THREE STONE

THREE STONE ZOOMINAR

9th July 2020 | 5pm – 6.30pm

SOLVING INSOLVENCY

The new world of The Corporate Insolvency and Governance 'Act' 2019-21

SPEAKERS

Francis Collaço Moraes

James Couser

Katherine Hallett

Michael Smith

Daria Gleyze

TOPICS

- Preventing early termination
- Re-invigorated restructuring plans
- The New Moratorium Procedure
- The restrictions on Winding up Petitions
- Wrongful trading and Covid

Remember to bring your own drinks and snacks!

RSVP
seminar@threestone.law

T +44 (0)20 7242 4937
E clerks@threestone.law
www.threestone.law

Three Stone
3 Stone Buildings
Lincoln's Inn
London WC2A 3XL

Restrictions in relation to winding up petitions and orders – CIGA 2020

Overview

Section 10 of the Act takes us to the temporary provisions in *Schedule* 10.

There are broadly four subjects to cover today: restrictions on statutory demands, restrictions on petitions, restrictions on winding up orders, and the modification of certain timeframes under the 1986 Act. I also want to mention the new Insolvency Practice Direction which was published last Friday.

Preliminary point

A preliminary point to note is that the Act does *not* affect petitions presented on grounds *other* than inability to pay debts, for instance public interest petitions. So, they can still proceed as normal.

Statutory demands

So, firstly, statutory demands in para.1.

No petition may be presented from the 27th April founded on a statutory demand which was or is served between the 1st March and the 30th September. The effect is that any existing statutory demand is void and there's no point serving one before the 30th September.

It should be noted at this stage that there are already calls to extend the relevant period beyond the 30th September in respect of the whole of Schedule 10 so keep an eye out for that in the next few months.

The consequences of para.1 appear to be clear and there is little if any room for argument about it in any given case.

Petitions

Next, petitions under paras.2 to 4.

No petition may be presented between the 27th April and the 30th September on the basis of the Company's inability to pay its debts unless the Petitioning Creditor has reasonable grounds for believing that one of the so-called Coronavirus conditions is met.

The two alternative conditions are that (1) the Coronavirus has not had a financial effect on the Company or (2) the Company would have been unable to pay its debts *even if* the Coronavirus had not had a financial effect on it.

“Financial effect” means “if (and only if) the Company’s financial position worsens in consequence of, or for reasons relating to,” the virus (para.21(3)). This definition is obviously very wide.

The reality is that the first condition will be almost impossible for a Petitioning Creditor to meet. There must be few companies whose financial position has not worsened in consequence of or for reasons relating to the Coronavirus. Some companies may of course have done very well recently – those manufacturing toilet rolls, home office supplies, and fitness equipment come to mind. However, they are perhaps unlikely to find themselves the subject of petitions based on an inability to pay their debts.

The second condition may well be difficult for a Petitioning Creditor to meet, not least because they will probably not have access to the relevant evidence in the hands of the Company. However, the date the debt accrued will be relevant, if it pre-dated the end of March and the start of the crisis in this country, as will previous promises to pay or excuses given for non-payment. Given the very wide definition of “financial effect”, Petitioning Creditors will have to consider Companies’ efforts to obtain funding via third parties, not just the *direct* effect the Coronavirus had on cash flow from trading.

The effect of all of this is that most existing petitions presented after the 27th April, to the extent that they have not already been withdrawn or effectively dismissed on injunction applications, will likely fall away. The Court will have to consider whether it “is satisfied” that one of the Coronavirus conditions was met on presentation. If it is not so satisfied, it may make such appropriate order to restore the position had presentation not occurred (para.4).

<u>Winding up orders</u>

Next comes winding up orders under paras.5 to 7.

At a preliminary hearing, before advertisement, the Court will have to consider whether “it appears” to it that the Coronavirus had a financial effect on the Company before presentation. As I’ve said, that appears likely to apply in most cases, despite ICCJ Barber holding in an injunction application on the 16th June (para.40, 44) that the evidential burden of proving that is on the Company. She also held that the threshold is low (para.44).

