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Business law untangled podcast

Episode 4: What the government's recovery of bounce back loan debts means for borrowers and directors

Stephen Downie	Hello and welcome to another spectacular podcast from Francis Wilks & Jones. My name is Stephen Downie and I am here today with my colleague Maria Koureas-Jones. We're both partners at FWJ specialising in commercial litigation and contentious corporate and insolvency matters. And we're here to talk about a very topical subject which is the recovery of the funding lent to businesses during the Covid-19 pandemic, particularly the bounce back loans and the connected threat personally to those business owners, directors and individuals who took out the loans innocently or, alternatively, may have taken advantage of the loans on offer. Now Maria will go into a bit of background about this subject. Maria.
Maria Koureas-Jones	Hello to all our listeners! I think we will all remember Rishi Sunak speaking back in March 2020 when he made a promise that he would do whatever was needed to support the economy and part of that promise was to provide financial support for businesses in various forms, so this included furlough, bounce back loans, the Commercial Business Interruption Loan Scheme - often referred to as CIBLS - grants and various other funding methods. We will focus during this podcast on bounce back loans simply because it formed the key form of government support during this period. It accounted for over 93% of the government loans made during the pandemic and for almost 60% of the funds disbursed by government during the pandemic.
Stephen Downie	Yes and don't forget Maria there was also a legal promise not to pursue directors for continuing to trade during this period called wrongful trading when, in ordinary times, without customers or funding, a company should that doesn't seek to wind up its affairs and mitigate the losses such customers or lenders suffer can be liable for wrongful trading, but Rishi Sunak struck that out. Out of interest, what sort of amounts are we talking about in terms of the monies that were lent to businesses under the various Coronavirus loan schemes?
Maria Koureas-Jones	We are looking at big money. Parliament issued a briefing note back on 4 November 2021 which indicated that £79 billion was lent before 31 May 2021.
Stephen Downie	Wow and of course this money will all have to be repaid by the companies who borrowed the loans. These loans are guaranteed by the government where the businesses default and therefore if the banks don't get repaid then government steps in but sooner or later those borrowers will have to be pursued.

Maria Koureas-Jones	Spot on. Rather scarily the Office for Budget Responsibility estimates that up to 40% of bounce back loan borrowers may default so, given the numbers that we are talking about, it looks like losses of around £33.7 billion from the bounce back scheme alone.
Stephen Downie	Wow, we're talking staggering numbers that's more than my bank savings. And the focus of government is on repayment of these loans (or pursuing those who took out the loans without ever intending to repay them). The bounce back loan scheme closed on 31 March 2021 and, just as a reminder, these loans were up to a maximum of £50,000 and had the benefit of a 100% government guarantee to the bank who lent these monies. The repayment terms are very generous, and they have a low rate of interest and flexible repayment terms meaning a number of years, so they are not expensive loans.
Maria Koureas-Jones	The scheme was obviously focussed around this time on getting money out to businesses quickly. There was lots of criticism at the time regarding delays in getting money out to business, businesses that needed this money. So as a result of this there was limited due diligence undertaken by the banks, the standard know-your-client checks that were undertaken by the banks were materially reduced and, in addition, to try and streamline the process, businesses had to self-certify that they met certain criteria for the loans. This massively left the scheme open to fraud and abuse.
Stephen Downie	Yes, it was pretty open to fraud from the start. If you offer £50,000 to any company with a limited supply of information and only a few checks, then it doesn't take a genius to tell you that fraud or misuse is almost inevitable. I recall the FT publishing an article which stated that, despite the pessimistic outlook, there was great positivity in terms of the increased number of new companies being incorporated. I think we know why now don't we?! The fraud and abuse of the scheme has been the subject of many a media article and we're all seeing fairly regular updates about criminal charges against some borrowers or people being pursued for various frauds committed around this overly generous lending and grant schemes available from government. Internally, our team at Francis Wilks & Jones is also seeing lots and lots of investigations by the Insolvency Service, particularly into directors' conduct, with a view to assessing whether a director of an insolvent company should now be disqualified for misusing the bounce back scheme.
Maria Koureas-Jones	I think considering the big numbers we are talking about the big question on all our tongues is: how will the bank and government recover the money that has been borrowed? Inevitably there are a variety of processes that will be deployed: ▪ criminal proceedings, for example, against some fraudsters ▪ civil court action by the bank seeking repayment of businesses that are still trading but haven't repaid the loan ▪ the banks are likely to pursue possible winding up proceedings also against borrowers who remain trading but have defaulted on loan repayments

