

Restructuring across borders *England and Wales*

THE POSITION OF DIRECTORS OF COMPANIES IN FINANCIAL DIFFICULTY | APRIL 2026



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General

There are four main areas of concern for directors of companies in financial difficulty

- wrongful trading;
- fraudulent trading;
- disqualification as a director for being “unfit”; and
- the duty to consider creditors’ interests where the company is insolvent or bordering on insolvency.

In addition, this factsheet considers certain recent reforms to the UK pensions and tax regimes that have possible implications for directors of companies in financial difficulty.

Directors, de facto directors, and shadow directors

As a preliminary point it should be noted that in relation to wrongful trading and disqualification, the term “director” has an extended meaning. It includes formally appointed directors, “shadow” directors and “de facto” directors.

The statutory definition of a shadow director is: “a person in accordance with whose directions or instructions the directors of the company are accustomed to act (but so that a person is not deemed a shadow director by reason only that the directors act on advice given by him in a professional capacity, or on instructions, guidance etc. given by a person in the exercise of a statutory function (e.g. a regulator) or a Minister of the Crown)” (section 251 Insolvency Act 1986).

The intention is to cover those who, although not formally appointed to the board, regularly give directions or instructions to the directors such that they exercise a real influence on the affairs of the company. It may also cover parent companies (that is, a parent company may be

the shadow director of a subsidiary) where the parent or the directors of the parent operate a “hands on” approach to running the group and interfere consistently in the management of the subsidiaries.

A de facto director is someone who has not been formally or validly appointed as a director of a company but who carries out directorial acts and so will be held for certain purposes to be a director. The cumulative effect of the director’s activity is relevant and the issue has to be looked at ‘in the round’. It is a question of fact and degree. The director will be someone who has real influence on company affairs (and in that sense, this director’s impact will resemble that of shadow directors).

By contrast, the fraudulent trading regime applies to “any persons who were knowingly parties to” the fraudulent trading.



Wrongful trading

Wrongful trading is designed to make directors liable in certain circumstances for debts and liabilities of the company of which they are officers.¹ It effectively places an onus on the directors, on becoming aware (or when they *should be aware*) that there was no reasonable prospect of avoiding insolvent liquidation or insolvent administration, to take every step with a view to minimising the potential loss to the company's creditors.

The aim is not to overload the directors with pressure in the already difficult circumstances of their company being in financial difficulty, but to ensure directors focus their minds during this time on the impact their actions and decisions may have on creditors.

The provisions apply in an insolvent liquidation and an insolvent administration. "Insolvent" for these purposes means that the assets of the company are insufficient to meet all liabilities and the costs and expenses of the winding-up/administration (i.e. a balance sheet test).

The court, on the application of a liquidator/administrator (or an assignee of such right of action)², may declare that a person who is or has been a director of the company is liable to make such contribution to the company's assets as the court thinks proper where:

- the relevant company has gone into insolvent liquidation/administration;

- at some point prior to the start of the liquidation/administration, that person knew or ought to have concluded that there was no reasonable prospect of the company avoiding going into insolvent liquidation/administration (the "Knowledge Condition"); and
- from the moment described above, that person failed to take every step they ought to have taken with a view to minimising the potential loss to the company's creditors.

The minimum standard required of a director is that of a reasonably diligent person having the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as that director. However, the actual standard by which a particular director is judged may be materially higher if that director's general knowledge, skill and experience are, in fact greater than might reasonably be expected. The standard is thus composed of objective and subjective elements. This combined standard is used to assess when the director should have concluded that insolvent liquidation/administration was unavoidable and also the steps the director should have taken to minimise losses to creditors.

The assessment of whether a director should have concluded insolvent liquidation/administration was unavoidable will not depend upon a snapshot of the company's financial position at any given time, but on rational expectations of what the future might hold.

Even if it has been agreed by the board that a director's responsibilities are limited to a particular area, this will not absolve that director of his or her wider duties to the company and its stakeholders.

However, a director is not expected to be clairvoyant and the fact that he or she may fail to see what eventually comes to pass does not necessarily mean that he or she will be liable for wrongful trading.

