Liability for wrongful trading

Service area / Dispute Resolution and Litigation
Location / Jersey
Date / March 2020

Increasing cash flow pressure on many businesses has resulted in a heightened risk for directors that a company may be wrongfully trading and personal liability may then accrue to the directors.

In Jersey, both the Bankruptcy (Désastre) Jersey Law 1990 (Article 44) and the Companies (Jersey) Law 1991 (Article 177) (the "Laws") make provision for personal liability in respect of wrongful trading. A company must be in a creditors' winding up or have had its property declared en désastre for these provisions to apply, however, it is essential that directors keep a constant eye on this prior to the commencement of any such process. We explain below how directors may protect themselves in the event that a company is approaching insolvency.

Insolvent – definition

The statutory definition of "insolvent" in the Laws is a simple snapshot cash flow test: are you able to pay your debts as they fall due? This creates immediate issues because very quickly a business's position can change. There are arguments, similar to the position in England and Wales, that the test needs to take account of the balance sheet and also an element of a look forwards cash flow test. Strictly, in Jersey, it is the simple cash flow test.

The point of "no return"

The definition of insolvent is key because in assessing any risk of wrongful trading, directors must work out if they are approaching, or are at, the point of "no return" – which hinges on whether or not a company is insolvent. In the event a relevant process is commenced, the court can look backwards to what was known at certain times before the commencement of that process. If a director:

- knew that there was no reasonable prospect of avoiding a creditors' winding up or a declaration en désastre; or
- was reckless as to whether the company would avoid a creditors' winding up or a declaration en désastre,

then the court can conclude (i.e. it is discretionary) that personal liability accrues to a director for liabilities that arose after the point of no return was reached. Points 1 and 2 above define what the point of no return is. However, the best advice is for all directors to ensure that not only are they asking if they have got to the point of no return, but also whether it is approaching. If it is approaching then there are steps that can be taken to minimise the risk that personal liability could accrue. These are discussed below.

The statutory "defence"

We have called this a "defence" in order to make the point that liability can be avoided, but it is important to note that the Laws do not make wrongful trading a criminal offence. For wrongful trading under the Laws, the Royal Court shall not make an order in respect of personal liability if it is satisfied that after the point of no return arose, a director "took reasonable steps with a view to minimising the potential loss to the company's creditors".

Note, that this is different to the test in England and Wales which requires a director to take "every step".

What does "reasonable steps" mean?

As you may expect, this is not defined. Practical matters that we recommend you take in order to be in the best position to satisfy the "reasonable steps" test include:

- Engage with your creditors: if you can reach an agreement in terms of deferral and/or delay then you can move back from the point of no return.
- Keep context in mind: many companies will only have short term cash flow issues, with good underlying business's and solid balance sheets. Time could be the healer and allow the debtor to get back into business and make all necessary payments in the future so look at your future and your balance sheet.
- Look continually to the best interests of the general body of your creditors: is keeping the lights on still to the overall benefit of the general body of creditors? Keep this question under review, and document your answers to it, and document your reasons and rationale for your assessment; ensure you can show you are looking at your business' affairs broadly.
- Keep expenses under review: stop what is unnecessary, keep what you need.
- Consider the nature of your business, review its operation and evaluate the options.
- Ask what the effects are of staying open/continuing to trade or closing down:
  a. Would it be a simple catastrophe (for creditors) or can you see yourself reopening?
  b. Will it result in your asset(s) going into a firesale at heavily discounted values?
  c. Would keeping the business running be likely to, protect value for your creditors?
  d. What are the liabilities that might accrue after the point of no return is reached?
- Have you got professional advice? If you have, this should assist in showing, and recording the fact that you have sought to take reasonable steps with a view to minimising potential loss to creditors. It will help record your analysis of your circumstances and demonstrate your thought process and the issues being considered. Experience shows this can be highly persuasive in the event wrongful trading is being considered by an office holder prior to referral to the Court and then subsequently by the Court when it considers whether or not to exercise its discretion to make an order.

In all of this, we cannot stress strongly enough the need to make sure you keep contemporaneous records of your actions and deliberations. English jurisprudence suggests it is for the directors to advance a positive case that they took the necessary steps in order to avail themselves of the "defence". Our view is the same would apply before the Royal Court in Jersey.

FIND US

Carey Olsen Jersey LLP
47 Esplanade
St Helier
Jersey JE1 0BD
Channel Islands

T +44 (0)1534 888900
E jerseyco@careyolsen.com

FOLLOW US

Visit our dispute resolution and litigation team at careyolsen.com

PLEASE NOTE

Carey Olsen Jersey LLP is registered as a limited liability partnership in Jersey with registered number 80.

This briefing is only intended to provide a very general overview of the matters to which it relates. It is not intended as legal advice and should not be relied on as such. © Carey Olsen Jersey LLP 2020