

Suspension of wrongful trading provisions

How will recent Government changes affect businesses ?

The government has recently announced that they will suspend the wrongful trading provisions of the Insolvency Act 1986 ("the Act") for an initial period of three months, retrospectively coming into force from 1 March 2020. This temporary suspension will allow directors breathing space in order to continue to trade and preserve their Company's positions without the threat of personal ramifications for any decisions they make over this period. Given the current extraordinary circumstances spanning the world, the government is looking to take steps to alleviate some concern amongst the business community to keep as much continuity in place at a time when we all working in uncharted territory.

Directors and Wrongful Trading

Directors have a fiduciary duty to act in the interests of the Company and owe a duty of care to the Company's shareholders. However, in cases where a company is insolvent, that duty of care switches to the Company's creditors. The wrongful trading provisions of the Act were designed to protect a Company's creditors from negligent or reckless directors who, at a time when the directors should have been taking insolvency advice and/or instigating a relevant insolvency procedure, may have chosen to ignore the warning signs and continue to trade from a point at which the Company could no longer survive. By continuing to trade, the Company may well continue to incur additional debt, further increasing any deficiency to creditors. It is this additional deficiency between the point at which the Company was insolvent and should have ceased to trade, and the eventual insolvency event, that could be claimed from a director personally, compelling them to contribute to the assets of the company as compensation for the wrongdoing.

The UK's insolvency and restructuring trade body, R3, has expressed concern regarding the Governments recently introduced plans, noting that the wrongful trading provisions are in place to protect creditors and that a blanket suspension risks abuse.

Has R3 got a point

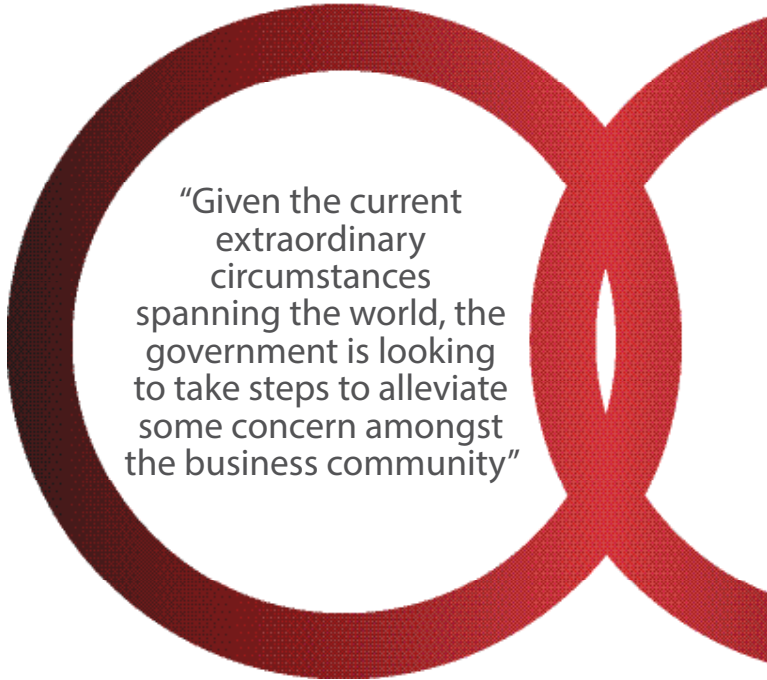
The Act already has a provision to safeguard those directors who took

every step with a view to minimising the potential loss to the Company's creditors following realisation that the Company may be insolvent to a point that it may not avoid the prospect of insolvent liquidation or administration. In those scenarios, you would expect a director acting reasonably to seek the guidance of a suitably qualified insolvency professional which will alleviate the risk of a potential wrongful trading action.

Who are the provisions aimed at?

If the dangers of any personal liability are removed from directors, they still continue to trade, and yet still end up in an insolvency scenario, was it right that these were allowed to continue in the first place? It may have been likely that these companies would have entered insolvency sooner, albeit under current circumstances the inevitable has been deferred for a number of months to the possible further detriment of creditors.

On the flip side, any company that weathers the storm may likely have meant that the suspension of the provisions didn't apply to them in the first place.



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Can things be that black and white? Insolvency rarely is

There will be a great number of directors and owner/managers currently fearing the worst. These directors may have been managing profitable business, providing employment to the local market and contributing to the local community and wider economy. However, given the current climate, they may have been forced to close their doors, seen their revenue drop and may even have been forced to place their workforce on furlough. It is likely that that these companies no longer have the working capital to service their debts as and when they fall due and would fall foul of the relevant insolvency tests.

However, these companies may be able to benefit from payment holidays with their secured and/or unsecured lenders, agree informal payment plans with their general creditors or utilise savings to weather the storm. Even with these options to hand, the fear of being made personally liable for not taking steps to enter into an insolvency procedure may be the icing on the cake for many which would force them to not seek alternative rescue solutions. The relaxation of the wrongful trading provisions may well have been enough to ease the concerns of these directors and ensure that these good businesses are not prematurely wound up. The economy is going to need as many of these businesses as possible to help provide a welcome boost in the times ahead

Advice

What is clear, even from a time before this unparalleled disruption, is the need to seek advice at all appropriate times from appropriately qualified professionals. Taking advice at any stage is not a sign of weakness, but a signal of strength, ensuring that you are acting properly in the pursuit of growth for your business.

Over the course of these troubling times we would recommend that all look to at least;

- keep a record of any key decisions made over this period, including any decision taken to pay a particular creditor before others where cash flow might be critical;
- keep up to date management accounts and monitor cash flow forecasts to identify any particular stress points over the coming

months;

- keep in regular communication with staff and senior management to help maintain control over business processes;
- open dialogue with any secured or unsecured lenders, or any critical/substantial suppliers to discuss your options for maintaining suitable payments.

Moorfields has extensive experience of assisting businesses with their cash flow, forecasting and providing expert advice at times of significant stress. We have experience in dealing with any number of creditors and have successfully negotiated many informal arrangements, including time to pay arrangements with HM Revenue & Customs.

If our assistance could be of benefit to your business or any of your clients, please do not hesitate to get in touch with our Advisory team.



If you would like to discuss how Moorfields can assist you or your clients with wrongful trading
please contact: **Milan Vuceljic: 020 7186 1166**

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