What is Wrongful Trading and Fraudulent Trading?

Wrongful Trading

Wrongful trading is defined under Section 214 of the Insolvency Act 1986, and is the less serious of the two offences.

Wrongful trading applies when:

(a) the company has gone into insolvent liquidation,

(b) at some time before the commencement of the winding up of the company, that person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation, and

(c) that person was a director of the company at that time.

In deciding whether or not a director of a company ought to have known or ascertained the company was insolvent, the conclusions which he ought to reach and the steps which he ought to have taken are those which would be known or ascertained, or reached or taken, by a reasonably diligent person having both—

(a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company, and

(b) the general knowledge, skill and experience that that director has.

Of course, these points are not a definitive ‘you’re guilty’, and the Insolvency Practitioner will investigate into the affairs of the company in detail to conclude whether or not you have committed an offence.

Defence for Directors in relation to Wrongful Trading proceedings

The Insolvency Practitioner will need to apply to court to proceed with action against a director for Wrongful Trading.

The Court will then have regard to any director falling under (b) above and will not make the order if it is satisfied that that person took every step with a view to minimising the potential loss to the company's creditors as they ought to have taken. (assuming him to have known that there was no reasonable prospect that the company would avoid going into insolvent liquidation)

Therefore it is very important to ensure all actions taken are well documented in the company records and you do not breach your 'fiduciary duty' as a director (*see Directors Duties guide*).

Fraudulent Trading

Fraudulent trading is defined under Section 213 of the Insolvency Act 1986 and is considered more serious than Wrongful Trading, but harder for an Insolvency Practitioner to prove.

The definition of Fraudulent Trading is, if in the course of the winding up of a company it appears that any business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose.

The Court could then, on the application of the Liquidator or Administrator, declare that any persons who were knowingly parties to the carrying on of the business in the manner above-mentioned are to be liable to make personal contributions to the company's assets as the Court thinks proper.

How you can help protect yourself against the risk of Wrongful or Fraudulent Trading

The most important protection against possible actions is to demonstrate that you acted reasonably as a director at all times.

You should be aware of your duties to the company as a director and ensure that at all times you act in the best interests of the company and its creditors.

The key four steps you should take as a matter of course as directors are to:

1. **Hold regular formal board meetings** to discuss the performance and stability of the company.

2. Ensure that you **review the company accounts on a regular basis** and familiarise yourself with the contents, ask your accountant if you are not sure of something as they will be happy to help.

3. **Document all decisions** made and file them in the company records. By doing this you can make sure that you are able to defend all actions taken.

4. **Take professional advice at an early stage**, involve your accountant and allow them to assist you. Too many times we are brought in at a stage where it is too late to save the company, meaning you have lost your company and your accountant has lost a client. If they can't help you, they will refer you to us for our guidance.

This article is for information purposes only and when considering insolvency professional advice should always be taken. DCA Business Recovery LLP provides free initial consultations to all clients and will advise on how to limit your personal liability as a director

Please contact us with any queries on our Freephone Helpline 0800 066 2544