	▪ and finally, through an insolvency process, so where a company borrower has entered an insolvency process, investigations by the insolvency practitioner to see whether there is a claim the company should pursue against the directors personally to increase the return to the company creditors is likely.
Stephen Downie	Maria, I mentioned earlier that we are seeing lots of investigations by the Insolvency Service into directors' conduct following a company failure where there is has been a bounce back loan taken. One additional tool, which may be used by the government to recover monies owed under a bounce back loan, is something called a compensation order. Now I remember these being introduced in 2015. They weren't really used a lot at the time, but they can lead to personal claims against directors who find themselves subject to disqualification proceedings.
Maria Koureas-Jones	Steve, how long after disqualification proceedings can the Secretary of State seek a compensation order?
Stephen Downie	It's two years from the date that the disqualification order is made, or a disqualification undertaking is entered. Compensation orders have historically been used to claw back losses suffered as a result of a director's conduct and in the current circumstances we anticipate that the main loss that will be focussed on will be the loss to HMRC. We can see this option being used as a tool to recover the bounce back loan, maybe plus interest and it will all be repayable by the directors personally.
Maria Koureas-Jones	It is worth us mentioning that traditionally director disqualification proceedings have followed an insolvency process so, as long as the proceedings were issued within three years of a company's insolvency, that's been an option that has been available.
Stephen Downie	That's right – so potentially, a director could be subject to director disqualification proceedings issued before the end of a three-year period after the company's insolvency and then, once those proceedings are determined (which if it is a contested disqualification claim could take 1-2 years), the director then faces the risk that they can then seek a compensation order within the next two years after the date of the disqualification order or a disqualification undertaking. So if you tot those numbers up you are talking up to seven years after the insolvency. Once a director is disqualified – whether they voluntarily undertake to be disqualified or are disqualified following litigation proceedings and a court order is made – then the defence to a compensation order is really quite limited - something we tend to refer to in the law as strict liability offence and the main focus will then be the evaluation of what loss a former director has to repay or has personally incurred leading to the loss. But there are, and I say this cautiously because it is still early days, but there are some defences that I am aware of that could be used to defend against compensation order applications or other cross applications which may not be so obvious, but I will remain quiet about that for now.
Maria Koureas-Jones	We have obviously mentioned that director disqualification proceedings are most commonly use following an insolvency process but, during the pandemic, a number of companies took bounce back loans and then simply dissolved their companies, so this was choosing to use the strike off process available through the Companies House process rather than placing the company into a formal insolvency process.

