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# CORPORATE RECOVERY & INSOLVENCY
## Directors Responsibilities

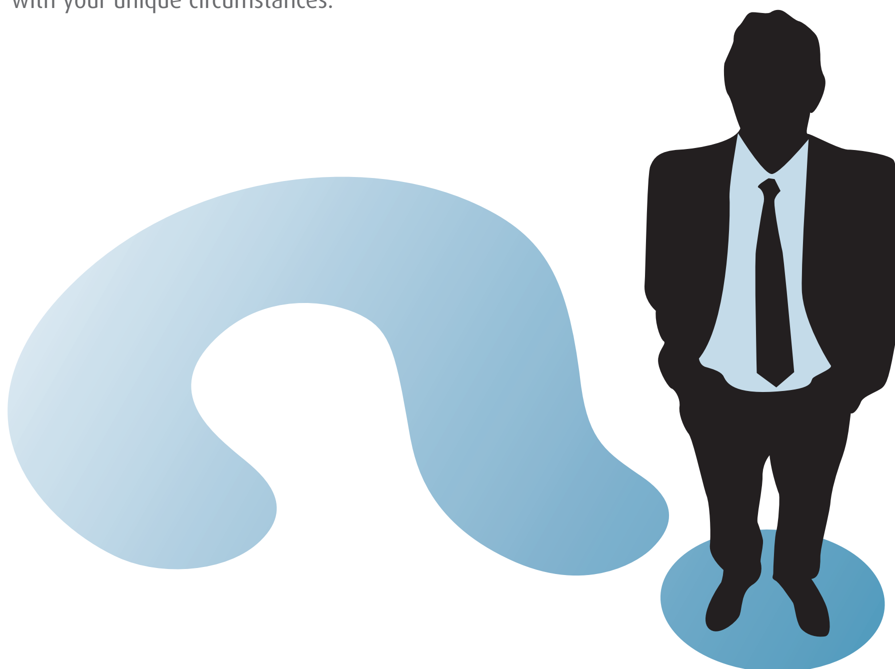
mlm
CORPORATE SOLUTIONS

# Your responsibilities as a company director explained.

Because it's hard to determine precisely when a business is insolvent, as a director it's important that you understand your role and responsibilities when your company faces financial difficulty. You must seek professional advice and be extremely careful about the liabilities your company incurs as soon as you know that financial problems exist. It's at this time that as a director, particularly if you control or own a smaller business, you must appreciate fully the alternative courses of action open to you – and the consequences of these both for the company and for you personally.

The Insolvency Act 1986 and the Company Directors Disqualification Act 1986 consolidated legislation on directors' responsibilities in relation to insolvent companies and introduced the new concept of wrongful trading, which can potentially attract personal liability. Directors' responsibilities are onerous and they increase as a company faces the prospect of insolvency.

This leaflet deals broadly with some of the queries that directors raise when a company is beginning to experience financial difficulties. But if you are unsure of your position it is best to speak face to face with one of our expert advisors who can deal specifically with your unique circumstances.



## Am I a director of a company?

A director is an individual or corporate body who has been properly appointed and registered as a director. The term also includes a "shadow director" being any person, which may include a corporate body, on whose instructions or directions the directors are accustomed to act, as well as those persons who hold themselves out as directors although not formally appointed as a director.

## To whom do I owe a duty of care?

At all times, a reasonable standard of skill, care, honesty and good faith is owed to the company, its shareholders and employees. If there is any doubt over the company's solvency, a similar duty is owed to the company's creditors.

Particular care needs to be exercised if you are the director of one or more companies in a group situation. There is a need to ensure that transactions between companies are in the interests of both of them and that any conflicts of interest are properly disclosed.

## What are my responsibilities?

Companies Act legislation sets out the responsibilities of directors. Any director is in effect a "trustee" of the company's assets in fulfilling his responsibility.

## When does a company become insolvent?

A company is deemed to be insolvent when the company is unable to pay its debts either as they fall due or where the value of its assets is less than the amount of its liabilities, including contingent and prospective liabilities.

## What action should I take as soon as I become aware of the company's potential insolvency?

Take professional advice from an authorised insolvency practitioner to advise you of the various alternative courses of action. MLM Corporate Solutions have expert practitioners who can help you.