The Court can only wind up the Company in such a case if satisfied that the Company would have been unable to pay its debts *even if* the Coronavirus had not had a financial effect on it. The burden in this respect is on the Petitioning Creditor (Barber, [45]).

Proposed petitions will have to be considered very carefully, not least because Petitioning Creditors must confirm on the petition pursuant to para.19 that the Coronavirus conditions are met and provide a summary of the grounds in support of that. I’ve already advised clients in this regard and my view has consistently been that

it would be very risky in most cases to present. There is no express provision for the Company to provide the necessary disclosure to allow the conditions to be fully assessed but it appears from the limited cases so far that the Courts will expect a certain, albeit low, level of transparency from the Company (Barber, [43]-[44]). It's also unknown at present whether the Court will be persuaded to order disclosure and/or cross-examination in order more fairly to deal with this aspect.

Winding up orders already made on the basis of inability to pay between the 27th April and the 26th June when the Act came into force may be void. This will be so if the Coronavirus conditions in para.5 did not apply. The retrospective nature of this raises some interesting questions about who should bear the costs incurred, and what will happen given that directors, employees, creditors and the OR may already have acted on the basis of the Company having been validly wound up. The OR and any Liquidator are protected from any liability for anything done during their period of supposed appointment (para.7(4)) and they can apply to the Court for directions, but it's not a very satisfactory position given the uncertainty.

Modifications to periods under 1986 Act

Moving on, paras.9-18 modify certain time frames under the 1986 Act in cases where a petition is presented between the 27th April and 30th September *and* the Court makes a winding up order on the basis of inability to pay debts. I would like to highlight two of these modifications.

The first is the date for the commencement of the winding up. Para.9 modifies s.129(2) of the 1986 Act such that the commencement of the winding up is not deemed to begin at *presentation* as previously but rather upon the making of the order. The effect of this is that there will be no void dispositions pursuant to s.127(1) of the 1986 Act.

This is an important change as it allows the Company to continue to trade validly despite presentation, possibly if not probably to the detriment of creditors.

The second date modification to note is that in para.15 which affects the 1986 Act s.240 definitions of "relevant time" for the purposes of preferences and transactions at an undervalue. Para.15 appears to try to preserve something approaching the previous position, despite the modification I just highlighted of s.129(2) of the 1986 Act. So, TUVs and connected party preferences have a relevant time, working backwards from the date of the winding up order, of the later of the day 2 years preceding presentation or the day 2 years and 6 months preceding the order. Non-connected party preferences have a relevant time of the later of the day 6 months preceding presentation or the day 12 months preceding the winding up order. This provision will obviously have to be examined with care in any given case to make sure that the behaviour of which complaint is made falls within the correct period applicable in the particular circumstances.

Insolvency Practice Direction

Finally, the new Insolvency Practice Direction was published last Friday, and it deals with the procedural changes required by the 2020 Act as regards petitions.

As I've mentioned, the petition must include confirmation that the Petitioning Creditor believes the Coronavirus condition to be met. Without that, the petition cannot be filed. It must also include, probably by way of separate witness statement, a summary of the grounds relied upon in that respect.

The petition will then be listed for a non-attendance pre-trial review with a time estimate of 15 minutes on the first available date after 28 days. The purpose of that PTR will be to give directions towards the preliminary hearing at which the Court will consider whether the Coronavirus test is met.

The petition will remain private, except for service on the Company, pending the preliminary hearing.

The Petitioning Creditor must file any evidence upon which it wishes to rely at the same time as the petition. The Company must then file its evidence within 14 days of service of the petition. The parties must then file listing certificates two days before the PTR.

At the PTR, if the Company doesn't oppose the petition and the Court is satisfied that it is likely to make a winding up order in light of the Coronavirus test, it will list the petition for hearing in the winding up list. Otherwise, the Court will list a preliminary hearing and give appropriate directions.

At the preliminary hearing, if the Court is not satisfied that it is likely to be able to make a winding up order in light of the Coronavirus condition, it will dismiss the petition. Alternatively, if it is satisfied, it will list the petition for hearing in the winding up list.