Additionally (and as mentioned above) the court will not make an order for wrongful trading if a director, knowing (based on the objective and subjective tests above) that there was no reasonable prospect of the company avoiding going into insolvent administration or liquidation, took **every step** with a view to minimising the potential loss to the company's creditors as he or she ought to have taken.



¹ The liability to contribute to the assets of the company is intended to be primarily compensatory and not penal in nature and, therefore, the starting point for quantifying the amount of any contribution by directors is to identify the increase in the net deficiency during the period under review - *Re Continental Assurance Company of London plc* [2007] 2 B.C.L.C 287.

² A liquidator and an administrator each has the statutory power to assign a right of action for wrongful trading and/or fraudulent trading and it is possible therefore that a director could find an action for wrongful trading and/or fraudulent trading brought against them by a party other than the liquidator or administrator of the company.

Wrongful trading (cont.)

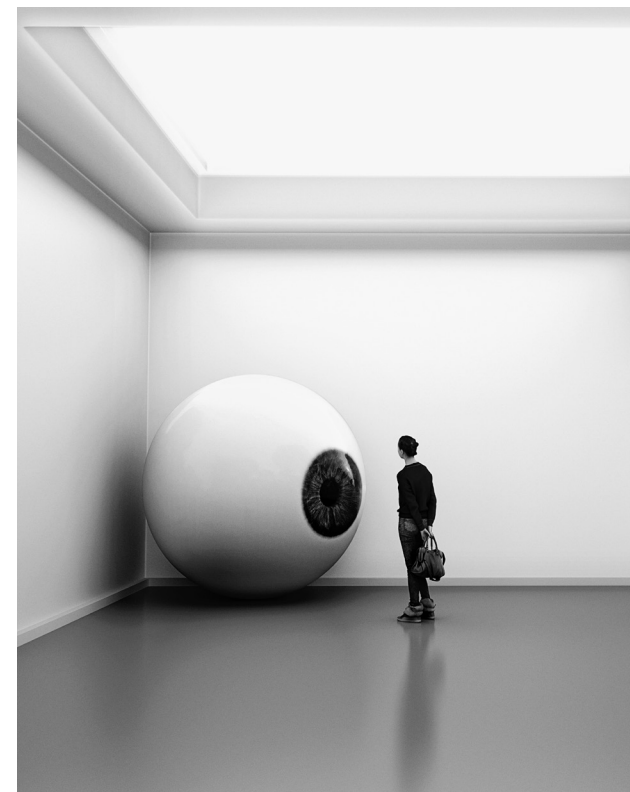
What these steps are in any particular case will depend on the circumstances and the combined test referred to above. In some circumstances, it will mean ceasing to trade and/or seeking to place the company into insolvency proceedings immediately; in others, it might be appropriate for the directors to continue trading with a view to trading out of insolvency³ or achieving a better result for creditors overall than would otherwise be the case. However, the courts have made it clear that this defence of directors' conduct is not available if an individual creditor is made worse off even if the position of the general body of creditors improves.

The courts have recognised the difficult position of directors in these circumstances where they may face criticism whichever course they pursue – “if directors close down immediately... although they are not at risk of being sued for wrongful trading, they are at risk of being criticised on other grounds”⁴ – given the greater likelihood of any resulting liquidation being insolvent, the costs of liquidating a company and the avoidance tactics debtors will try to employ to avoid paying the insolvent company. Continuing to trade may be the most reasonable course where the company has incurred most of the upcoming costs for running the business and reasonably anticipates that profits will soon be forthcoming⁴.

Dishonesty is not an element of wrongful trading and the absence of that element will often make wrongful trading easier to prove than fraudulent trading (see next section).

It is likely that the wrongful trading provisions will be regarded as having extra-territorial effect and so will not just apply to directors (or shadow directors) based in the U.K.⁵.

A director found to be liable for wrongful trading and who is required to contribute to the assets of the company may also have a disqualification order made against him or her (see further below).



³ Re Continental Assurance Company of London plc [2007] 2 B.C.L.C. 287.

⁴ In the matter of Marini Limited [2003] WL 1823004.

