



The Law Society of Jersey

Wrongful trading under Jersey law: practice statement issued by The Law Society of Jersey Financial and Commercial Law Sub-Committee for and on behalf of The Law Society of Jersey

Introduction

The Law Society of Jersey has been asked by the Minister for External Relations of the Government of Jersey to issue guidance commenting on wrongful trading under Jersey law given the financial difficulties caused by the COVID-19 pandemic.

The COVID-19 pandemic has caused financial distress to a range of companies.

The directors of such companies should consider their duties and liabilities as directors.

One liability that directors tend to be particularly concerned with during periods of financial distress is the potential liability for wrongful trading.

It is hoped that this practice statement will give appropriate reassurance concerning the nature of this risk.

Directors should be wary of immediately concluding that the only way to avoid liability for wrongful trading is to permanently cease trading.

Narrow focus of practice statement

Where a company is insolvent or facing insolvency, there are likely to be a range of other legal matters which will be relevant to a director of such a company (including, without limitation, the statutory and customary law duties that a director may owe to the members and/or creditors of the company). This practice statement has a narrow focus commenting only on the wrongful trading provisions under Jersey law. It does not comment on any other legal matter.

Not legal advice

This practice statement is only intended to provide a general overview of wrongful trading under Jersey law. It is not intended as legal advice and should not be relied on as such. Directors who are concerned about potential liabilities should seek independent legal advice.

What is wrongful trading?

There are two main bankruptcy procedures which apply to Jersey companies:

- a creditors' winding up under the Companies (Jersey) Law 1991 (the "**Companies Law**"); and
- the property of a Jersey company being declared *en désastre* pursuant to the Bankruptcy (Désastre) (Jersey) Law 1990 (the "**Bankruptcy Law**").

If there is a creditors' winding up, a liquidator will be appointed and the liquidator will administer the creditors' winding up.

If there is a declaration of *en désastre*, the property of the company will vest in the Viscount (the executive officer of the courts of Jersey) who will administer the *désastre*.

The wrongful trading provisions are contained in Article 177 of the Companies Law and Article 44 of the Bankruptcy Law.



The Law Society of Jersey

Under these provisions, the liquidator (if there is a creditors' winding up) or the Viscount (if there has been a declaration of *en désastre*) may apply for a court order to be made against a director of the company.

If an application is made, the Royal Court may order that a director be personally liable (without limit) for all or any of the debts or other liabilities of the company arising after a particular time.

The particular time is when the director:

- (a) knew that there was no reasonable prospect that the company would avoid a declaration of *en désastre* or a creditors' winding up ("**Condition A**") ; or
- (b) on the facts known to him or her was reckless as to whether the company would avoid a declaration of *en désastre* or a creditors' winding-up ("**Condition B**").

In order to be liable, the person must be a director when Condition A or Condition B is first satisfied.

A director means any person occupying the position of director by whatever name called. Therefore, a director will include a de facto director.

Matters to emphasise

The following points should be emphasised:

- A claim can only be made for wrongful trading if the company is the subject of a formal bankruptcy process (i.e. a declaration of *en désastre* has been made or a creditors' winding up has commenced).
- The liquidator or the Viscount will need to establish that Condition A or Condition B is satisfied. This may be a significant evidential burden that the Viscount or liquidator will need to overcome.
- Condition A uses the language "reasonable prospect". Condition A means that the director must know that the company no longer has a reasonable prospect of survival. In many cases, and not least in these unprecedented times, there may be a wide spectrum of legitimate views as to what constitutes a "reasonable prospect". If there is a wide spectrum of views, the Viscount or the liquidator may not wish to make a claim as such an action could be regarded as being speculative in nature. The Viscount or the liquidator may only wish to pursue a clear claim.
- The costs in bringing an action against a director may also need to be considered by the Viscount or the liquidator.
- In practice, a claim against a director is only likely to be pursued if the director has the personal resources to fund any order made against the director or the director has D&O insurance or other indemnification arrangements. This may act as a practical barrier to the bringing of claims.
- We are not aware of any successful wrongful trading claim being made before the courts of Jersey.