Once a petition is listed in the winding up list, the normal rules about advertisement and further conduct of the petition become operative.

KATHERINE HALLETT

9th July 2020

THREE STONE

MORATORIUM

https://www.gov.uk/government/publications/insolvency-act-1986-part-a1-moratorium-guidance-for-monitors

Daria Gleyze

THE NEW RESTRUCTURING PLAN

Existing legislation

Companies Act 2006 – Part 26 (s.895-901)

New regime

Companies Act 2006 – Part 26A (s.901A-901L), inserted by s.7, Schedule 9 Corporate Insolvency and Governance Act 2020

Updated Schemes Practice Statement

https://www.judiciary.uk/wp-content/uploads/2020/06/Schemes-Practice-Statement-FINAL-25-6-20.pdf

Insolvency and Corporate Governance Consultation, Government Response

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/691857/Condoc_-_Insolvency_and_Corporate_Governance_FINAL_.pdf

Michael Smith

CIGA 2020

The statutory override of the insolvency termination provisions in a contract[1]

Introduction

1. The Act adds to the current provisions found in ss. 223 and 233A of the IA 1986 preventing "essential suppliers", (e.g. utilities, communication providers, computer hardware and software etc.), from terminating contracts upon the company becoming subject to an insolvency procedure.

2. The provisions[2] are a statutory override of insolvency termination provisions in a contract. The purpose being to assist an insolvent company in preserving its business critical contracts with a view to facilitating a rescue of the company or its business.

3. The provisions are designed to complement the other rescue tools in the CIGA 2020: the moratorium and the restructuring plan.

Summary

- The Act seeks to expand cover to supplies of goods and services.
- Suppliers will not be able to rely on any termination provisions in their contracts, if a business has become subject to an insolvency event.
- It also prevents suppliers from making it a condition that pre-insolvency debts are paid in return for continuing to supply their goods or services.
- Where an insolvency event has occurred that would have allowed a supplier to terminate its contract before the business entered into the consequent insolvency procedure, but that right has not been previously exercised, it is suspended once the business enters the insolvency procedure;
- However, the provisions do not prevent a supplier exercising any contractual right that may arise whilst the company is going through the relevant insolvency process. If the supplier's right to terminate arises after an insolvency event begins, (for example,

[1] Implemented by ss. 14 and 15 and Schedule 12 of CIGA 2020.
[2] Sections 233B-233C and Schedule 4ZZA of the IA 1986.

for non-payment for goods supplied after that time), then this right to terminate is not prohibited by CIGA 2020.

Contracts caught

- Applies to contracts for the supply of goods and services.
- The provision is therefore narrower than its US Chapter 11 counterpart, which generally applies to all executory contracts (subject to carve-outs).
    - This discrepancy in scope is highlighted by the conflicting judgments handed down by the US and UK courts in *Belmont Park Investments PTY Ltd v BNY Corporate Trustee Services Ltd,* in which a subordination clause (a clause which effectively reversed the parties' priority under the payment waterfall) was held to be valid and enforceable by the UK Supreme Court, but was found by the US bankruptcy court to be unenforceable pursuant to US bankruptcy law[3].
- However, its scope is also limited to long-term contracts for supply, rather than arrangements which are made on an order-by-order or ad-hoc basis.

The Trigger - When it applies

- The trigger when a company becomes subject to a "relevant insolvency procedure"[4]:
    - a moratorium,
    - administration,
    - administrative receivership,
    - a company voluntary arrangement,
    - liquidation,
    - provisional liquidation, or
    - a restructuring plan.

<u>Note</u>

- CIGA 2020 does not include a scheme of arrangement in this list despite including the new restructuring plan.

[3] Given the narrow scope of the CIGA 2020 provisions, the Belmont case would still be decided in the same way, thereby demonstrating a continuing difference between the two regimes.

[4] Section 233B(8) of the IA 1986.

- Whilst the termination provisions may have been helpful in a trading liquidation such as Thomas Cook or British Steel, such liquidations are not the norm. Since the purpose of provisions are to aid the rescue of a company as a going concern or of its business, the justification, for permitting such interference in contractual rights in a typical liquidation where the business ceases to trade almost immediately, is not clear.

