

A Guide for Directors of Troubled Businesses

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This guidance note aims to summarise the legal and practical considerations which directors of insolvent companies, or companies facing insolvency, should take into account when plotting the company's future course. What is Insolvency? The most commonly used definitions of insolvency are that the company cannot pay its debts as and when they fall due, or alternatively, that the value of its assets is less than the value of its present and contingent liabilities. The term "insolvency" is also used inter-changeably to describe the various formal procedures which may apply to an individual or business, such as bankruptcy or liquidation. The current statutory framework for insolvency is primarily governed by the Insolvency (NI) Order 1989 and the Insolvency (NI) Rules 1991.

Risks for the company when it is, or is close to becoming, insolvent:

- risk of being compulsorily wound up by creditors
- transactions entered into by the company are at risk of being set aside by the Court as "undervalues" or "preferences"
- risk that loans made to the company will be "called in" by the lender
- risk of automatically terminating important commercial contracts and agreements

Personal Liability of Directors

There are a number of significant risks for directors on Insolvency:

- incurring personal liability pursuant to personal guarantees
- incurring personal liability for wrongful trading
- risking criminal and personal liability for fraudulent trading
- future disqualification as a director

* A director's liability for fraudulent and/or wrongful trading can only arise if the company is in administration or liquidation. ** Personal liability pursuant to guarantees given by the directors and the risk that the director may be disqualified can generally arise whatever form the insolvency takes. Directors concerned about the financial standing of their company should consider doing the following:- Take Advice at the Earliest Opportunity In order to assess properly the various alternatives open to a company in financial difficulty, all directors should ensure that they have access to proper financial and legal advice. It is crucial to ascertain the full facts about the company's financial position and future prospects before taking significant decisions. In most cases, it is also appropriate for the company to retain an Insolvency Practitioner to advise the company on the alternative strategies open to it. Monitoring the Financial Position of the Company The directors should regularly assess the company's financial position and prepare financial projections in order to consider if the company is currently solvent and, indeed, to assess whether the company will be in a position to avoid an insolvent liquidation in the foreseeable future. Formulating a Viable Strategy It is likely that the immediate goal of the directors will be to devise a short-term and long-term strategy to avoid insolvent liquidation. In general terms, the strategy may include one or a number of the following options:

1. Reducing overheads;
2. Identifying profitable trading strategies;
3. Disposing of unprofitable trading strategies;
4. Obtaining additional finance;
5. Maximising existing asset value;

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6. Proposing an informal arrangement with major creditors, or a more formal arrangement such as a Company Voluntary Arrangement.

In terms of pursuing a new strategy, the support of the Board (and preferably the full Board) is recommended. Equally, the viability of the agreed strategy should be reviewed by appropriate advisors, and its implementation should be fully monitored. Provided the directors have carried out a full assessment, and have taken a reasonable view that the agreed strategy provides a realistic solution to solve the company's financial problems, then the Board is entitled to pursue this without taking more immediate steps to protect the company's creditors.

Practical Advice

When faced with a potential insolvency, each individual director and the collective Board of directors should consider the following, suggested, approach:

1. take immediate advice from appropriate professionals in the field, after having provided the professionals with the fullest information available;
2. consider the advice carefully and minute these considerations;
3. ensure that decisions and the reasons for taking them are properly recorded and fully minuted, thus ensuring that a future liquidator or administrator can analyse the attempts the Board of Directors took to protect the company's creditors;
4. if the result of all of the above illustrates that it is reasonable to expect that there is a viable, practical way forward which is in the best interests of creditors, then it is unlikely that the director will be found guilty of wrongful trading.
5. if a director takes a contrary opinion to that of the Board, he or she should make his opinion known to his or her fellow directors, preferably at a full Board Meeting. For his own protection he should ensure that the Board minutes for that meeting reflect his view, and his reasons for this. In such circumstances, a director should point out his opinion at every opportunity and refrain from incurring further indebtedness on behalf of the company. Resignation in itself will not necessarily be enough for a director to avoid a contribution order.

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