

Wrongful Trading – Gillian Harding

In tough trading conditions, the risk of being found guilty of wrongful trading can seem to loom overhead. Wrongful trading occurs when directors continue to trade when they know or ought to have known that their company was insolvent and should be put into liquidation. If it is proved, the directors will be personally liable to the company's creditors. A recent Court of Appeal judgement provided helpful guidance on the question of when a company is insolvent by clarifying the test it will apply. The Court concluded that determining whether a company can pay its debts is "more than an exercise of simply assessing net assets or liabilities" and approved a report saying that:

"A balance has to be struck between the right of an honest and prudent businessman, who is prepared to work hard, to trade out of his difficulties if he can genuinely see a light at the end of the tunnel, and the corresponding obligation to 'put up the shutters', when, by continuing to trade, he would be doing so in disregard of those business considerations which a reasonable businessman is expected to observe."

The Courts will look at all of the facts to determine whether a company has reached 'the point of no return' "with a fair eye both on commercial reality and commercial fairness".

It is assumed that any reasonable director would ensure that they have the necessary financial information to be able to tell whether a company is insolvent, so delegating financial matters to a particular director does not absolve the other directors from responsibility.

Even if a company is insolvent, its directors won't be personally liable if they took every step with a view to minimising the potential loss to the company's creditors that they ought to have taken as soon as they knew or ought to have concluded that they had reached that 'point of no return'. A key step is ensuring that the company doesn't incur further debt.

Where there is a genuine possibility of survival by a certain course of action, the directors should not ignore it. Each director must carefully consider any plans to rescue the company, in order to ensure that he genuinely considers that they are in the best interests of the company and do not constitute a fraud on its creditors.

Wrongful trading cases are uncommon and, even as the economic storm clouds gather again, this is one small silver lining for directors who act in the best interests of their company and its creditors. For more information about company law contact Gillian Harding (gillian.harding@hrjlaw.co.uk) or David Howard (david.howard@hrjlaw.co.uk) at our Hitchin office on 01462 628888.



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