The Restrictions

Permanent

- A contractual right of a supplier to terminate on the grounds of insolvency is permanently immobilised (it ceases to have effect) upon the company becoming subject to the relevant insolvency procedure.
- This permanent immobilisation also applies to any contractual rights a supplier may have to "do any other thing" due to the company entering into a relevant insolvency procedure (for example, amending payment terms).
- Where the provisions are engaged, a supplier cannot make it a condition of post-insolvency supply that any outstanding invoices must be paid.

Suspension

- A supplier's contractual right to terminate on the grounds of any pre-insolvency events of default (not exercised prior to the insolvency process) are temporarily suspended until the relevant insolvency procedure comes to an end (unless the company exits into a subsequent insolvency procedure).

Note

CIGA 2020 does not provide for circumstances in which an office holder does not want to continue taking supply of certain goods or services (unlike its Chapter 11 counterpart).

- Under the new regime, suppliers contracted to supply goods or services will be under a statutory duty to continue performing their contractual obligations, regardless of the office holder's intentions or ability to pay for the goods or services.
- Accordingly, office holders and suppliers will have to resolve any supply issues early on in an insolvency, in order to avoid disputes over whether unwanted supplies should be paid for as a liquidation or administration expense.

The Exceptions[5]

There are three exceptions/safeguards for suppliers which permit termination:

- Where with the office holder consents or the company itself consents, if it is subject to debtor-in-possession proceedings (for example, the new restructuring plan or a company voluntary arrangement);
- With the approval of the court, where continuation of the contract would cause the supplier **hardship** (CIGA 2020 does not define "hardship" and it is likely that a relatively high bar will be set by the courts);
- If a post-insolvency event of default occurs giving rise to a new event of default.

The Exclusions[6]

- Contracts for the supply of goods or services to or from insurers, banks and recognised investment exchanges (amongst others).
- Financial contracts (including contracts for the provision of financial services), securities financing transactions and derivatives.
- Essential supplies where s. 233A(1) applies.
- *Temporary* exclusion for small suppliers between 26 June (the date of enactment) and 30 September 2020. A "small supplier" needs to satisfy two of the following conditions in relation to its most recent financial year[7]:
    - a turnover of not more than £10.2 million.
    - a balance sheet total of not more than £5.1 million.
    - 50 or fewer employees.

Practical effects and Steps to be taken

- The provisions will allow trading providing a *breathing space* to facilitate rescue and therefore a possibly a gain for creditors.
- However, the provisions will be an additional burden for suppliers.

[5] Sub-section 233B(5) if the IA 1986

[6] See Schedule 4ZZA of the IA 1986 for the first two exclusions and section 15 of CIGA 2020 the third (temporary) exclusion.

[7] Separate criteria apply to businesses with less than one year of trading.

- For suppliers, this may mean an increase in ongoing insurance costs and possible legal costs in applying to a court to be exempt using the hardship exemption[8]. Suppliers will not want to test the 'scope' of the hardship provision.
- Suppliers should amend their contracts so that CIGA 2020 is not overlooked.
    - This may not be strictly necessary, but may make sense if your contracts to manage client's expectations and the contractual relationship generally.
- Finally - Guidance on Responsible Contractual Behaviour[9] - On 7 May, the government issued, with little fanfare, non-binding guidance on responsible contractual behaviour.
    - The general approach that the government wishes to see is that businesses should concentrate on the long term and, it states, to 'act responsibly and fairly in the national interest in performing and enforcing their contracts, to support the response to COVID-19 and to protect jobs and the economy.'
    - However, the guidance makes it clear that it doesn't override 'any specific support or relief available' in any relevant contracts, such as any termination provisions.

Francis Collaço
Moraes Three Stone
9 July 2020

[8] The government's best estimate of the cost to suppliers, one of the main affected groups, is that it will cost them £292.9 million over ten years

[9]https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/883737/_Covid-19_and_Responsible_Contractual_Behaviour__web_final___7_May_.pdf

Wrongful Trading

The position as at 29th February 2020

If you happen to be lucky enough to own a time machine you could set it to take you back to 29th February 2020 and see for yourself what the pre COVID-19 world looked like from the perspective of the naughty director who engages in wrongful trading. Actually, you could go back to most of March because although the suspension of the rules on wrongful trading were introduced on 28th March 2020, they were given retrospective effect and backdated to 29th February 2020. So the naughty director gets away with it without even knowing why.