# What options does the company have if insolvency is looming?

The alternatives may include one or more of the following:

- *examine business strategy*
- *inject additional capital*
- *sale of the business*
- *restructuring*
- *conversion of debt to equity*
- *discussion with company bankers*
- *company voluntary arrangement or scheme of arrangement*
- *administrative receivership (if appropriate debenture or floating charge is in place)*
- *administration order*
- *creditors' voluntary liquidation*
- *compulsory liquidation*

In examining your options ensure you obtain advice from an authorised insolvency practitioner.

# What must I be aware of once I know the company is approaching insolvency?

In your role as a director, you must keep track of (and disclose when asked) any or all of the following:

- *your duties to the company and its creditors*
- *wrongful trading*
- *fraudulent trading*
- *disposal of assets at an undervalue*
- *diversion of assets for your own use*
- *drawing an inappropriate level of remuneration*
- *paying in customer deposits against the company overdraft*
- *paying certain creditors who are your close associates without considering the rights of other creditors*
- *allowing significant arrears due to Crown creditors such as PAYE, NIC and VAT to accumulate*
- *paying off creditors whom you have personally guaranteed*

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# For which liabilities can I be personally liable?

- *your own personal PAYE and NI deductions which are unpaid*
- *any unpaid income tax arising where you have taken cash drawings from the company*
- *any personal guarantees given on behalf of the company, most commonly to banks, finance companies, landlords and occasionally major trade creditors*

In addition you may subsequently be liable for the following if the company is placed into administration or insolvent liquidation:

- *any liability arising under a subsequent action for wrongful trading or misfeasance when the company is in liquidation*
- *any liability arising from an action for voidable preference (unfair preference in Scotland) where your position as director has improved against those of the general body of creditors within the two years (six months in Scotland) prior to an insolvency*
- *any liability where you have benefited from a transaction at an undervalue (gratuitous alienation in Scotland)*

# What is wrongful trading?

Where directors, including shadow directors, carry on trading where they are or ought to be aware that the company cannot avoid an insolvent liquidation then the Court can order contributions to the assets of the company from the directors.

# What steps should I take to minimise the loss to the company's creditors when I become aware of its insolvency?

- *protect assets*
- *incur no further credit*
- *make no further payments unless they are strictly necessary to preserve the value of the company's assets*

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## Can I pay any creditors after I am aware of the company's insolvency?

You should only pay bills which are essential to protect the value of the company's assets for the benefit of creditors. However, you should seek advice from an authorised insolvency practitioner to protect your personal position before making any payments. Examples of legitimate payments are premiums for short-term insurance of the assets or paying cash on delivery for food to protect livestock.

## Can I sell assets after I am aware of the company's insolvency?

Once the company is insolvent you should not sell assets to pay creditors. In exceptional circumstances, such as perishable foodstuffs, a sale of assets may be appropriate if supported by advice from an authorised insolvency practitioner and professional valuations.

## Can I use the company's assets to repay the bank and protect my personal guarantee?

Once you are aware of the company's insolvency no creditor should be paid in preference to any other. Any director who has guaranteed the company's bank borrowings has a conflict of interest. Extreme caution should be exercised when realising any of the company's assets and making payments into the bank with the effect of reducing personal guarantee exposure. In these circumstances, professional advice should be obtained from an authorised insolvency practitioner.

## What is misfeasance?

A breach of duty in relation to the use of the funds or property of a company by its directors or managers.

## What is a transaction at an undervalue?

A gift or transaction where the company receives consideration less than the market value of the goods or services. A liquidator or administrator may take action to reverse the transaction or seek payment for the difference. In Scotland such a transactions is known as a gratuitous alienation.

## What is a preference?

A transaction whereby a director or other party is placed in a better position as against other creditors in the event of the company being placed into insolvent liquidation.

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In England and Wales for a director or other connected party the relevant time is up to two years ending with the onset of insolvent liquidation or the making of an administration order. In Scotland the relevant time is restricted to six months and such a transaction is known as an unfair preference.

## Can I pay the employees all their entitlements before I proceed with a formal insolvency?

Employees' claims for arrears of wages and salary, holiday pay, pay in lieu of notice and redundancy will normally be dealt with in accordance with the Employment Rights Act 1978, which protects employee entitlements at the time of a company's insolvency. In no circumstances should claims for redundancy and pay in lieu of notice be paid. In the case of arrears of wages and salaries and holiday pay, it may in certain circumstances be appropriate to make payment but this should only be done after prior consultation with an authorised insolvency practitioner. Payments may also be made for the purpose of retaining the services of staff essential to the preservation of the business and assets.

