

**A Guide to
Limiting
Director
Liability During
Liquidation**



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About

An independent business advisory legal firm, Inquesta specialises in providing a high-quality Insolvency service.

Our team of experts are on hand to assist legal advisors on matters including but not limited to:



Commercial disputes



Matrimonial disputes



Loss of profit claims



Business interruption



Fraud



Company liquidation

At Inquesta, it's our aim to relieve you of some of the burden and stresses that can come with running a business. We understand the importance that some space to breathe and think can have. We operate to take some of the unnecessary pressures away from you, allowing you to focus on what's important to you – the future success of your company.

When you're dealing with Inquesta, you can be assured that there are no hidden agendas. From start to finish, you can be completely confident that you're working with a firm with your best interests at heart.

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The Role of a Company Director

A company director is a figure chosen by a limited company to manage the day-to-day operation. The role of these directors is to ensure that everything is operating lawfully and is done for the good of the company and all of its shareholders.

The role of a company director comes with a variety of duties to their business, this includes:

Introduction

Part of the role of being a company director is that you owe a certain level of duty to the business you are responsible for, and its shareholders. However, when insolvency is threatened, it may be possible for you to also owe much more, this time to creditors.

The last thing any business owner wants is to be found personally liable for company debts. However, it is surprisingly common for this nightmare scenario to become a reality thanks to a variety of different potential factors and decisions made by a company director leading up to their firm becoming insolvent.

The business world is complicated, the situation at one company cannot be directly compared to that of another. This is why when you're under threat of insolvency, you need to be absolutely certain of where you stand to ensure that you can't be exposed.

Find out more about the role of a company director, what exposure directors can be liable for, what situations could lead to you being seen as liable, potential ways to avoid director exposure, and more in our directors exposure fact sheet.

Exercise Care and Awareness

No company wants their director to act too impulsively, particularly to the detriment of the wider operation. To promote these values, a director must pay particular attention to the following and more:

- Potential drawbacks to any decisions made
- Possible long-consequences of any actions or decisions made
- The best interests of company employees
- The company's environmental impact
- Maintaining high standards of service and conduct

Foster Success At All Times

It goes without saying that when appointing a director, the intention is for them to always promote the values and long-term success of the company they serve. A failure to act in a way that is at the very least intended to benefit the business in some way should be deemed as an egregious failure on the part of any director



Always Act Within Powers

One of the core duties of a company director is to always adhere strictly to the policies and strict needs of the business they serve. Constitutions that the director must follow at all times for fear of sanction include the articles of association, shareholder agreement, and joint venture agreements.

Avoid Any And All Conflict of Interest

A director must, under no circumstances, get into a situation of a conflict of interest – regardless of how much it could benefit the company.

Examples of actions that could be construed as directorial conflict of interest includes:

- Also being a director or shareholder of a competitor, supplier, customer, etc.

- Personally investing in a competitor or supplier

- Advising a competitor, supplier, customer, in a professional or non-professional capacity.

- Personally gaining or profiting from your position as director

These actions would still apply if they were performed by a person with close ties to a company's director (partner, parent, child, etc.) and could be tied back to the director.

What Is Director Exposure to Liabilities?

A director is exposed to liability when they are deemed to be personally liable for the actions of the business. Actual litigation against directors is quite rare – however it is becoming increasingly common nowadays, meaning that all directors should be careful.

It is also possible that a director is held accountable for the actions and failures of somebody underneath them.

Another situation where a director could be exposed to liabilities would be if an individual suffers financial losses as a direct result of their dealings with the company. The first port of call in this situation would often be to claim against the company. However, were this to fail for any reason, they may then wish to take direct action against the director.

Additionally, a director may be deemed personally liable for company debts if the business owed money that it could not pay – this debt could then fall on the director to settle up. Debts that could qualify for this include unpaid invoices, rent, and loan repayment.

A director can even be held accountable when the company in question is no longer trading or they have left the business.

When Are Directors Personally Liable For Company Debts?

Company directors are not generally held responsible for the debts of their company. However, there are statutory exceptions to this, including when there is evidence of wrongful trading, fraudulent trading, deceit, misfeasance, and personal guarantee issues.

Examples of when directors could be deemed personally liable for company debt includes:

Wrongful Trading

Wrongful trading refers to times where a company has continued to trade and incur additional debts and credit despite having already gone into liquidation, entered administration, been handed a winding up petition, etc.

Should a director purposely and knowingly carry out wrongful trading, it is possible that they could be seen as personally liable for any additional debts incurred after the point they became aware or should have been aware that liquidation/administration was inevitable.

The finite point where the director should have been aware of their wrongful

trading is generally worked out by taking into account expertise, experience, qualifications, etc. meaning that the more qualified the director, the harsher the judgement will be.

