

Wrongful trading; mitigating the risk

Most directors are unaware of the personal risks they take by continuing to trade their company after it may be considered to be insolvent.

What is wrongful trading?

The law states “where a director knew, or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation” (Section 214, IA86).

Or, putting it simply, a director could become personally liable for the debts of a company incurred after a time when a reasonable person would have stopped trading. You may recall the Government stepped in during the pandemic to relieve directors of this wrongful trading threat – albeit temporarily. This suspension of provision was revoked on 30 June 2021. With Section 214 back in play, alarm bells should be ringing for directors if the company is unable to pay any of its debts as they fall.

What should I do next?

You will be surprised how often businesses find themselves operating whilst insolvent but it is possible to “keep calm and carry on” trading without being in breach of Section 214. If the directors can evidence that they took every step, with a view to minimising potential losses to the company’s creditors and the creditor position doesn’t worsen, they may not be held personally liable for the additional debts. However, the onus is on the directors to prove what steps were taken; when and why.

If you (or a client) find themselves in this position, here are a few practical steps that may well help the director at a later date to avoid any allegations that the company traded wrongfully.

- Document the decisions made by you and fellow directors.
- To keep abreast of the financial position, speak to the accountant and ask for their professional assistance in providing financial information on a regular basis.
- Monitor cash flow projections to ensure the company continues to operate in a positive cash flow manner going forward.
- Watch out for the unexpected (e.g. loss of significant contract or unanticipated liabilities) which could result in the original strategy being altered or even scrapped.
- Make sure the staff within the organisation follow the plan of action, as directors ultimately held responsible if things go wrong.
- Don’t be afraid to seek specialist professional advice from an Insolvency Practitioner. We are here to help and provide support.

In summary, alarm bells should be ringing for directors if they think they might be insolvent. However by taking the appropriate action, risks can be mitigated and trade can continue.

Northampton
100
St James Road
Northampton
NN5 5LF

Telephone
01604 754352

Banbury
18 South Bar
Banbury
Oxfordshire
OX16 9AF

Telephone
01295 272121

Coventry
1160 Elliott Court
Herald Avenue
Coventry Business
Park
Coventry
CV5 6UB

Telephone
02476 226839

Hitchin
7 Paynes Park
Hitchin
Hertfordshire
SG5 1EH

Telephone
01462 429718

Milton Keynes
2nd Floor
Elm House
Woodlands
Business Park
Linford Wood West
Milton Keynes
MK14 6FG

Telephone
01908 317387

Spalding
Room39
Welland Workspace
10 Pinchbeck Road
Spalding
PE11 1QD

Telephone
01775 741020

Case study: A diamond in the rough

The pandemic has had a devastating effect on the retail sector and BRI were asked to help one such retailer, being a jewellers based in London.

The jewellers were tied into a lease with two years still to run, and was struggling to meet its ongoing rental obligations, let alone pay off historic debt. Without the means to invest further funds the director saw no solution other than liquidation. As the landlord represented by far the majority creditor, we considered that if a resolution with the landlord could be achieved then formal insolvency could be avoided.

Despite increasing pressure from other creditors and a relatively hostile relationship between the director and landlord having developed, we set about negotiating the debt owed to the landlord. Initial offers were rejected however, a second round of negotiations led to the landlord agreeing to an informal surrender of the lease with no future rent payable. Throughout this period, the company continued trade despite being heavily insolvent.

With the rental burden removed the company has been able to continue to trade via ecommerce. Although still not entirely out of the woods, current assets should enable all other liabilities to be met. Despite still being cash flow insolvent, there was a plan to carry on without worsening the position for the remaining creditors.

The company not entering liquidation also helps the director in saving the need to write off a significant sum invested in the business. It is hoped these funds can now be recovered from successful future trade.

What the client said

“I will always remember how much your advice helped me and how without you, I would have been at the mercy of the insolvency sharks unnecessarily. I am truly grateful to you for saving me that misery at such a shocking time. You were heroic!”

We like to think our actions speak louder than words, but it is still always good to share the positive feedback from clients.

If you or your clients are currently experiencing any difficulties including the threat of insolvency, do not give up hope, instead please contact BRI and we will assist in considering all of the potential options open to you. Please be assured here at BRI we will always provide the right advice, first time every time, regardless of the fee outcome to us