You may take it from the tone of the last paragraph that I regard the suspension of the wrongful trading rules as a thoroughly bad thing. And I do. But that is not to say that the position was all that much better prior to 29th February 2020. The problem is not the wording of the statute itself, although it is worth noting that the wording of s 214 of the 1986 Act is very different to the draft clause proposed in paragraph 1806 of the *Cork Report*. Section 214[1] reads as follows:

> ***214 Wrongful trading.***
>
> *(1) Subject to subsection (3) below, if in the course of the winding up of a company it appears that subsection (2) of this section applies in relation to a person who is or has been a director of the company, the court, on the application of the liquidator, may declare that that person is to be liable to*

[1] And note also s 246ZB of the 1986 Act which deals with the position of a company in administration.

make such contribution (if any) to the company's assets as the court thinks proper.

(2) *This subsection applies in relation to a person if—*

(a) *the company has gone into insolvent liquidation,*

(b) *at some time before the commencement of the winding up of the company, that person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation, and*

(c) *that person was a director of the company at that time;*

but the court shall not make a declaration under this section in any case where the time mentioned in paragraph (b) above was before 28th April 1986.

(3) *The court shall not make a declaration under this section with respect to any person if it is satisfied that after the condition specified in subsection (2)(b) was first satisfied in relation to him that person took every step with a view to minimising the potential loss to the company's creditors as (on the assumption that he had knowledge of the matter mentioned in subsection (2)(b)) he ought to have taken.*

(4) *For the purposes of subsections (2) and (3), the facts which a director of a company ought to know or ascertain, the conclusions which he ought to reach and the steps which he ought to take are those which would be known or ascertained, or reached or taken, by a reasonably diligent person having both—*

(a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company, and

(b) the general knowledge, skill and experience that that director has.

(5) The reference in subsection (4) to the functions carried out in relation to a company by a director of the company includes any functions which he does not carry out but which have been entrusted to him.

(6) For the purposes of this section a company goes into insolvent liquidation if it goes into liquidation at a time when its assets are insufficient for the payment of its debts and other liabilities and the expenses of the winding up.

(6A) For the purposes of this section a company enters insolvent administration if it enters administration at a time when its assets are insufficient for the payment of its debts and other liabilities and the expenses of the administration.

(7) In this section "director" includes a shadow director.

(8) This section is without prejudice to section 213.

Now I mentioned that s 214 is drafted in somewhat different terms to what was proposed by Sir Kenneth Cork, and that may be of some relevance because the courts have undoubtedly interpreted it in a far more director-friendly manner than was the intention of the Cork Committee. The *Cork Report* expressly discusses the previous position relating to fraudulent trading under s 332 of the Companies Act 1948, and notes that the use of the word 'fraudulent' in both the civil (s 332(1) and (2) of 1948 Act) and criminal (s 332(3) of the 1948 Act) provisions had led to the Chancery Division interpreting the civil cause of action as requiring evidence to be established to the criminal burden of proof, which was something that the Cork

Committee regarded as undesirable when relating to civil liability. The *Cork Report* expressly says that the purpose behind the new provision of wrongful trading was to make establishing liability against naughty directors easier[2].