Stephen Downie	Maria, you also mentioned that liquidators and administrators may also pursue directors for such losses.
Maria Koureas-Jones	Absolutely. So in addition to the director disqualification route we are also seeing directors potentially exposed as a result of claims by liquidators of companies that have taken bounce back loans. So now that government financial support packages have been withdrawn, debt incurred during the pandemic period obviously needs to be repaid. In October 2021 it suddenly became possible for creditors to also look at issuing winding up petitions again, albeit the debt has to be more than £10,000 which is higher than pre-pandemic levels. But as a result of these factors, we are expecting an increase in the number of corporate insolvencies. So, we are talking here about companies being placed into an insolvency process such as administration or liquidation and this can either be by the director themselves choosing to appoint an insolvency practitioner simply because they just can't continue to pay the payroll or meet the debts that are due and owing but it is also as a result of the court making a winding up order in respect of companies. So, we know from the stats released for October 2021 that there was an increase in the number of director-appointed liquidations. What we are not yet seeing is an increase in the number of court liquidations or court winding up orders but certainly the level of director-appointed liquidations is at a higher rate now than it was before the pandemic.
Stephen Downie	And we expect it to fully continue to increase with the increased winding up petitions. We expect the number of company or corporate insolvencies to increase further in the next six months given: 1. The expectation that there will be a gradual increase in the number of winding up petitions; 2. The need for businesses to repay the pandemic related debt and; 3. The increasing business costs arising from conventional trading. There are numerous ripples in the economy that the pandemic has caused - supply related problems, recruitment related problems and all of them are contributing to increasing business costs. So, it is tough out there for the SMEs.
Maria Koureas-Jones	And I think the point here is that, regardless of whether a director decides to appoint a liquidator or there ends up being a winding up order, a liquidator will be appointed and that liquidator will analyse the company's accounting records, will look at the company's accounts, books, bank statements and, where there is a bounce back loan, the liquidator will look at whether that loan has been repaid, what it was used for and whether the company did in fact meet the criteria that it had to self-certify when making the application to the bank for the loan.
Stephen Downie	And we can have a quick look at the eligibility criteria, the number one problem being that you can ask for any information but if you require no proof of that information then they can make up anything to get a loan so it effectively can turn into a free money process but the directors who may face such claims when applying for the loans had to self-certify that the company: ▪ Firstly, had been adversely affected by the pandemic;

	▪ Secondly, was engaged in trading or commercial activity since or before 1 March 2020; ▪ Thirdly, was not in business difficulty as of 31 December 2019, that's well before the pandemic; ▪ Fourthly, was not in liquidation or undergoing any debt restructuring at the time of the application; and ▪ Fifthly, it derived more than 50% of its income from trading activity so that effectively excludes companies that should not have been affected by the pandemic such as investment companies.
Maria Koureas-Jones	There is no doubt that we've seen, as a team, a huge number of cases where the self-certification by directors has quite simply been false, either as a result of companies who had ceased trading prior to the pandemic applying for a bounce back loan or companies that had attempted or started going through the dissolution process applying for a bounce back loan. So, we are not talking about a small number of directors who face an issue here it is a much bigger number than you might imagine.
Stephen Downie	Yes, it's pretty serious, we've seen some where the business was obviously already in financial difficulties as at the end of December 2019. This loan scheme came along and a fraud on the loan application form the consequence of which could be quite severe for that director.
Maria Koureas-Jones	So, where it is obvious on a review that a director has made a false statement regarding the company's eligibility for the bounce back loan and where the debt is outstanding, a liquidator will pursue a claim against the director who has falsely signed the application for a bounce back loan. There will be a claim against the directors personally and we can't hide from the fact that these are going to be where judgment is obtained enforced against the director's personal assets and this of course includes the family home.
Stephen Downie	Yes, unfortunately so. Maria, we have seen examples of directors transferring the bounce back loans from the company to their personal accounts. Now, unless this payment can be justified, and when having regard to the duties that a director owes to the company, this again is likely to see a director at the receiving end of a claim. For the listeners, we have another podcast on director's duties and what a director owes to the company and other third parties and that may be worth a listen.
Maria Koureas-Jones	Alternatively, listeners can have a look on our website www.fwj.co.uk for this information, this podcast you are currently listening to and the other podcasts in our series. Steve, whether the payment from a company to a director can be justified is perhaps not as black and white as you might think it is.
Stephen Downie	No, absolutely.

