BULLETIN

DIRECTORS / WRONGFUL TRADING

The temporary provisions have provided directors with some measure of protection from the risk of personal liability. With these provisions due to end we consider what directors should be aware of,

BY MATTHEW RICE

Sections 214 and 246ZB of the Insolvency Act 1986 are worthy of some reconsideration, given that temporary provisions protecting directors from personal liability for wrongful trading will come to an end on 30 June 2021. That said, it is important to note that these temporary protections have a chink in the armour as they weren't effective for the period 30 September 2020 to 26 November 2020, and a director's conduct during that time can be challenged under ss. 214 or 246ZB.

This Bulletin will seek to consider the wrongful trading provisions and provide some practical tips for directors on when to seek out professional advice.

Statutory Provisions

Wrongful Trading is a provision under the Insolvency Act 1986 which potentially exposes directors to personal liability where their company goes into liquidation (section 214) or administration (section 246ZB). From the point in time at which a director knew or ought to have known that the company had *no reasonable prospect*

of avoiding insolvent liquidation (or administration) he is under an obligation to take all steps to minimise the loss to creditors. Failure to take such steps constitutes 'wrongful trading'. Once a company is insolvent the directors' statutory and fiduciary duties are no longer owed to the members of the company but rather to the company's creditors.

The failure of a director to take every such reasonable step to protect the company's creditors may result in his having to contribute personally to the shortfall to creditors. All directors must be alive to this risk of personal liability.

Can my company avoid insolvency

A director is deemed to have the *ordinary knowledge and competence of a reasonable director*. Whether a director ought to have known whether the company could avoid insolvency is both an objective and subjective test.

Directors can demonstrate a knowledge of their company's position by insisting that they have the necessary information to hand which enables them to run the company competently. This is likely to include access to the company's balance sheet, accounts and any financial forecasts as well as the company's bank accounts and details of its indebtedness.

A company's ability to pay its debts may well be contingent on the success of other projects. Even successful companies at one time or another may be technically insolvent because their ability to pay debts is reliant on cashflow from work in progress. A director must therefore maintain a realisitic and informed view of the prospects of the company at all times - and must be prepared to take professional advice when appropriate. It will not be enough for directors to rely on optimistic projections and directors would be well placed if they can evidence their decision making processes and regular, realistic cash flow projections.

AMB Law is able to assists boards by attending board meetings and ensuring that the directors fulfil their duties and that proper board minutes and records of decisions are kept. This evidence is likely to provide some safeguard to directors in the event that the company does enter an insolvency process.

Minimising Loss

When the directors reach the conclusion that the company cannot avoid insolvency they must focus their attention on minimising the loss to creditors and would be well advised to ensure that their efforts are documented for future evidence.

All businesses, small or large, have a degree of complexity and directors will require pragmatic professional advice. For many companies the steps required to minimise loss will be a ceasation of trade and taking steps to enter a formal insolvency practice. Where, however, the underlying business model is good there are alternatives available and ceasing business may not be the best course to minimise the loss to creditors. AMB Law stands ready to assist directors in managing their legal liability and with our network of professionals can help shape a path that will either wind down the company gracefully or take steps to rescue the business.

COVID-19

Since March 2020, many companies that would otherwise have entered an insolvency process have not done so. It cannot be denied that this will in part be because directors have not had to concern themselves with the risk of personal liability. From 1 July 2021, directors will need once again to consider that risk.

These last 15 months have undoubtedly been difficult for some businesses and many directors should actively consider taking insolvency advice. This will especially be the case for those companies that have relied heavily on Government support measures which, inevitably, will also soon come to an end. Should those directors fail to have a realistic appreciation on their company's position they run the risk of exposing themselves personally to the liabilities of their company.

Key Takeaway

- Directors should be open to taking legal and financial advice on their position (especially where they are exposed to heavy reliance on Government support programs).
- Board meetings should be held regularly and properly recorded. Financial documents and cash-flow projections should be provided to directors in these meetings and decision making processes should be evidenced.
- Any cash-flow issues should be actively monitors and discussed by the directors.

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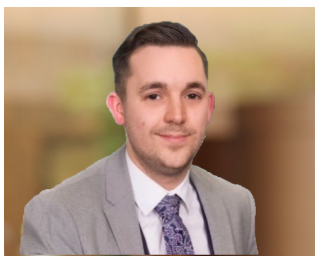

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