

What Impact Will the Suspension of Wrongful Trading Have on UK Company Directors?

The temporary suspension of wrongful trading provisions introduced in March 2020 and initially set to run until 30 June 2020 will continue with the implementation of the Corporate Insolvency and Governance Act on 26 June 2020.

However, although the threat of personal liability has been significantly reduced, company directors must remain attentive to other considerations relating to the continued trading of their businesses, as they are still bound by directors' duties as set out in company law.

The new Act contains a number of permanent and temporary measures that address business challenges resulting from the COVID-19 pandemic. One of the key measures is the continuation of the temporary suspension of wrongful trading.

The Insolvency Act 1986 included several provisions that protected creditors from the actions of rogue directors. In particular, section 214 on wrongful trading required company directors to assess the likely prospects of avoiding insolvency. Continuing to trade when there was no reasonable prospect of avoiding insolvency can have dire consequences including personal liability for debts and trading losses. Furthermore, disgruntled creditors can commence direct action against the director and protection of limited liability would not apply. This is commonly known as 'piercing the corporate veil', thus ensuring that in distressed situations directors were acting in the interests of creditors, rather than shareholders.

The Corporate Insolvency and Governance Act does not entirely turn off these wrongful trading provisions, but it does provide directors with some relief. For directors who may have previously hurried to start insolvency proceedings and avoid the

possibility of any personal liability, the temporary suspension will help postpone many from triggering that process and assist them to emerge intact on the other side of the COVID-19 pandemic.

The majority of businesses are now facing unprecedented financial challenges, with the UK economy enduring its worst quarterly fall since 1979. In response, the government has made sweeping changes to insolvency law, but has stopped short of providing company directors with complete immunity from liability and their duties.

In our experience, the vast majority of directors understand the difference between steering the business through a challenging period and crossing the line into wrongful trading for which there remain severe penalties, including personal liability and disqualification. On a cautionary note, all other sources of risk and liability under the Insolvency Act 1986 are unaffected. For example, directors are still bound by their fiduciary duties, and also by the fraudulent trading provisions of section 213, which means that they will still face sanctions and penalties if they knowingly attempted to defraud the company or creditors.

In addition, directors will still have duties under the Companies Act 2006 and must continue to act and be mindful of interests of creditors if the likelihood of insolvency increases. Overall, this means that the temporary suspension of wrongful trading doesn't change the attention that directors should be giving when evaluating the financial position of their company. Directors' actions will remain subject to scrutiny, making it critical that they consider very cautiously whether to continue trading if there is not a realistic chance of their company avoiding insolvency.

Although the easing of lockdown measures is picking up pace and businesses are beginning to open their doors, numerous challenges lay ahead, particularly with the expected reduction in consumer demand and confidence. Many company directors will likely face challenging decisions over whether to continue trading or instigate an insolvency process in the coming months.

If directors are worried that their business is experiencing or expecting financial difficulty, they must continue to consider the needs of all key stakeholders and creditors in any decision and maintain 'good housekeeping' in the form of board meetings and keeping records of actions taken with an assessment of the reasons for certain decisions. Where possible, they should also seek appropriate professional advice. Duff & Phelps has extensive experience in assisting in the negotiations with key creditors, as well as providing further support in the decisions to continue to trade with the support of creditors. We would urge directors facing increased financial volatility in the face of COVID-19 to contact us.

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