

BEWARE OF WRONGFUL TRADING

In these challenging economic times it is tempting for company directors to try and “trade the company out of trouble”. This can be guided by the mistaken beliefs that “good times must be just around the corner” and “I’m just a director of the company, so I’m not liable for any of its debts or losses anyway”. While we all hope that the first of these beliefs is true, the second one needs more careful thought...

Limited Liability

The general position is that directors of limited companies are not liable for the company’s debts or obligations. Those debts and obligations are owed by the company and must be satisfied from the company’s assets. Directors will only have taken a financial risk if they have also invested as shareholders or offered to personally guarantee any of the company’s borrowings (such guarantees are commonly required by banks before an overdraft facility will be put in place).

Directors’ Liabilities

It is, therefore, commonly believed that company directors are only answerable to the shareholders and can act as they wish without consequence. Clearly, if this were the case, a company’s creditors would be at a serious disadvantage were the company to continue to trade and borrow money in the knowledge that it was insolvent, or rapidly approaching insolvency.

Wrongful trading

The offence of wrongful trading has sought to rebalance this situation by making it an offence for a director to allow a company to continue to trade if he or she knew, or ought to have known, that the company was insolvent or could not avoid insolvency.

If a company is wound up due to its insolvent position, the liquidator will be obliged to investigate the actions of the directors. If it were discovered that a director allowed the company to continue to trade and incur additional losses and debts, that director may be ordered to contribute towards the money available to the liquidator from his or her own personal assets. The amount of the contribution will reflect the amount by which the company’s assets have been reduced as a result of the director’s actions from the moment when they should have realised that the company could not avoid insolvency.

The court also has the discretion to make an order disqualifying the director involved from acting as a director of a company for a set period.

Reducing the risks

In light of the above, it is extremely important that directors do not bury their heads in the sand in the hope that a company’s fortunes will miraculously pick up in the future. If you do think that your company is in financial difficulty, you should seek professional advice as quickly as possible. Doing so may count in your favour if you are investigated for wrongful trading, and it may even enable the company to avoid insolvency altogether.

If you would like more information on wrongful trading, or would like to discuss your own situation, please contact Chris Wills on 01872 226992, or email chris@murrellashworth.co.uk.

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