

# Director Risks Explained

Wrongful trading, preferences, overdrawn loan accounts, and other common director concerns explained simply.

One of the first questions directors ask when their company faces insolvency is: "What does this mean for me personally?" This guide explains the most common risks that directors face, the circumstances in which personal liability can arise, and what you can do to protect yourself.

## The Starting Point: Limited Liability

As a director of a limited company, you benefit from the principle of limited liability. This means that, in normal circumstances, you are not personally responsible for the company's debts. The company is a separate legal entity, and its obligations are its own.

However, this protection is not absolute. There are a number of situations where the "corporate veil" can be pierced or where statute imposes personal liability on directors. Understanding these situations is important, particularly when the company is insolvent or approaching insolvency.

## Wrongful Trading

Under section 214 of the Insolvency Act 1986, a director can be held personally liable for wrongful trading if they allowed the company to continue trading at a time when they knew, or ought to have concluded, that there was no reasonable prospect of the company avoiding insolvent liquidation.

The key question is not whether the company was insolvent, but whether the director took every step they ought to have taken to minimise the potential loss to creditors once they knew (or should have known) that insolvency was unavoidable. Taking professional advice at an early stage is one of the most effective ways to demonstrate that you acted responsibly.

## Fraudulent Trading

Fraudulent trading under section 213 of the Insolvency Act 1986 is more serious than wrongful trading. It applies where a company has been carried on with intent to defraud creditors or for any other fraudulent purpose. Unlike wrongful trading, fraudulent trading can also give rise to criminal liability. In practice, successful claims for fraudulent trading are relatively uncommon because the burden of proof is high — the liquidator must demonstrate actual dishonesty.

## Preferences

A preference occurs when the company does something, or suffers something to be done, that puts a creditor in a better position than they would have been in had the company gone into insolvent liquidation. If a preference is given to a connected party (such as a director, a family member, or a company controlled by the director), it is presumed that the company was influenced by a desire to prefer, and the liquidator can apply to the court to reverse the transaction.

Common examples include repaying a director's loan while leaving trade creditors unpaid, paying a family member's company ahead of other creditors, or transferring assets to connected parties at less than their market value. The relevant look-back period is two years for connected party preferences and six months for unconnected creditors.

## Transactions at an Undervalue

Under section 238 of the Insolvency Act 1986, a liquidator can challenge transactions entered into by the company in the two years prior to insolvency where the company received significantly less than the value of what it gave. This could include selling assets at below market value, writing off debts owed to the company, or making gifts. The court can order that the transaction be reversed or that the recipient pay compensation.

## Overdrawn Director's Loan Account

If you have an overdrawn director's loan account — meaning you owe money to the company — the liquidator will be required to pursue recovery of that debt. This is one of the most common issues directors face in liquidation. The amount owed is a debt due from you personally to the company, and the liquidator has a duty to collect it on behalf of creditors.

If you know your loan account is overdrawn, it is important to discuss this with your insolvency practitioner before the company enters liquidation. In some cases, arrangements can be made, but the liquidator's primary duty is to creditors.

## Personal Guarantees

Many directors sign personal guarantees in order to obtain finance, premises, or credit for the company. A personal guarantee is a separate obligation from the company's debt and survives the company's liquidation. If you have given personal guarantees, the guaranteed creditor can pursue you directly for the outstanding amount once the company defaults. This is not a consequence of the insolvency process itself, but it is a practical consequence that many directors need to address.

## Director Disqualification

The Company Directors Disqualification Act 1986 gives the court power to disqualify directors whose conduct makes them unfit to be concerned in the management of a company. The liquidator is required to submit a report on the conduct of each director to the Insolvency Service, which decides whether to pursue disqualification proceedings.

Conduct that may lead to disqualification includes allowing the company to trade while insolvent for an unreasonable period, failing to maintain proper accounting records, failing to file statutory returns or accounts, and non-payment of Crown debts (VAT, PAYE, etc.). A disqualification order typically lasts between 2 and 15 years, during which time the individual cannot act as a director or be involved in the management of a company without the court's permission.

**Perspective:** While the risks described above are real, the vast majority of directors who take timely advice and act in good faith do not face personal liability or disqualification. The key factors that protect directors are acting promptly once insolvency becomes apparent, taking professional advice, cooperating fully with the liquidator, and not preferring their own interests over those of creditors.

## How to Protect Yourself

The single most important thing a director can do is take professional advice early. If you are concerned about your company's financial position, speaking with a licensed insolvency practitioner allows you to understand your obligations, make informed decisions, and demonstrate (if it ever becomes relevant) that you acted responsibly and sought appropriate guidance.

Contact Insolvency Direct for a free, confidential initial consultation. We will help you understand where you stand and what steps you should take to protect both the company's creditors and your own position.