⁵ It was assumed that the wrongful trading provisions had extra-territorial effect in Re Howard Holdings Inc [1998] BCC 549. The Supreme Court in Bilta (UK) Ltd (in liquidation) v Nazir [2015] UKSC 23 held that the fraudulent trading provisions had extra-territorial effect.

Fraudulent trading



Fraudulent trading may apply if, in the course of a liquidation/ administration of a company, it appears that any business of the company has been carried on with the intent to defraud creditors of the company (or creditors of any other person) or for any fraudulent purpose.

The court, on the application of a liquidator or administrator (or an assignee of such right of action), may declare that any person who was knowingly party to the carrying-on of the business in this manner is liable to make such contribution (if any) to the company's assets as the court thinks proper⁶.

This will require the court to consider whether the person concerned: (a) participated in the carrying on of the fraudulent business; and (b) did so knowingly i.e. where he or she was participating with knowledge that the conduct was intended to defraud. Knowledge will extend to deliberately shutting one's eyes to the obvious.

Fraudulent trading carries both criminal and civil liability, with a maximum sentence of ten years imprisonment. Actual dishonesty in the running of the company is an essential element of the offence. It is not enough to show that the company continued to run up debts when the directors knew that there was no prospect of avoiding insolvency; there must have been actual dishonesty involving real moral blame (although note that fraudulent trading may be proved where debts are dishonestly incurred by directors on behalf of a company where the directors know there is little prospect of the debts ever being paid in full). Wrongful trading was introduced because fraudulent trading was, and is, difficult to prove.

As mentioned above, the Supreme Court has held that the fraudulent trading provisions have extra-territorial effect and so will apply not just to directors (or shadow directors) based in the UK⁷.

A director found liable for fraudulent trading may also have a disqualification order made against him or her (see further below).

⁶ Whilst this of course may encompass the directors of the relevant company, the Supreme Court has confirmed that fraudulent trading is not merely confined to those involved in the management or control of the business - *Bilta (UK) Ltd (in liquidation) and others v Tradition Financial Services Ltd* [2025] UKSC 18.

⁷ *Bilta (UK) Ltd (in liquidation) v Nazir* [2015] UKSC 23.

Disqualification and compensation orders

The court will make a disqualification order (of between 2 and 15 years) against a particular person where it is satisfied that:

- the person is or was a director or shadow director of the company which has become insolvent during or after the time the person was a director (or shadow director); and
- the conduct of the person as a director is such that the person is unfit to be concerned in the management of a company.

For these purposes, a company “becomes insolvent” in one of three ways:

- if it goes into liquidation at a time when its assets are insufficient for payment of its debts and liabilities, and the expenses of the winding-up;
- if a company enters administration; or
- if a company has an administrative receiver appointed to it.

The liquidator, administrative receiver, administrator or official receiver has a duty to send the Secretary of State a report on

the conduct of all directors of the insolvent company who were in office in the last three years of the company's trading. The report is to cover any conduct of the director which may assist the Secretary of State in deciding whether to seek a disqualification order against a relevant director. In lieu of initiating disqualification proceedings, the Secretary of State may accept a voluntary disqualification undertaking from a director to speed up the process of removing the director from the realm of corporate directorships. This procedure avoids the expense and delay of court proceedings. Disqualification undertakings will only be accepted where it appears expedient in the public interest for this route to be followed.

In deciding whether a person is unfit to be concerned in the management of a company, the court will consider the full range of the director's conduct, including the extent of the director's responsibility for:

- the causes of the company (or any overseas company) becoming insolvent;

- having caused the company to breach the law; and
- any misfeasance breach of fiduciary duty or breach of the law by the director himself or herself (and the frequency of any such conduct).

For unfitness, in general terms, a court is looking for evidence of a lack of probity, integrity or honesty, not just commercial misjudgement. Liability for wrongful or fraudulent trading may also be considered in determining whether a director is unfit to be concerned in the management of a company.