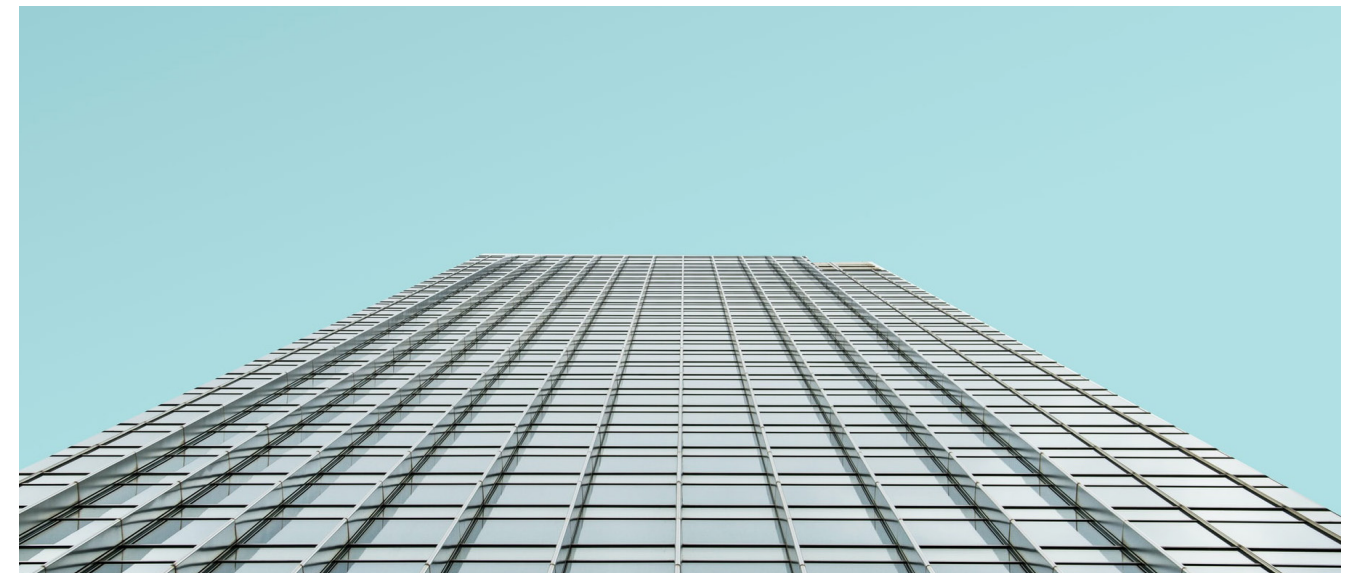
Fraudulent Trading

A director found guilty of committing fraudulent trading could be sentenced to up to 10 years in prison. Fraudulent trading is when a company continues to operate after the start of the liquidation/administration process, but unlike wrongful trading, the business is intending to defraud their creditors by making it harder or impossible for them to receive the payments owed to them.

Misfeasance

Misfeasance refers to when a company director, during the process of winding up, misapplies, retains, misappropriates, or becomes accountable for any money or high-value assets (such as a vehicle or property) that can be traced back to the business.

Should a director be found guilty of misfeasance, the court may order them to repay any money and restore any assets left unaccounted for – with interest. If the assets are no longer in possession of the director, then it is likely that they must compensate for the loss.



Personal Guarantees

Should a director have ever, for any reason, provided a personal guarantee to, for example, acquire loan funding for the business, then they will be held personally liable to repay if the company cannot – in line with the original agreement made.

In a circumstance such as this one, creditors would be able to claim against the directors assets.

If Stated in Shareholders Agreement

It is possible that in certain circumstances, a shareholder agreement may stipulate that directors be held personally liable, and therefore must provide security for the debts of the business.

Overdrawn Directors' Loan Accounts

When the director's loan account becomes overdrawn, they are deemed to owe this money to the company. It is common, in this situation, for the repayment to be put off for months if not years.

However, if the business is forced to enter liquidation due to financial struggles, any money owed will immediately become another asset to be recovered.

The liquidator will pursue this money with the intention of adding it to the company's fund to repay its creditors.

What Can Directors Be Exposed To?

Directors of an insolvent company can, if a situation is allowed to develop beyond a certain point, find themselves exposed to a variety of potential punishments and liabilities. This can include disqualification, being forced to cover company debts, and in some circumstances even litigation.

A selection of possible things that directors could be exposed to can include:

Contract Termination

A director breaching their fiduciary duties in some way is highly likely to be grounds for disciplinary action. The most common, and in many cases, accepted punishments will surround the termination of their service contract, ceasing their time as director.

If the situation is deemed to be particularly egregious as a result of some form of gross misconduct, the director in question's contract could be immediately terminated with no notice or payment in lieu of notice.

Disqualification as a Director

If the court deems that a director's conduct has been so poor that they are no longer fit for the position of director, it is possible for them to disqualify you. This would entail you no longer being able to act as a director of any company for between 2-15 years.

For you to be disqualified as director, it is likely that you must have had a particularly negative impact on the business, so much so that enabling you to start fresh with a new company would only put other individuals (consumers, employees, suppliers, directors, etc.) at risk.