> *In future, we propose that a company shall be trading wrongfully if, being insolvent or unable to pay its debts as they fall due, it incurs liabilities to other persons without a reasonable prospect of meeting them in full; and that a person who was party to the carrying on of the company's trading may be made personally liable for the debts of the company if he knew or, as an officer, ought to have known that the trading was wrongful.*
>
> *Our proposals introduce, and are intended to introduce, a radical extension of those aspects of section 332 which relate to civil liability.*
>
> …
>
> *We recommend that if the directors at any time consider the company to be insolvent, they should have a duty to take immediate steps for the company to be placed into receivership, administration or liquidation. Failure to do so will normally expose any director who is party to the company's continued trading to civil liability.*

But for some reason known only to themselves, judges have repeatedly interpreted s 214 in ways that let the directors off of the hook. So in a number of recent cases we have seen directors

[2] Paragraphs 1781 – 1782 and 1786 of the Cork Report 1982, Cmnd 8558

evade personal liability because one should not rely on hindsight[3] or because there was no net increase in the company's deficiency towards creditors after the date on which the directors ought to have concluded that insolvent liquidation was inevitable[4]. However, that tendency to let directors off is not what was intended when wrongful trading was proposed, and nor is it a natural interpretation of the statute, even as it is worded. For example, hindsight has nothing to do with wrongful trading because what one is looking at is what a reasonable director would have concluded on the evidence before her at the time. Either the director behaved reasonably, judged objectively (but with a subjective element if the director happens to possess special attributes[5]) or they did not. If they did not behave reasonably, then they should not be forgiven.

The net increase in deficiency argument is, if anything, even more dangerous than reliance on hindsight arguments. The point made in the *Ralls Builders* case was that, by trading on after the directors knew that insolvent liquidation was inevitable, existing creditors were paid off but only by incurring new liabilities to other creditors. On that basis, the Judge held that in balance sheet terms, the company's net position did not alter; it was insolvent when the directors ought to have concluded that insolvent liquidation was inevitable, and it was equally insolvent when it eventually entered into administration. In accounting terms that is of course correct, but the danger that such an approach throws up should be obvious: the director of the

---

[3] *Brooks v Armstrong* [20017] BCC 99, on appeal from the decision of Registrar Jones [2015] BCC 661

[4] *Grant v Ralls* [2016[BCC 293

[5] Although note that Registrar Jones declined to hold that a defendant who had substantial experience as a director of a number of companies should be held to the higher standard contained with s 214(4)(b) in circumstances where that experience related to companies operating in a different retail sector to the company in liquidation. With respect, that cannot be correct. The consideration for the purposes of s 214(4)(b) is of the individual's experience as a director, not as a retailer. Liability under s 214 can only apply to someone who chooses to trade through limited liability, and the *quid pro quo* of that limitation on personal liability is the duty to operate the company properly in accordance with the duties owed by the directors (acting *qua* director, not *qua* retailer), including the duty not to continue trading once insolvent liquidation becomes inevitable.

company, seeing that the company's demise is rapidly approaching, may decide to trade on in order to ensure that the business' keys suppliers are repaid so as to maintain a good working relationship with trade creditors or the bank when they start a new business, all of which is only achieved at the expense of new creditors who the director does not happen to care about. The position on the balance sheet may not alter, but the position of the creditors does. The fact that such payments may (but only may) be susceptible to challenge as preferences does not alter the point that wrongful trading should not be interpreted in this way, and there is nothing in the wording of s 214 that requires such an interpretation.

But don't take my word for any of this, Dear Reader. Shortly before he died Gabriel Moss QC – a man who knew a thing or five about insolvency – published an article titled *No Compensation for Wrongful Trading – Where Did it All Go Wrong? (2017) Insolvency Intelligence 49*, in which he made exactly these criticisms of the approach taken by the courts. But that is the position now and, short of someone taking matters to the Court of Appeal (at the least) there's not very much any of us can do about it.

<u>The (retrospective) position from 1st March 2020 until 30th June 2020 (and possibly beyond)</u>

All of the above brings us full circle to the position as at 29th February 2020. Because as at that date, no liquidator in his right mind would ever have considered bringing a wrongful trading claim against a former director because of the substantial hurdles that the caselaw in this area has put in the way of establishing liability. Moreover, there is no need to rely upon wrongful trading when the rule in *West Mercia Safetywear Ltd v Dodd* [1984] BCC 30 and s 172(3) CA 2006 mean that the director's duty when a company is of dubious solvency (and not

just where the director ought reasonably to conclude that insolvent liquidation is inevitable) shifts to require the director to act in the best interests of the company's creditors, with failure to do so constituting misfeasance. Equally, there are the other statutory duties contained within the CA 2006, some or all of which will always overlap with the particular circumstances of a company that has been trading wrongfully, as I will come onto in the next section of this note.

