

On 25 June 2020 the Corporate Insolvency and Governance Act (the Act) received Royal Assent. The Act makes both temporary and permanent changes to the UK insolvency laws.

One of the significant measures can be found at clause 10 of the Act. This is the temporary relaxation/suspension of liability for wrongful trading under sections 214 and 246ZB of the Insolvency Act 1986. The intention of this measure is to allow directors to ensure that their businesses continue through the COVID-19 pandemic without fear of personal liability for wrongful trading. However, wide drafting may have raised as many questions as the answers it provides.

Changes to Wrongful Trading Laws

The Act states that during the “relevant period”, in determining whether wrongful trading has occurred, the court will “assume” that a director is not responsible for the worsening of the financial position of a company or its creditors. This effectively relieves the director of any liability for wrongful trading during this period.

The relevant period in question is from 1 March 2020 until 30 September 2020. It is important to note that this period can be extended by 6 months at a time or shortened by secondary legislation.

A number of companies are excluded from these changes. Firstly, the new measures do not apply to companies listed in schedule ZA1 of the Insolvency Act 1986 such as insurance companies, banks and investment firms. Building societies, friendly societies and credit unions are also exempt, along with any company carrying out a regulated activity under Section 4A FSMA. Before relying on the Act in respect of wrongful trading, directors should consider whether their company is among the excluded categories.

Interestingly, there is no requirement for the worsening of the financial position of a company to be attributable to the COVID-19 pandemic. This creates a very wide scope for potential application (and possibly abuse) of the new measures and it remains to be seen how this will be assessed.

Potential for Exploitation?

Many have noted that the broad drafting of the Act to include companies that have not necessarily been directly affected by COVID-19 seems to leave potential for exploitation. However, it is important to consider whether there was a workable alternative. If the Act distinguished those companies that are affected by COVID-19 from those that are not, there would have been a requirement for directors to be certain that their company’s difficulties are exclusively related to COVID-19 before they made the decision on continued trading. It was felt that such a requirement was “a test too far”. Where there was any doubt about continued trading, directors would probably have erred on the side of caution and ceased trading to avoid potential personal liability. This in turn would lead to the insolvency of the company and the overriding objective of this temporary measure (namely to save otherwise viable businesses) would not be achieved.

Potential Risk?

The flexibility of the “relevant period” may also be cause for concern for some directors. A shortening of the relevant period with relatively little notice may result in a director facing exposure to liability for wrongful trading. While it seems unlikely that there would be a shortening of the relevant period soon, it is possible that a six-month extension may be shortened in the future. If a director has committed to a course of action that will take a number of months to be fruitful, a shortening of the relevant period could leave a director facing a decision whether to stop this course of action to the detriment of the company and its creditors, or continue with it and risk liability for wrongful trading.

Suspension or Relaxation?

The wording of clause 10, which states that “the court is to assume that the person is not responsible for any worsening of the financial position of the company or its creditors that occurs during the relevant period” will also raise questions for directors.

The fact that there is an assumption by the court that directors will not be responsible for any worsening of financial position opens up the possibility that such an assumption may be rebutted (although here is no reference to a rebuttable presumption in the Act itself). The possibility of a rebuttable assumption suggests that the liability for wrongful trading is being relaxed as opposed to suspended.

Concerns have been raised about such a blanket suspension of liability for wrongful trading. However, the Government was keen to point out that other protections for creditors will continue to apply. For instance, directors' duties under the Companies Act and directors' disqualifications actions are unaffected by the changes in the Act. Therefore, notwithstanding these changes, directors should continue to act honestly and reasonably and take professional advice if they find themselves in this situation.

Other Changes to UK Insolvency Law

In addition to the temporary changes to the UK wrongful trading laws the Act introduces permanent changes to the UK Insolvency regime including:

New Moratorium for Companies

This will provide a simple way for companies who cannot or are unlikely to be able to pay their debts, to obtain the benefit of a moratorium for an initial 20 business days, with the option to extend that by a further 20 business days (up to 12 months with creditor/court consent), providing a breathing space from creditor pressure and a payment holiday for certain debts.

Similar to a Chapter 11 restructuring in the US, the company remains in the directors' control during the period of the moratorium, but 'monitored' by an insolvency practitioner

Protection of Supplies to Enable a Company to Continue Trading During the Moratorium

This new provision will prevent suppliers of goods and services from terminating a contract because of an insolvency event and potentially jeopardizing the rescue of a business. This will apply to existing UK insolvency procedures (including administrations, CVAs and liquidations) as well as the new moratorium.

New Restructuring Plan

This new insolvency tool will enable companies to propose a plan that (subject to obtaining requisite consent and court approval) will bind all creditors, including dissenting and secured creditors, whether or not they vote in favour of the plan, through the use of "cross-class cram down".

Conclusion

It is clear that a number of businesses are facing unprecedented financial challenges and that the government has sought to recognise this with changes in the law. However, questions remain as to how measures in relation to wrongful trading will operate and whether directors are actually being afforded the protection that is suggested at first glance.

In the circumstances, directors should continue to take early advice and not treat the new measures as a "get out of jail free" card? In reality, there should be no change in the need for directors to exercise reasonable behaviour to ensure that they do not fall foul of the new legislation or incur liability for misfeasance or breach of duty under existing legislation. More detailed guidance can be found in our [directors' duties alert](#).



Contacts

John Alderton

Partner, Leeds
T +44 113 284 7026
E john.alderton@sqirepb.com

Russ Hill

Partner, Birmingham
T +44 121 222 3132
E russell.hill@sqirepb.com

Susan Kelly

Partner, Manchester
Cross Border Restructuring Practice Co-Chair
(UK & Europe)
T +44 161 830 5006
E susan.kelly@sqirepb.com

Devinder Singh

Partner, Birmingham
T +44 121 222 3382
E devinder.singh@sqirepb.com



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