The Small Business, Enterprise and Employment Act 2015 (the **SBEEA**) widened the scope of people who may be the subject of a disqualification order/ give a disqualification undertaking. Where a person (whom the legislation calls the main transgressor) is disqualified or gives a disqualification undertaking and conduct of the main transgressor in respect of which the disqualification order is made (or which relates to the disqualification undertaking) resulted from the main transgressor acting in accordance with another person's directions or instructions, that other person is also liable to be disqualified.

The SBEEA also introduced the concept of *compensation orders* which the court can make against a director being disqualified. Where a disqualification order has been made or a disqualification undertaking accepted, if the underlying conduct has caused loss to one or more creditors of the insolvent company, then the relevant person who is subject to the disqualification order or undertaking may be required to pay an amount as a contribution to the assets of the relevant company or for the benefit of a particular creditor or class of creditors⁸.

The Rating (Coronavirus) and Directors Disqualification (Dissolved Companies) Act 2021 further extended the directors' disqualification regime, so that the regime applies to former directors of companies that have been dissolved where the company did not first enter into an insolvency proceeding (including circumstances where the dissolved company was not insolvent).

Disqualification means that, for the stipulated period, the relevant person is barred from being a director of a company or otherwise being concerned in the management of a company or from acting as an insolvency practitioner.

⁸ In the case of *Re Noble Vintners* [2019] EWHC 2806 (Ch) the court made a compensation order of in excess of GBP500,000 against the disqualified director.

Duty to consider creditors' interests where the company is insolvent or bordering on insolvency

The general duties of a director (previously a matter of common law and equitable rules) are codified in sections 171 to 177 of the Companies Act 2006. A company may provide for more onerous duties in its articles, but the articles may not dilute the statutory duties.

While a company is solvent and trading normally, the directors' primary consideration remains, as before, to think of the interests of its shareholders – although this duty is expressed as a duty to act in the way the director considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole.

When a company finds itself in financial difficulties (either actually insolvent or bordering on insolvency), the common law position is that the duty of the directors to act in the best interests of the members is modified so that they have to consider the interests of the general creditors as well as those of the members and, if appropriate, to act in the general creditors' interests. When the duty has been modified in this way, the directors must balance the general creditors' interests against the members' interests. The Companies Act 2006 preserves the common law position by including a proviso (in section 172(3)) that the duty to promote the success of the company is subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.

It has been confirmed by the courts that this proviso has the effect of preserving the consideration given to the interests of creditors when the company is insolvent or bordering on insolvency; that is, that section 172(3) simply preserves the common law position with regard to considering or acting in the interests of creditors.



Duty to consider creditors' interests where the company is insolvent or bordering on insolvency (Cont.)



The principles below can be drawn from the cases considered by the courts since the Companies Act 2006 came into force:

- (a) Established, definite insolvency is not a pre requisite for the directors to be required to consider the interests of creditors⁹.
- (b) The directors' knowledge as to whether the company is insolvent or of doubtful solvency is a subjective matter but claims of "blissful ignorance" can expect rigorous examination.
- (c) Where the company is insolvent or is bordering on insolvency, the directors must take the interests of creditors into account and, if appropriate, act for the benefit of the creditors as a whole. In doing so, they must balance the creditors' interests against those of the shareholders and other stakeholders¹⁰.
- (d) Where the insolvent liquidation or administration of a company is unavoidable, the creditors' interests are "paramount". Short of unavoidable insolvent liquidation or administration, the weight given to the considerations of the creditors' interests will increase as the company's financial problems become more serious.

(e) The duties imposed on directors are ordinarily subjective ones i.e. the question is not whether, viewed objectively by the court, the particular act or omission which is challenged was in fact in the interests of the company/creditors but rather whether the director honestly believed at the time that his or her act or omission was in the interests of the company/creditors. In practice, where the act or omission results in a substantial detriment to the company/creditors, the directors will have a harder task persuading the court that they honestly believed it to be in the company's interest¹¹.

(f) The subjective test in paragraph (e) above becomes an objective one (that is, the director's actions are subject to a reasonableness assessment) in two circumstances:

- the subjective test only applies where there is evidence of actual consideration of the best interests of the company; if there is no evidence of any such consideration, the proper test will be objective – whether an intelligent and honest man in the position of a director of the company concerned could, in the circumstances, have reasonably believed that his actions/decisions were for the benefit of the company; and

• where a very material interest, such as that of a large creditor (whether an immediate, contingent or prospective creditor) is unreasonably overlooked without objective justification, and not taken into account, the objective test will apply.