## What do I do when the bailiff arrives to levy execution on a judgement debt? (England and Wales)

If insolvency of the company is looming, endeavour to negotiate a series of payments over a period of time. Do not agree to a schedule of payments which cannot be met from the company's resources.

## What do I do when the sheriff officers arrive to seize assets on the premises? (Scotland)

Assist the sheriff officers to make an inventory, which can include assets not owned by the company. Immediately afterwards arrange to take advice from an authorised insolvency practitioner to avoid prejudice to the company, the creditors of the directors.

## How do I deal with a creditor claiming title retention on goods supplied?

If the point of insolvency has been reached do not allow the creditor to repossess the goods, but allow him to count and take a written record of goods supplied which are presently on the company's premises. A copy of the written record should be signed by both the creditor and yourself as agreement to the count.

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The creditor should be requested to supply documentation to support his claim to title retention.

The physical count record and the supporting documentation supplied by the creditor should be passed to an authorised insolvency practitioner or the company solicitor so the validity of the claim can be considered.

In the meantime, goods supplied by the creditor should not be sold and they should only be returned once independent positive confirmation is received on the validity of the creditor's claim.

## Which creditor claims rank as preferential?

Employees' remuneration for a period up to four months before the Insolvency together with any accrued holiday pay.

## Are the settlement of debts due to my family or other companies in which I have an interest likely to be scrutinised by a duly appointed insolvency practitioner?

Under the Insolvency Act, family members and other companies in which you have a financial interest are usually deemed to be connected parties. Consequently, if any debt due to a connected party is settled within two years in England and Wales or six months in Scotland of the company's insolvency, it may be possible for the Liquidator or Administrator to recover the amount of the payment if the company was insolvent when the company made the payment.

## What are my responsibilities as a director once a formal insolvency has taken place?

- *provide the insolvency practitioner with a statement of the company's financial affairs*
- *co-operate with the insolvency practitioner in realising the company's assets and providing him with such information as he may require in relation to the company*
- *attend on the insolvency practitioner at such times as he may reasonably require*

There are also additional duties but these vary with the type of insolvency procedure adopted.

## How can I protect my own position if I know the company is insolvent and my fellow directors refuse to acknowledge the fact?

- *ensure all meeting are properly minuted with your dissenting view*
- *advise your fellow directors in writing of your views and the reasons for them*
- *consider resignation although this of itself will not be a means on avoiding personal liability*
- *take advice from an authorised insolvency practitioner and also consider taking independent legal advice*

## What reports are made on me as a director of a failed company?

Within six months from the date of his appointment, the insolvency practitioner has a duty to report to the Secretary of State for the Department of Trade and Industry on the conduct of any director of an insolvent company who has been a director within three years from the date of insolvency.

It is a matter for the Secretary of State to determine whether to take proceedings for the disqualification of a director.

## What are the implications of being disqualified as a director?

You are unable to be a director or take part in the promotion, formation or management of a company.

## For how long can a director be disqualified?

Between two and fifteen years as determined by the Court.

## Can I incorporate another business and use a similar name to that of the failed company?

Once a company is in insolvent liquidation it is an offence for a director of that company to set up a new company with a similar name or to act as a director of be concerned with

a similar name or to act as a director of or be concerned in the management of such a company or to take part in an unincorporated business using a similar name. A director can however seek the leave of the Court to use a similar name or where the insolvency practitioner sells the business of the insolvent company to a purchaser of which the director is also a director, then that company may give notice to the insolvent company's creditors within 28 days of the purchase. This procedure avoids the need for the director of the insolvent company to seek leave of the Court.

The legislation on prohibited names is complex and proper advice should always be sought before a potentially prohibited name is used by a director or the originally insolvent company in a new business. The maximum penalty for the use of a prohibited name by a director is two years' imprisonment and personal liability for the debts of the new business.

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This leaflet has been prepared in order to help directors consider their responsibilities when their company is faced with financial pressure. However, this information represents only a brief summary of some very complex law and legislation, and should not be taken as sufficient advice for making decisions. There is no substitute for taking specific advice from an authorised insolvency practitioner as each situation varied according to its own facts.

## For further information or advice please contact:


### Glasgow
Craig Mathieson on 0845 051 0210/07717 661 040
or Maureen Leslie on 0845 051 0210

### Livingston
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Craig Mathieson on 01786 451055/07717 661 040
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