Directors of Insolvent Companies

Brief Guidance Notes

1 The purpose of these guidance notes is to assist directors in understanding their duties in the period leading up to an insolvency procedure. As these notes are brief they cannot be comprehensive. Advice should be obtained if further information or clarification is required.

The period leading up to the insolvency procedure

Directors' responsibilities

2 As soon as it is recognised that a company is insolvent and will not avoid having to be placed into an insolvency procedure, the directors must ensure that they act in the best interests of the company, its creditors and shareholders. Any failure to do so may result in a breach of duty or misfeasance.

3 If the company will enter into liquidation the directors must take all reasonable steps to protect the interests of the creditors. They must ensure that the position of the creditors does not deteriorate. If they fail to do this they could subsequently be adjudged to have been guilty of wrongful trading. This could result in the directors being personally liable for some or all company's debts.

4 Directors should be aware that they remain responsible for the management of the company and its affairs in the period leading up to an insolvency procedure even if they are taking the advice of an insolvency practitioner. As a consequence they could be called upon to account for their actions in this difficult period.

5 The Companies Act 2006 sets out the duties and responsibilities of directors and directors may wish to take independent legal advice if they have any doubt as to what those duties and responsibilities are.

6 Directors should also be aware that an insolvency practitioner appointed in an insolvency procedure as a result of a company's insolvency has a statutory duty to submit a report or return on the conduct of all those who have been a director in the three years leading up to the insolvency procedure. This report or return is submitted to the Insolvency Service which can take action against directors if their conduct has not been satisfactory and this can lead to the disqualification of directors for periods of between two and fifteen years.

Trading

7 If trading is to continue in the period leading up to the insolvency procedure, steps must be taken to ensure that any sale of stock in normal trading realises more than would be obtained after the insolvency procedure had commenced. The directors may wish to obtain the advice of a valuer on this point. There should an awareness that transactions in the period are likely to be subject to scrutiny. Where the circumstances allow there are distinct advantages at this stage of trading on a cash basis as far as possible. If goods are sold on credit care must be taken not to sell to any person or company which is owed money by the company.

8 The company should incur no further credit in the period. No deliveries should be accepted from suppliers unless those goods can be sold for more than cost. If, after consideration, such goods are accepted this must be on the basis that they are paid for immediately.

9 If it is the company's practice to take deposits from customers prior to work being carried out or goods supplied, these should only be accepted from customers if the monies are paid into a separate bank account opened for such payments and where it is likely that the contract to supply will be completed.

Assets

10 In general no assets should be sold in the period unless professional advice is obtained which confirms that it is advantageous to do so. If assets exceeding £2000 are sold to the directors or associates of the company a formal resolution of the company must be passed ratifying the sale before the transaction is completed.

11 If any assets are sold for less than their true values in this period, such transactions may be reversed during the insolvency process. Where any sales of assets take place the directors must be prepared to justify the reasons for the sales and the value obtained.

Employees

12 Only those employees who are strictly necessary should be retained and steps must be taken to ensure that funds are available to pay all employees in full for the period. Payments should be restricted to current wages as far as possible. In an insolvency procedure employees can make claims under the Employment Rights Act for all other entitlements such as arrears of wages, holiday pay, redundancy pay and pay in lieu of notice.

Creditors

13 Any creditor who claims to have reservation of title clauses in his conditions of sale should be allowed access to identify the existence of his goods. It must be made clear that specific identification is required and that they will not be allowed to remove any items until an insolvency practitioner has been appointed and scrutinised their claim.

14 No payments must be made to creditors regardless of any action taken by them. Advice should be obtained notice of any legal actions is received. In a liquidation the convening of a meeting of creditors should be sufficient to prevent the continuance of any legal action. Directors should seek legal advice if landlords attempt to exercise their right to distrain.

15 Any creditor who has a floating charge or a fixed and floating charge over most or all of the company's assets has the power to appoint an administrative receiver to the company. If it is the intention of the directors, whether or not they are acting on advice, that the company should enter into creditors' voluntary liquidation, the creditor who holds the charge or charges must be advised at an early stage of that intention so that they consider whether they wish to exercise their right to appoint an administrative receiver.

Prospects for a sale as a going concern

16 There may be a possibility that the business can be sold as a going concern. The directors will have to decide how likely this is. Although a higher price could be expected from a sale on a going concern basis this must be set against any losses which might be incurred from continued trading whilst the possibility of a sale is explored.

During the insolvency procedure

17 In general the powers of directors cease upon the appointment of a liquidator. During an administrative receivership or an administration the directors will only have very limited powers and all executive decisions will be taken by the insolvency practitioner.

18 A report on the conduct of directors must be submitted to the Insolvency Service by every liquidator, administrative receiver and administrator. If the Insolvency Service believes that any director is unfit to be concerned in the management of a company due to his conduct it can ask for the court to disqualify that person from acting as a director for between 2 and 15 years.

19 Directors have a duty to deliver the company's assets or any records under their control to the appointed insolvency practitioner ("the appointee") in a liquidation, administrative receivership or and administration. They also have a duty to co-operate with the appointee and provide him with such information as he may reasonably require. If the directors fail to provide the information which is required or to co-operate, the court may summon them to answer questions on oath.

20 Where in the two years before the insolvency procedure, but when the company was insolvent, a liquidator or administrator can ask the court to set aside any transactions which:

- have resulted in the company obtaining less than full value for what it paid, or

- put a creditor in a better position than the general body of creditors.

Where the transactions are a preference and concern persons not connected with the company that period is reduced to six months.

Use of the company's name

21 Directors of company's which enter into liquidation are not able to act as directors or managers of any company or business with a similar name for 5 years unless:

- the other company was trading under that name for at least 12 months prior to the liquidation, or

- another company buys all or the major part of the business from the liquidator and gives notice to the insolvent company's creditors of the transaction, or

- the court's permission is obtained.

22 If the above procedures are not followed the directors or manager of the company with the unauthorised name will be personally liable for all of the debts which the company incurs, in addition to which they can be fined or imprisoned. The prohibition extends to all of the names under which the company traded or was known at any time in the 12 months prior to liquidation.

23 Should you wish to consider using the company's name or a similar name in future trading it is recommended that you seek legal advice.

Further advice

24 These notes are only able to deal with the major issues which arise on insolvency. Further guidance may well be required to clarify the points made or to deal with matters not dealt with in these notes. This guidance should be obtained from a licensed insolvency practitioner or a solicitor who specialises in solvency law.

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