	This area is all about conduct, behaviour and what was right or wrong and so it always tends to be quite grey and when a person thinks they are right, and they are absolutely right they are usually wrong. If a company has received a bounce back loan of £50,000 and that has been transferred to a director's personal account the following day, this is a fairly black and white scenario in which the director is unlikely to be able to justify sending the monies to their own account. But it is not always the case – for small companies legitimate business expenses may be, because of timing issues, paid by the director personally or they may not even yet have a company bank account or they may not even run a company bank account. In a lot of cases the actual use of funds will demonstrate whether the money was just effectively stolen or was instead used practically for the company's benefit but perhaps not in a very clean way. It is the actual behaviour rather than the form of the behaviour that is important. Where a director has breached their duties to a company, the liquidator will certainly pursue a claim against them for repayment of the bounce back loan of £50,000 plus interest running from the date they transferred the loan out of the company and there will be the liquidator's legal costs. So £50,000 can very quickly become £150,000 if you don't pay early attention to the problem. In addition to these breaches of duty, there are other claims under the insolvency regulations and at common law.
Maria Koureas-Jones	I think going back to the black, white and grey situations, if a company has received £50,000 under a bounce back loan, the company's staff have been placed on furlough and the company's director was not eligible for furlough, if genuinely the director had no other income and continued to pay themselves a monthly sum that was at a similar rate to that paid pre-pandemic it is likely to be difficult for an insolvency practitioner to pursue a claim for repayment of those sums.
Stephen Downie	You are absolutely right Maria. There has to be a balance of common sense in these situations. Each case is going to be very fact specific and has to be determined against the background of the events and in consideration of the duties the director owes to the company.
Maria Koureas-Jones	It certainly is and this is recognised by the profession in its entirety so R3, the Association of Business Recovery Professionals, issued guidance earlier this year for insolvency practitioners specifically on the issue of bounce back loans. These FAQs reinforced that assessment will need to be made based on the facts and based on what the bounce back loans were used for and they recognised that bounce back loans used to pay reasonable living expenses at a rate similar or lower to pre-pandemic rates are likely to be fine but if a director has of course received the money, paid it to themselves within a very short period of time and that these sums outstripped all previous drawings, that is likely to land a director in hot water.
Stephen Downie	So, we have black, white and a huge amount of grey - unlike me, hopefully for a long period of time! This means that where a director does receive enquiries from a liquidator with regard to a bounce back loan, they need to take advice prior to responding. It is important that the director communicates with the liquidator in a way that reduces their personal risk. It is also important that the director if they are in a situation where he / she is simply going to be unable to justify their personal use of the bounce back loan, they should take early advice about their exposure of such repayment demands and what they can do to

	mitigate or reduce this exposure for example by properly examining any set-off claims or any sums owed by the company to them or whether they have just partially used such funds for legitimate company expenses.
Maria Koureas-Jones	So true, the bottom line is if a director is in a position where they are simply not going to persuade a liquidator or, more importantly, the court, that their use of the funds can be justified, they need to be really careful about running spurious defences that are destined to fail and will simply serve to increase their own exposure both to the amount payable back to the company but also the liquidator's costs, court fees, disbursements, all those sort of additional costs.
Stephen Downie	Yes, so in the majority of cases, it is likely that there will be a grey area almost always and therefore it is important that a director does not say anything to reduce their available defences, when liaising with liquidators in the early stages, following their appointment. A director is under a statutory duty to co-operate with the company liquidator so we are not saying that you shouldn't co-operate, you have to co-operate with their reasonable requests for information relating to the company, but we are simply suggesting that a director needs to consider whether the use of the bounce back loan funds can be fully or partially justified when having regard to their duties which they owe to the company.
Maria Koureas-Jones	I think one of the things we are regularly seeing as well is that what a director thinks may amount to justification might actually differ quite materially from what the court would regard as justification for spending company money, and this is often arising from the fact that directors frequently understand their business extremely well but do not necessarily understand the ins and outs of the director's duties owed under the Companies Act. So, a common example is where a director is running a business, a friend or family has lent money to that business, that friend or family member is pushing for repayment, there are other creditors, but the director in an attempt to keep those pressings wolves from the door actually takes the decision to simply pay off the relative or friend. So, where there is an admission of that made post appointment of a liquidator it is going to materially reduce the options available to the lawyers and the defences available to decrease the overall liability. So, I think the point here is just make sure you take early advice because what you think is justification and what a director thinks is justification for that payment we have just mentioned might actually shoot that director in the foot because in this instance it would amount to a preference payment.
Stephen Downie	We are not telling people to lie or withhold truths, but it is getting into context legally the background and the global view of what was happening with the company is the correct approach to take rather than just answering questions individually without considering all the other aspects. But obviously Maria all of the above assumes a bounce back loan was taken, and then either the company was dissolved or placed into an insolvency process. As we have just discussed, both of these have a mechanism for policing the director's conduct and, if necessary, taking action against that director to seek compensation for the losses arising. But where the borrower isn't in an insolvency process - or rather the company isn't in an insolvency process and hasn't been dissolved - then the banks will be using their standard debt recovery routes to seek payment from a company. This will include court actions against the company, seeking judgments, enforcing the

