COVID-19 wrongful trading in Guernsey

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The UK Government has announced new insolvency measures, intended to temporarily suspend wrongful trading provisions, in order to protect companies from being put into an insolvency process by directors who may fear that they will become personally liable during the pandemic. The move will allow directors of companies to pay staff and suppliers, even if there are fears the company could become, or is insolvent. A similar provision has not been adopted in Guernsey yet, but could soon follow. So what are the current wrongful trading provisions in the Bailiwick of Guernsey, and what should directors be considering in these extraordinarily uncertain times?

The Law in Guernsey

Wrongful trading under Guernsey law is governed by section 434 of the Companies (Guernsey) Law, 2008. Pursuant to that provision, directors can incur personal liability for wrongful trading if they, '*knew or ought to have concluded that there was no reasonable prospect of the company avoiding going into insolvent liquidation*', unless they took every step with a view to minimising the potential loss to the company's creditors.

Accordingly, if a director allows a company to continue to trade when it is insolvent, and there is no reasonable prospect of avoiding an insolvent liquidation, then they could be liable for wrongful trading. It should be borne in mind that a director will not be liable for wrongful trading if a company continues to trade while it is insolvent, provided there is a reasonable prospect of avoiding liquidation proceedings.

The law also provides a defence for directors, in that the Court shall not make a declaration in respect of any director if it is satisfied that the director, after he/she knew or ought to have known of the company's insolvency, took every step with a view to minimising the potential loss to the company's creditors that (assuming him to have known that there was no reasonable prospect of the company avoiding going into insolvent liquidation) he/she ought reasonably to have taken. The key question for directors is; when does the duty to creditors arise?

Duty to Creditors

The Royal Court of Guernsey recently considered the previous wrongful trading provision pursuant to the Companies (Guernsey) Law 1994 (which is largely the same as section 434 of the 2008 Law). LB Marshall QC's judgment in *Carlyle Capital Corporation Limited v Conway Others, Royal Court, Unreported Judgment 38/2017* provided useful guidance on when the duty to creditors comes to the fore, confirming that:

'*I hold the duty to have regard to the interests of creditors arises when it can be seen that decisions about the company's actions could prejudice the creditors' prospects of recovering their debts in a potential liquidation*'.

In *Carlyle* LB Marshall QC concluded that the directors had not committed wrongful trading, because they did not or ought not to have known that the Company would be unable to pay its debts as they fell due prior to the Company entering insolvency. This part of her judgment was not appealed to the Court of Appeal.

The issue of wrongful trading and when the duty of directors to creditors is engaged, is due to be considered by the Supreme Court of England and Wales in the case of *BTI 2014 LLC v Sequana SA and others, UKSC 2019/0046*. Given that the same panel of judges sit in the Supreme Court and the Judicial Committee of the Privy Council, Guernsey's highest Court, this authority is likely to be very persuasive in the Bailiwick.

The Court of Appeal in *Sequana* considered when the creditors' interests duty is engaged. It stated that the answer to that question has '*very significant practical consequences for the conduct of business*'. The Court of Appeal clarified that the creditors' interests duty may be engaged *prior* to actual insolvency and, in a new statement of the test, held that the duty is engaged from the point at which directors 'know or should know that the company is or is likely (in the sense of probable) to become insolvent'.

The Court of Appeal commented that, if the duty was engaged from the point at which directors know or should know that the company is or is likely to become insolvent, it was hard to see that creditors' interests could be anything other than 'paramount'.

It will be interesting to see how the Supreme Court determines the issue but, as things currently stand, the test in Guernsey means that directors must be constantly vigilant of the solvency of the company and cognisant of its assets and liabilities.

Guidance for directors

In light of the above law and authorities, what should directors be considering at this time to avoid potential claims for wrongful trading if a company goes into insolvent liquidation? Below are some considerations for directors:

- Follow best practice at directors' meetings
- Always have up to date financial information to hand
- Can the company meet its contractual obligations?
- If the company is or is likely to become insolvent, consider creditors' interests carefully and record it
- Take professional advice as appropriate
- Is it time to cease trading?
- Resignation – not generally recommended unless, perhaps, the rest of the board do not accept the director's view that the company will be wrongfully trading if it continues.

The States of Guernsey may well follow Westminster's lead and relax the wrongful trading provisions to enable companies to survive which may otherwise have the plug pulled by directors who fear personal liability for allowing their company to trade whilst insolvent. However, until the States of Guernsey grant this relief, directors must act with caution and seek advice rather than run the risk of being held personally liable and potentially face disqualification.

If directors were to utilise any relaxation of the law regarding wrongful trading, other issues may still arise if the company were – nevertheless – to go into liquidation, such as preference payments. But this is a whole other consideration.

If you have any queries on the above, please don't hesitate to reach out to the team; we are here to help.

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