(g) Even where there is a prospect of avoiding insolvency, in certain circumstances where the directors adopt a course of action to the probable detriment of creditors without a proper consideration of their interests, (for example, embarking on a risky rescue strategy that is unlikely to succeed and will therefore likely result in a diminution of company assets), they could be held liable for a breach of their duties (so-called "misfeasant trading")¹².

In summary, the position will, as before, very much depend on the facts and the exercise of commercial judgement based on those facts. Below, we set out some practical steps which directors should take to ensure they are fully apprised of the company's position, and its impact on their duties, whether to comply with their Companies Act duties or to avoid wrongful trading.

⁹ Capitol Films Ltd (in Administration) [2010] EWHC 2240; Bilta (UK) Ltd (in liquidation) v Nazir supra and, in the Court of Appeal, [2013] EWCA Civ 968; Re HLC Environmental Projects Ltd (in liquidation) [2013] EWHC 2876; Goldtrail Travel Ltd (in liquidation) v Abdulkadir Aydin and others [2014] EWHC 1587.

¹⁰ BTI 2014 LLC v Sequana SA [2022] UKSC 25.

¹¹ BTI v Sequana [2019] EWCA Civ 112.

¹² Wright and Rowley, BHS and others v Chappell and others [2024] EWHC 1417 (Ch).

Groups of companies



A group of companies often acts as though it is a single legal entity. It must be remembered, though, that each company is distinct. However artificial it may sound or seem, a director of a number of companies in a group must wear his or her hat as director of each company in turn, individually, and consider the financial position of **that** company alone in the light of the above legal considerations. The rationale of this is that if one company goes into liquidation, its creditors are not going to derive any comfort from knowing that the other companies in the “group” survived.

There is a positive duty for directors to avoid potential conflicts of interest. Where a director holds a number of directorships within a group of companies, the fact that one of the companies is in financial difficulties may give rise to potential conflicts of interest (for example where a parent company funds a subsidiary, where there are cash sweeping agreements or where there are intra-group guarantees).

The director should ensure that the financial difficulties have not caused a potential conflict of interest with their position as director of other companies within the group. Where there is a potential conflict of interest, consideration should be given to whether shareholder ratification is possible or whether the relevant director might resign from one or more of his or their positions or recuse himself or herself and take no part in the board discussions or decision-making at one company or another.

Other potential liabilities

Pension scheme liability

Directors of a company that is (or that is in the same corporate group as) an employer for the purposes of a pension scheme will need to consider the UK pensions regime. Of particular focus in a distressed scenario is the presence of a defined benefit pension scheme, and the company (or another company in the same corporate group) is a scheme employer.

Briefly, the UK Pensions Regulator has the power to impose liability on the employer company and its connected and associated parties. These powers, referred to as the “moral hazard powers”, give the Pensions Regulator the ability to issue a contribution notice (being an order for that person to make a payment to the pension scheme) or a financial support direction (being an order for that person to provide ongoing support, such as a guarantee or security, to the pension scheme) upon occurrence of certain trigger events.

In addition, the Pension Schemes Act 2021 introduced a number of reforms to the U.K. pension landscape. Notably, there are two new criminal offences - the “avoidance of employer debt” offence and the “conduct risking accrued scheme benefits” offence. The scope of potential criminal liability under these offences is broad, and may include anyone who is “party to” the act or failure. As such, directors, shadow directors and de facto directors (as well as other persons) could fall within the scope of these criminal offences.

In light of the moral hazard powers and the criminal offences regime, directors of a company that is an employer for the purposes of a defined benefit pension scheme (or where there is an employer company within the same corporate group) should take advice on the pensions position in relation to their particular factual scenario.

Joint and several tax liability

HMRC has the ability to issue a notice to directors, shadow directors and certain other persons, to impose joint and several liability on that person for a company’s tax debts. These notices may only be issued provided certain conditions are met, which predominantly relate to circumstances where there has been tax avoidance or evasion, penalties imposed for facilitating tax avoidance or evasion, or where there has been repeated cases of insolvency and non-payment of tax debts.