So what does the suspension of wrongful trading as a cause of action actually do? Answer: not very much. It suspends recourse to a cause of action that no one really uses anymore, and it does so without protecting the director from liability under other (much more attractive to a liquidator because they are so much easier to establish) causes of action. And that should not be a cause for complaint. If a director knows that his company is going to go pop, he should not be putting his head in the sand and ignoring that fact. Nothing about the present pandemic has altered that. If the company is not going to make it, then a swift death is preferable to a long, drawn out one. We are not talking about the borderline cases here, the ones where the director elects to continue trading because there is an objectively reasonably held belief in a turnaround in the company's fortunes. That would not be wrongful trading on anyone's interpretation of s 214. We are instead talking about companies where all that continued trading does is delay the inevitable. That also deals with the counter argument that suspending the wrongful trading rules is a good thing because it encourages directors not to cease trading too readily. But that can only be a relevant consideration if insolvent liquidation is not already a foregone conclusion, which is the only situation that s 214 applies to.

<u>Misfeasance (or "so are the new rules simply a waste of time?")</u>

I touched upon the fact that the suspension of the rules on wrongful trading does not, subject possibly to the last section of this note, alter the position in respect of the duties owed under the Companies Act 2006. The point is that continuing to trade once insolvent liquidation has become inevitable will also involve infringement of some or all of these duties. For example, it is at least well arguable that trading on once insolvent liquidation has become inevitable is not exercising the director's powers in accordance with the purpose for which those powers were conferred (s 171 CA 2006). Equally, trading on cannot promote the success of the company (s 172 CA 2006, and in particular subsection (3) of that provision). Nor can it be said to be the exercise of reasonable care, skill and diligence on the part of the director (s 174 CA 2006). Depending on all of the circumstances of the case there may also be infringements of the requirement to avoid conflicts of duty and interest. Suspending wrongful trading does nothing to alter liability under these heads of liability.

<u>Section 1157 to the rescue</u>

However, the argument that is likely to be deployed by naughty directors is that they ought fairly to be excused. The provision is a well-known one, but I set out the relevant part of it for the sake of completeness:

1157 Power of court to grant relief in certain cases

(1) *If in proceedings for negligence, default, breach of duty or breach of trust against—*

(a) *an officer of a company, or*

(b) *a person employed by a company as auditor (whether he is or is not an officer of the company),*

it appears to the court hearing the case that the officer or person is or may be liable but that he acted honestly and reasonably, and that having regard to all the circumstances of the case (including those connected with his appointment) he ought fairly to be excused, the court may relieve him, either wholly or in part, from his liability on such terms as it thinks fit.

The argument that will be deployed is that if trading on did not amount to wrongful trading during the currency of the pandemic, then the decision of the director to continue trading despite knowing that insolvent liquidation was inevitable must have been honest and reasonable in all the circumstances of the case. Personally, I rather hope that the courts will give any such arguments short shrift. But I'm not convinced that they will, and if I were acting for a director in those circumstances that is certainly the defence that I would be running. As is often the case, the *Cork Report* provides a clue to the resolution of any such argument because the draft wrongful trading clause proposed by Sir Kenneth, but eventually rejected by Parliament, included the following defence[6]:

…if… it appears to the Court that such person has acted honestly and that having regard to all the circumstances of the case he ought fairly to be excused that Court may relieve him, either wholly or in part, from personal liability on such terms as it may think fit.

So there you have it. Parliament has rejected the notion that a materially identical defence to that provided by s 1157 CA 2006 should apply to wrongful trading, and there is no good reason why that decision on the part of Parliament should be subverted by allowing s 1157 CA 2006

[6] Paragraph 1806 of the Cork Report 1982, Cmnd 8558

to relieve directors from liability for breach of duties on their part, where the breaches in question also amount to wrongful trading, or would if s 214 had not been suspended due to the pandemic.

James Couser

Three Stone Buildings

3rd July 2020