale of the company's business and assets as a going concern outside any formal insolvency
5. Administration, which is a court driven procedure which stops the creditors or any other parties
6. A company voluntary arrangement whereby the company agrees a payment schedule or some other arrangement
7. Making a request for the appointment of an administrative receiver if the company has granted a floating charge
8. A creditors voluntary liquidation whereby the company convenes a meeting of its creditors to vote on a resolution to liquidate or a compulsory liquidation whereby the company is wound up by the court following the presentation of a petition for winding up

Conclusion

Though incorporation can shield shareholders from liabilities, the directors (who are often the shareholders) are not protected.

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