

Guidance Note: Wrongful trading and Covid 19

(Issued by the Viscount on 13 May 2020)

The purpose of this guidance note is to explain the rules on wrongful trading in Jersey and to clarify how these may be applied during the current public health crisis.

The Viscount, who is the administrator of bankruptcy (*désastre*) proceedings, is very much aware of the challenges which many local businesses face during these unprecedented times.

Support measures have been announced by Government which are intended to reduce the likelihood of businesses having to close permanently and to enable them to restart trading as soon as possible after the relaxation of social distancing and other containment measures.

The Viscount understands, however, that directors of some Jersey companies may be particularly concerned about the possibility of claims being made against them personally for wrongful trading. This may arise in both bankruptcy and winding-up proceedings.

As explained below, liability for wrongful trading will only arise where a director knew there was no reasonable prospect that the company would avoid a winding up or the making of a declaration under the bankruptcy (*désastre*) law and the director did not take reasonable steps to try to minimise the potential loss to the company's creditors.

If a person is concerned about the solvency of the company of which they are a director, they should consider carefully what action they should take, taking into account the company's business and its future prospects. It may not be the case that the only way to avoid a wrongful trading claim is to cease trading immediately on a permanent basis. Continuing the business, or taking steps to ensure that it can restart its operations in due course, may be a better way of minimising loss to creditors.

If directors are in any doubt about the action they should take, they should seek professional accountancy or legal advice as soon as possible.

Wrongful trading

The Bankruptcy (Désastre) (Jersey) Law 1990 (the “**Bankruptcy Law**”) and the Companies (Jersey) Law 1991 (the “**Companies Law**”) deal with wrongful trading by company directors.

If a company becomes *en désastre* (bankrupt), the Viscount can apply to the Royal Court for an order making a director personally liable for the debts of a company which have been incurred from the time when:

(a) the director knew that there was no reasonable prospect that the company would avoid bankruptcy; or

(b) the director was reckless as to whether the company would avoid bankruptcy.

Similar provisions exist where a company goes into an insolvent winding-up, allowing the liquidator to apply to the Court for an order.

In summary:

- Liability for wrongful trading will only arise if a company becomes bankrupt or goes into insolvent liquidation; and
- The Viscount (or the liquidator) will have to show to the Court that the director knew (or was reckless as to whether) there was no reasonable prospect of avoiding insolvency.

Both the Bankruptcy Law and the Companies Law establish a key **defence** to a wrongful trading claim.

The Court cannot make an order against a director if the Court is satisfied that, from the time insolvency became likely, the director took reasonable steps with a view to minimising the potential loss to the company's creditors.

A director will not be personally liable, therefore, where they can show the Court that they took **reasonable steps** to minimise the potential loss to the company's creditors. There may be a strong argument, as part of the defence, that what is "reasonable" should be viewed by the Court with considerable latitude in the context of these exceptional times.

It is vital, therefore, that directors think carefully about what reasonable steps can be taken to minimise loss to the company's creditors and ensure that those steps are taken.

Reasonable steps

What constitutes reasonable steps will be different for each company, depending on its own particular circumstances and business operations.

The directors of any company facing financial difficulty should be able to demonstrate prudent business management, including:

- Holding frequent board meetings to monitor the financial situation of the company including by reviewing up to date management accounts and projections. The discussions and decisions of directors should be fully recorded in board minutes.

- Modelling the company's cash flows sensibly. Cash flows of a company will need to be modelled on appropriate assumptions to identify the company's fundamental stress points. The modelling will need to be updated in line with the regular government announcements concerning lock down measures.
- Communicating with creditors proactively and regularly, possibly with a view to negotiating payment breaks, extensions to loan periods or a reduction in regular repayment instalments.
- Considering ways to improve or conserve cash flow. This may, for example, involve a company seeking additional loan finance (if appropriate in the circumstances) or funding from shareholders, reducing stock levels or disposing of surplus assets. Directors should also consider taking full advantage of the various government schemes that have been introduced to mitigate the financial hardship of COVID-19. Details of the Government schemes are available at <https://www.gov.je/Health/Coronavirus/BusinessAndEmployment/Pages/GovernmentSupportForBusinesses.aspx>.
- Taking professional advice from a local lawyer or accountant.
- Contacting other support agencies, such as Jersey Business, which provides free, independent, confidential advice and support to businesses in Jersey. It can support businesses in gathering the information required to complete applications for the Government's Business Disruption Loan Guarantee scheme and provide support and guidance on other options available. Jersey Business also provides businesses with access to free consultations with HR & Property Professionals. The Jersey Business website is at: www.jerseybusiness.je.

Lastly, it is important to note that there is a difference between English and Jersey law in relation to wrongful trading. Under English law, the directors of an insolvent company are required to take *every step* that a reasonable director would take. Jersey law does not require a director to take every step but requires *reasonable steps* with a view to minimising loss to creditors. If directors are in any doubt about the legal requirements in Jersey, they should seek advice from a Jersey-qualified legal adviser.

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