Coronavirus: Managing potential solvency risks in UK businesses

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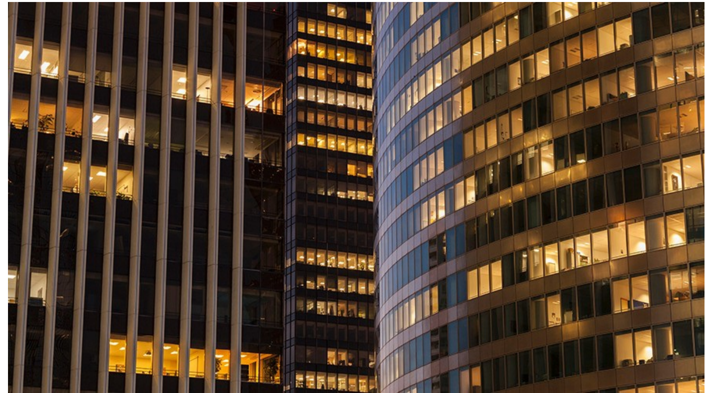

Click here to read more insights on how we can weather the coronavirus outbreak with you.

Despite the substantive monetary and fiscal steps recently taken to alleviate the effects of COVID-19 and cushion short term supply disruptions and cashflow problems for UK companies, there are a number of risks that can impact business strategy and planning at this turbulent time. Whilst these risks can present opportunities, companies need to proceed with caution, particularly if COVID-19 continues its global spread.

Regardless of policy measures, there may be a severe, short term impact on cashflow, which could lead to concerns about the financial stability of any business. If such problems materialise, directors of companies should consider taking steps to mitigate the risks to both the company and to themselves(1).

Potential risks for directors

As a director, you have general duties to a company(2) including to promote its success and to exercise your reasonable care, skill and diligence. In carrying out such duties, you must take into account the impact that your decisions have on the company's business relationships with suppliers, customers and employees.

If your company finds itself in financial difficulties, you must also be mindful that your duties then extend to the company's creditors in order to minimise their potential losses. A breach of these duties can lead to personal liability and possible disqualification from acting as a director.

If your company were to become insolvent, your overriding duty becomes to protect the interests of the company's creditors, rather than its shareholders. In particular, if the company were to go into liquidation, there are provisions in place that allow an appointed officeholder to investigate your conduct before liquidation and, if appropriate, bring a claim against you. These include:

- where officers or those involved in the management of company may have misapplied or retained or become accountable for any money or property of the company. Examples of such conduct include unauthorised loans or improper payments of dividends(3);
- when it appears that any business of the company has been carried out with the intent to defraud creditors(4). Examples include when directors allow a company to incur a debt that they know will not be recoverable; and
- when it appears that directors have authorised payments to third parties, whether associated parties or not, which can be challenged either as preferences or undervalue transactions under existing legislation, with possible resultant consequences for them.

Managing the insolvency risk

If there is a real prospect that your company may become insolvent – for example, that debts cannot be paid as and when they fall due to creditors – there are two immediate options available that you may wish to consider:

A 'Company Voluntary Arrangement' ("CVA")

This is where your company enters into a formal agreement with the approval of at least 75% of its creditors. A CVA is unique to each company's circumstances but often sought when you need help delaying or potentially reducing debts due because of short term cashflow problems.

Under a CVA, your company will continue to trade and you, as the director(s), will continue to operate the company, albeit under the supervision of an appointed insolvency practitioner i.e. a nominee. Dependent on the company's size, and subject to the approval of the nominee and the filing of appropriate forms at court, a statutory moratorium may also come into effect.

Administration

This option is available to a company that has become insolvent, and often when it has become apparent that a CVA cannot be quickly agreed to. Subject to specific provisions, you, as the director(s), have the ability to place a company into administration. Upon administration, an insolvency practitioner is appointed to manage the affairs of the company, taking control of the company's assets and business to repay as much of the debt due to creditors as possible.

Administration is particularly helpful to management if legal action has been threatened or commenced by a creditor because the company has failed to make payment by a due date. A statutory moratorium automatically comes into effect, which means that no legal process may be instituted or continued against the company except with the consent of the administrator or with the permission of the Court.

What next?

If you have any concerns regarding insolvency arising either as a consequence of COVID-19 or more generally, speak to a member of our team at the earliest opportunity. Click here to read more insights on how we can weather the coronavirus outbreak with you.

FOOTNOTES

1. The Insolvency Act 1986 (the "Act") has pitfall provisions for directors to avoid, as well as provisions providing opportunities for companies to manage solvency risk for the benefit of both the company and its creditors (and ultimately themselves).
2. Under the UK Companies Act 2006.
3. Misfeasance under section 212 of the Act.
4. Fraudulent trading under Section 213 of the Act.
5. Wrongful trading under section 214 of the Act.

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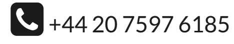
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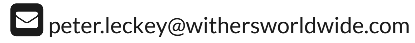
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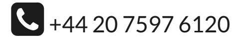
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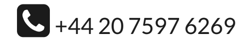
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