

Deciding if it is time to take steps to place a company into an insolvency process, versus continuing to trade in the hope that a “white knight” will save the day, is not easy for any director.

As directors, you may have traded the business for years, invested time, money and effort into it, successfully traded through difficult financial periods before and hope to do the same again. However, when the light at the end of the tunnel is fading too fast, directors should be taking steps to place the company into an insolvency process. This not only protects creditors and employees, but also directors, who could be personally liable for any losses suffered by creditors as a result of undue delay in doing so.

Taking steps to place a company into an insolvency process at the right time, was brought into sharp focus last year, following the court finding directors of BHS liable for misfeasance trading (and liable to contribute £110m)- a claim that is more easily established than a claim for wrongful trading.

## What Is a “Reasonable Prospect”?

When deciding whether to continue to trade, one of the key questions is “Is there a reasonable prospect that the company can avoid going into insolvent liquidation or administration?” However, what does “reasonable prospect” actually mean?

The below sets out some of the “red flags” that can indicate there is no reasonable prospect. These are necessarily broad, and should be considered in the context of the circumstances of any particular case. However, there is one thing that is common in all cases: take advice, listen to and apply that advice and if the advice is that there is no longer a reasonable prospect that the company will avoid insolvent liquidation or administration, observing that. If your advisers are saying that there is no longer a reasonable prospect and the company should be placed into an insolvency process, then observe that advice. Failure to do so will materially increase the risk to the business, materially increase the risk to creditors and employees and materially increase the risk of personal liability for the directors.

Common signs that there is no reasonable prospect of avoiding insolvent liquidation or administration are:

- The company cannot continue operating within existing facilities while managing the position with creditors generally.
- The company’s financiers have withdrawn any facilities previously made available to it (such as overdraft facilities) or have indicated that they are not willing to provide ongoing support.



- The company’s secured lenders have indicated that they intend to take enforcement action.
- There is no cash in the business to pay wages.
- Key suppliers and customers have sought to terminate contracts.
- If debtors defer payments, this will have a material effect on the company’s cash flow.
- HMRC are unwilling to agree a time-to-pay agreement.
- Shareholders are not willing to extend further facilities to the company.
- It is not realistic that the company can be sold as a going concern at a value sufficient to ensure all creditors will be paid in full, with a return to shareholders

Directors should consider all these factors (and any others) in tandem with their advisers to evaluate whether there is a reasonable prospect that the company will avoid insolvent liquidation or administration. Having been involved in advising many companies, your advisers are often in the best position to judge the timing of an insolvency process, and to give you impartial objective advice on when a prospect that you might think is reasonable, is not.

Directors are unlikely to be criticised for following advice; there is a much higher personal risk if they chose to ignore it.

Furthermore, delay in taking action will reduce the number of restructuring options that are available to rescue the company.



## Evidencing Reasonable Prospect

During any difficult trading period, directors should regularly review and make decisions based on their knowledge of what the company's net deficiency position is – bearing in mind that it might reduce further or increase. A 13-week cash flow is also an invaluable barometer of the liquidity of the business and so whether it can trade through its difficulties.

The board should also keep full and accurate minutes of its reviews, decisions (including any dissenting views of individual directors), the reasons for those decisions and the information (particularly financial information that should be attached to the minutes) upon which such decisions are based, in order to support their view that the company had a "reasonable prospect" of avoiding insolvent liquidation or administration.

If the company ultimately ends up in an insolvency process, those records can be relied on to demonstrate why the directors continued to trade and why the company was only placed into administration or liquidation when it was.

## Continuing Trading?

Of primary importance is listening to and acting on the advice of the company's advisers. If you think there is a "reasonable prospect," but your advisers say otherwise, it is prudent to listen to and act on what they say to minimise the risk of personal liability.

However, if the directors decide to continue trading against advice, and the company ultimately ends up in an insolvency process, the decision to continue trading will be heavily scrutinised.

If you act against advice, there is a materially increased risk of claims against you personally for misfeasance and wrongful trading and an enhanced risk of proceedings to disqualify you as a director. D&O insurance will not protect you when you have ignored advice.

That said, taking and acting on professional advice is not a 'magic bullet' that will absolve the board of any liability. In particular, it is key that advisors are fully informed about the operations and financial position of the company, and are providing their advice on the basis of the most complete and best possible information. The more siloed advisors become, the less useful their advice will be.

Continuing to trade can also cause significant issues at board level where there is a difference of opinion about continuing to trade. In practice, we have seen this lead to the resignations of directors who disagree with the decision to continue trading, further increasing the risk of personal liability for those that remain in office and creating operational issues – because the company has lost key personnel and also may be unable to function because it is no longer possible to hold quorate meetings.

If, notwithstanding the risk, directors decide to continue to trade, then, as explained above, proper records should be maintained to evidence decisions that there is a "reasonable prospect," because these will be reviewed if it turns out that the decision of the directors to continue trading against advice was in fact the wrong one.

## Key Contacts



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