Repay, Restore, or Account for Money

Should a director be found to have conducted an offence such as misfeasance or fraudulent trading where they have breached their fiduciary duty, then they could be required to pay back any misappropriated funds.

For example, should the director be found to have committed misfeasance, the court may order the director in question to repay, restore, or account for any money or property with interest.

Buyout

Particularly common in cases of unfair prejudice, it may be possible for courts to order a director to buy-out an aggrieved party so they take over their share in the business.

The price of the claimants share will be decided by the courts – generally to the benefit of the aggrieved party.

How To Avoid Director Exposure

For any director looking to explore ways to minimise exposure to personal liability, there are certain measures that can be taken. This goes beyond the obvious suggestions that a director should always try to minimise potential losses and act honestly in all actions.

Measures a director can take to minimise exposure to personal liability in the event that their business become insolvent should be split into two base categories, things the director should attempt to do, and things they should avoid doing:

What to do to Avoid Director Exposure

Measures and habits that you, as a director, can take and begin right now if you wish to minimise the risk of exposure include:



Be Proactive

A passive director with little idea of what is going on in their business is one risking being found personally liable. Regularly monitor all company finances and accounts so you can be totally certain that everything is above board, up-to-date, and how they should be. This can ensure that any financial assessments can be made quickly and easily, and you can't ever be accused of burying your head in the sand.

As director, it is vital that you stay on top of all debts. You should never sit around and wait to be alerted of any problems with the repayment of a company debt.

Make Sure

A business that intends to continue trading beyond the point they are found to be insolvent, must be absolutely certain that they are not doing so by risking the future debt repayments when they fall due.

Trading while insolvent should be seen as a measure to help a company to find the funds to repay their creditors, not worsen their position further.

Stay Organised

Should you have any loans or financial agreements in place, it is important that you remain aware and organised when it comes to the terms. An inability to repay a loan, particularly if a personal guarantee is in place, could lead to the company being forced to repay the entire loan or debt in one sum.

Additionally, it is important that regular board meetings are organised, as well as the company AGM. Not only should the meetings be held, but they should also be properly recorded. All important decisions, agreements, and disagreements should be noted for future reference.

Seek Professional Advice

Perhaps the most important step a director can take in order to avoid direct personal exposure would be to seek expert advice, preferably from an insolvency practitioner.

An independent expert can advise you prior to any major business decision that could come back on you as director in the future. This can include entering into a contract with another party, paying creditors, trading when insolvent, and much more.

Another party will also be able to check the terms of all articles of association, shareholders agreements, etc. to ensure that you are covered from any potential future personal liability should the firm's fortunes sour.

What Not to do to Avoid Director Exposure

Sometimes, not doing something as a director is as important as changing the way you operate. Examples of what not to do in order to avoid director exposure includes:



Keep Pushing It

It is not uncommon for the director of a struggling business to continue pushing on and on in the face of disaster, either to ignore the issues or to attempt to turn a situation around before it gets too far.

This can be by taking out loans that cannot be repaid, putting off debt repayments, and agreeing to repayment structures that the firm will not be able to afford in the long-term to gain some breathing room.

Knowing when you need to take a breath to take stock of your situation and consider what the next steps should be is a vital skill for a director to learn.

Run Away From Issues

Two common misconceptions for directors of a struggling company are that resigning from their position will free them of any potential issues down the line, and ceasing trading immediately will protect all parties from claims of fraudulent or wrongful trading.

In a vast majority of situations, resignation won't classify as taking every step to minimise creditors losses and it is likely that should the situation continue to devolve to the point of insolvency, the past creditors actions will come under scrutiny regardless of if they are still with the company or not.

Conclusion

No matter what position your business is currently in, regardless of how strong a position you feel that you might be in, if you are currently operating as a director of a limited company it is absolutely vital that you check your position in regards to potential directors exposure.

As you can see, the topic of director exposure is a highly complicated and delicate situation that needs to be managed and approached very carefully. Protecting yourself from and avoiding director exposure should be seen as a priority for the director of any business, no matter the size, the industry, or the location.

If you require help ensuring that your position is secure and your financial security is guaranteed no matter what may happen, an insolvency expert should be your first call. With decades of experience supporting and protecting directors against the risks of personal liability and beyond, Inquesta's team are on hand to help you with any issue.

The needs of our clients are the number one priority in everything we do. Our process will generally begin with an initial consultation, this is designed to help us better gain an understanding of your case, the specifics involved, what complexities are present, and to discuss what we can do to help.

The next step will entail members of our dedicated team getting to work assessing the realities of your situation. We will keep you informed throughout so you're never in the dark, before finally presenting our findings to you alongside a clear and detailed report covering your current position and what your next steps should be.

Get in touch today for a high-quality, high-reliability service designed to cater to the every needs of our clients. Contact a member of our team for a no-obligation consultation and find out more about what we can do to help.

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