

Suspension of wrongful trading rules: what it means for businesses

March 31, 2020

The UK Government announced on Saturday, 28 March 2020 that it intends to amend insolvency law to suspend the offence of wrongful trading by directors of UK companies. The measure is aimed at giving companies breathing space and avoiding premature insolvencies by allowing directors to keep businesses going without the threat of personal liability.

What is wrongful trading and why does it matter?

The current insolvency rules provide that directors of limited liability companies can become personally liable for business debts if they allow the company to continue to trade once insolvent administration or liquidation becomes unavoidable. Under the current wrongful trading provisions found in the Insolvency Act 1986 (ss. 214 and 246B IA86), upon concluding that there is no reasonable prospect of the company avoiding insolvent liquidation or administration, a company director has a duty to take every step to minimise potential loss to the company's creditors.

The court may order a director that is found liable of wrongful trading to make a personal contribution to the company's assets in the amount the court thinks proper in light of the loss suffered by the company's creditors. Any award is compensatory in nature and only arises if the company is worse off as a result of the continuation of trading.

These rules are often the trigger for directors filing for formal insolvency proceedings in order to minimise the risk of incurring personal liability. Additionally, a director held liable for wrongful trading may also be subject to a disqualification order under the Company Directors Disqualification Act 1986. The minimum period of a disqualification order is two years and the maximum is 15 years.

If you have any questions concerning this memorandum, please reach out to your regular firm contact, the following authors or our [COVID-19 task force](#) directly by clicking here.

For more information, please consult the [COVID-19 Resource Center](#).

LONDON

David Billington
+44 20 7614 2263
dbillington@cgsh.com

Jim Ho
+44 20 7614 2284
jho@cgsh.com

Polina Lyadnova
+44 20 7614 2355
plyadnova@cgsh.com

Bianca Buzatu
+44 20 7614 2234
bbuzatu@cgsh.com



What is being changed and why?

The wrongful trading provisions will be temporarily suspended for three months with retrospective effect beginning from 1 March 2020, in response to the COVID-19 crisis. The suspension is intended to ensure that, in the uncertain COVID-19 environment where many businesses may be nearing insolvency, directors are able to take decisions to continue to trade and incur additional debt, including under the new government funding initiatives, without the threat of potential personal liability in respect of wrongful trading should the company ultimately fall into insolvency.

However, this change will not affect the directors' duties regime and other insolvency law offences such as fraudulent trading (ss. 213 and 246ZA IA86), transactions defrauding creditors (s. 423 IA86), and misfeasance (s. 212 IA86). These rules, together with director disqualification laws, remain in force to deter director misconduct. Therefore, in this challenging economic and trading environment, directors still need to ensure that they obtain professional advice and do not breach their duties.

The Government announced that legislation to effect the change will be introduced in Parliament at the earliest opportunity and provisions will be included to allow for extensions, if necessary. The change will have retrospective effect from 1 March 2020. Parliament is currently in recess until 21 April 2020.

What does this mean for businesses?

As the newly-announced measures to support businesses during the COVID-19 crisis do not modify the existing regime on directors' duties, when taking on new debt whether under the government schemes or otherwise, directors should ensure that they meet their general duty to act in the way they consider, in good faith, to be most likely to benefit the company members as a whole or, when there is a heightened risk of insolvency, to instead act in the interests of the company's creditors (s. 112 Companies Act 2006).

Once a company enters formal insolvency proceedings, the directors' duties will be owed to the company's creditors instead. It is at this point that the

suspension of the wrongful trading provisions discussed above will have a practical effect by removing the threat of personal liability where company directors elected to continue to trade in good faith using their best endeavours despite the company facing a high risk of entering insolvent liquidation. At the time of writing, there were no additional details on the mechanics of the suspension and the scope of this relaxation remains to be further clarified once the legislation is published.

While this is clearly a welcome development as companies navigate turbulent times, it is important for directors not overlook the need to comply with existing laws and mitigate the risk of breaching their duties when exploring options for corporate rescue.

Additional measures

This announcement comes after a series of recent measures aimed at mitigating the economic effects of COVID-19 on UK businesses, including:

- **New restructuring plan and moratorium.** There are few details on this measure, but it appears to build on reforms announced in August 2018 to enable UK companies undergoing rescue or restructuring to continue trading, increasing their chances of avoiding insolvency. This will include enabling companies to continue buying certain essential supplies, such as energy, raw materials or broadband, while attempting a rescue.
- **A three-month extension period for filing accounts, announced on 25 March 2020.** Although companies will need to apply for the extension, companies citing issues due to COVID-19 will be automatically and immediately granted an extension. More than 10,000 businesses have already successfully applied for the extension;
- **Covid Corporate Financing Facility.** This is new lending facility from the Bank of England to help support liquidity among larger firms, provided they had a short or long-term rating of investment grade (or equivalent) as at 1 March 2020;
- **Coronavirus Business Interruption Loan Scheme.** This is government scheme offers loans

of up to £5 million for SMEs through the British Business Bank that will be guaranteed up to 80% by the UK Government and the first six months' interest will be paid for by the Government;

- **Coronavirus job retention scheme.**
- **12-month business rates holiday.** This applies to all retail, hospitality, leisure and nursery businesses in England;
- **Option to defer VAT payments.** The option applies to VAT payments due between 20 March and 30 June 2020, and is available until 31 March 2021; and
- **HMRC Time To Pay Scheme.**

...

CLEARY GOTTlieb