Phoenix companies

Where a company has entered insolvent liquidation (i.e. creditors voluntary or compulsory liquidation), any directors or shadow directors of that company who have acted in that capacity within the preceding 12 months are prohibited (for a period of 5 years from the date the company goes into insolvent liquidation) from being directors of any company, or being involved in the the promotion, formation or management of any company or business, where that company or business is known by a “prohibited name”. A “prohibited name” is one that is the same as the name of the insolvent company, or one so similar as to suggest an association with that company. There are certain limited exceptions - including where the relevant person has obtained the prior approval of the court, or if the person gives notice to all creditors of the insolvent company before they act in contravention. A failure to comply with these restrictions can result in criminal and/or civil liabilities, and may also lead to a personal liability for certain debts of the “successor” company.



Practical steps



It is impossible to attempt to list *all* the practical steps which directors of companies in financial difficulty might or should take in particular circumstances. Much will depend on the facts of the particular case. The following ideas for directors, however, will be applicable to many situations:

- ensuring the company has adequate and proper up-to-date financial information (including budget, cash flow and outcomes (particularly short-term cash flows), and tax liabilities);
- taking regular legal and financial advice;
- scrutinising expenditure and cash outflows carefully;
- having a suitable business plan and business rescue plan, including plans for minimising losses;
- if a director has material doubt about the financial viability of a company, seeking independent professional advice in this respect;
- acting in concert, wherever possible, as the advocacy of, for example, cessation of trade by one director would place a correspondingly greater burden on the remaining directors should they need to justify a decision to carry on;
- carefully monitoring compliance with financial and other covenants in any agreements with lenders;
- considering the appointment of a Chief Restructuring Office (a person experienced with dealing with situations of financial distress, stakeholder management and turnaround);
- engaging with D&O insurance providers (ensuring any policy also includes ex-directors and sufficient monetary caps);
- preparing suitable fall-back plans for a formal insolvency;
- monitoring closely variables important to the company's financial health and holding regular board meetings to consider the company's up-to-date position; and
- maintaining contemporaneous records and minutes of the directors' considerations in relation to significant decisions, and articulating the reasons for any decision (and why other alternative actions were discounted).

Key contacts

If you require advice on any of the matters raised in this document, please contact any of our partners or your usual contact at A&O Shearman, or email rab@aoshearman.com.

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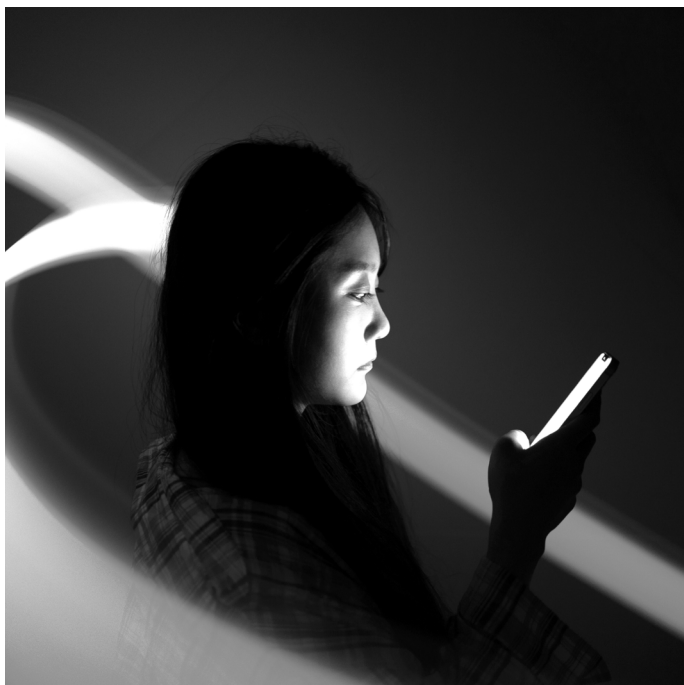
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Further information

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