The Law Society of Jersey

The statutory defence – reasonable steps to minimise loss

The Jersey courts cannot make an order against the director if, after Condition A or Condition B was first satisfied, the director took reasonable steps with a view to minimising the potential loss to the company's creditors.

Therefore, even if the Viscount or the liquidator is able to establish that Condition A or Condition B is satisfied, the director may still have a statutory defence to a claim.

It should also be emphasised that the statutory defence does not require losses to have been actually minimised. At the end of the day, it may be that the steps taken fail and losses are not minimised. However, what matters under the statutory defence is not the end result. The focus of the statutory defence is whether reasonable steps were taken.

Depending on the facts, the taking of reasonable steps may mean that the company has to permanently cease trading. But there are a range of possible responses depending on the facts and it is not necessarily correct to assume that the cessation of business is the only or best way forward.

At the heart of the statutory defence is the need for directors to be able to demonstrate prudential financial and cash flow management. Practical steps that should be considered include the following:

- Companies and directors should take independent professional advice from lawyers and accountants as needed.
- Frequent board meetings should be held to monitor the financial position of the company. In order for these meetings to be meaningful, up to date management accounts and cash flow forecasts should be tabled. The discussions and decisions of directors should be fully minuted.
- The cash flow forecasts should be sensibly modelled on varying assumptions to identify the fundamental stress points relating to the company. The modelling should be updated in line with each relevant government announcement concerning lock down measures. The actual date when the lock down will end is not yet known. However, given that the Jersey government has announced plans to relax the Jersey lock down measures, it would appear reasonable to assume that there will be a continuing relaxation of the Jersey lock down measures in the coming weeks and that such relaxation will benefit many business sectors in Jersey. This should, of course, be revised in any cash flow forecasts if circumstances change.
- The company should communicate with its creditors proactively and regularly.
- There may be particular sensitivities where new liabilities are incurred. The incurring of new liabilities may mean that the directors have not taken reasonable steps to minimise the potential loss to creditors.
- The directors should actively manage cash flow – this could involve adopting (or revising) policies relating to debtors; identifying and disposing of surplus assets; reducing stock levels; taking full advantage of the government schemes that have been introduced to mitigate the financial hardship of COVID-19; reviewing and curtailing capital expenditure programmes; and identifying other ways to cut costs and improve cash flow. Steps are more likely to have a positive impact if they are taken sooner rather than later. The directors should clearly avoid only taking steps when it is too late for those steps to have any positive impact on cash flows.



The Law Society of Jersey

- It may be sensible to conduct a wider risk analysis of matters which could disrupt cash flows (such as considering the impact of the insolvency of key customers).
- Where the company is a member of a group of companies, the commercial approach of management may be to view matters more on a group basis (almost as if the group consists of one economic unit). This approach is incorrect and misplaced. The position of each company needs to be considered in relation to that company alone.

There may be a wide spectrum of legitimate views as to what amounts to reasonable steps. However, we would hope that the courts of Jersey would provide considerable latitude in this area when considering the difficulties caused by COVID-19. These are truly unprecedented times. What is "reasonable" is an objective standard. With any objective assessment, it is necessary to consider (in broad terms) what others in similar positions would do in a comparable situation. With COVID-19, there may simply be too many different views and approaches to say with any certainty that the directors did not take reasonable steps.

Difference from the English law wrongful trading defence

It should be noted that the equivalent English law wrongful trading defence requires a director to take "every step" with a view to minimising the potential loss to creditors as he or she ought to have taken. For these purposes, the steps which he or she ought to have taken are those which would be 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 such director and (b) the general knowledge, skill and experience that such director has.

In contrast, the Jersey wrongful trading defence only requires a director to take "reasonable" steps.

The emphasis on "reasonable" steps rather than "every" step lowers to some degree the hurdle that directors must overcome in order to take advantage of the Jersey defence as compared to the availability of the English defence.

Conclusion

It is hoped that directors of Jersey companies can take comfort from the positions outlined in this practice statement. The directors of a Jersey company should not be penalised under the Jersey wrongful trading provisions if they take reasonable steps to minimise the potential loss to creditors.

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