	judgment and then there are other available enforcement options against the company's property which could comprise further court proceedings or the instruction of a high court enforcement officer or a bailiff to seize company assets.
Maria Koureas-Jones	And let's not forget as well the bank's option of seeking to pursue the insolvency route either by issuing a statutory demand or a winding up petition against the company which obviously, where a winding up order is made, will lead to the consequences that we have just been discussing. Given the existence of the government personal guarantee of these bounce back loans I think one of the things that we are not sure of particularly having regard to the costs that the banks will incur in proceedings with a debt recovery route is the extent to which the banks will utilise the process, I suspect that that is going to come down to very much how obvious it was that the director made a false statement for example on the application and time will tell.
Stephen Downie	Yes, legal proceedings can be expensive and not always the best option where the amount claimed is not a mammoth sum. I think the key here is that there are various avenues open to the banks and government to recover the huge debt of unpaid bounce back loans incurred during the pandemic in the sum of £33.7 billion, which is a sizeable chunk of money which we, our children, our children's children, and our children's children's children will probably be paying off through taxes for years and years to come going into the future.
Maria Koureas-Jones	Steve you mentioned earlier context and I think this is really important because as a team we are regularly helping directors and we understand and see the immense pressures that directors have been on both professionally and personally actually during the pandemic so I think ensuring that using the well-used phrase, "unprecedented times" ensuring that the message regarding the context of decisions being made in unprecedented times is really important but also enveloping those in a way that actually has a valid legal defence is going to be extremely important.
Stephen Downie	Yes absolutely and the problem that the courts, government, banks, anybody not having personally been involved in running the business from the bottom up is that they don't understand the pressures of setting up a business and continuing to run a business, profit margins etc. etc. They just analyse or make decisions on them after the event. We've frequently referred to ostrich syndrome in our previous podcasts, which is the normal reaction of any debtor – they ignore letters or emails of enquiry and pressure, and generally hoping it will all go away with the consequence that the overall cost of all of this will just continue to rise as more and more professionals are employed to enforce the debt. But I do feel that we are giving them a bad name (I am talking about the ostriches here) Ostrich Syndrome is a phrase we use for sticking your head in the sand in circumstances where the use of a bounce back loan is almost inevitably going to give rise to a claim against directors personally. In those circumstances, it is unwise to ignore such claims and seek assistance early as delaying such enforcement will only increase your exposure.
Maria Koureas-Jones	Completely and I think this is true either where a business has gone through an insolvency process or dissolution or is perhaps in receipt of a winding up petition but also even before then if you have a live company where you know that there is a bounce back loan that cannot be repaid take steps early to try and mitigate those losses, it is really

	important.
Stephen Downie	And the same for professional advisors most popularly accountants, who will usually see the red flags early and are in a better position to fulfil their professional duties and assist their clients and their businesses and may even partake in such advice early preserve the businesses. If you are an accountant with clients who are unable to repay bounce back loans or you are a director of a company in this boat, then have a review of your repayment options and take steps early. At Francis Wilks & Jones our experienced team is more than happy to help accountants, companies and directors navigate the issues flowing from the bounce back loan scheme.
Maria Koureas-Jones	You have been listening to a podcast from Francis Wilks & Jones, presented by myself Maria Koureas-Jones and my colleague Stephen Downie. So, for now, it is goodbye from me.
Stephen Downie	And it is goodbye from Maria.