BUSINESS RECOVERY AND INSOLVENCY

Bounce Back Breaches Exposed

As one of the measures introduced during 2020 to support businesses affected by COVID-19, the Bounce Back Loan Scheme ('BBLS') was designed to help small and medium-sized businesses obtain low-interest, Government-guaranteed bank loans of between £2,000 and £50,000. As at 31 July 2022, UK businesses had drawn a total of £46.6 billion through the BBLS and a recent evaluation of the scheme concluded that up to 500,000 businesses could have permanently ceased trading in 2020 in the absence of the scheme.

To assist those businesses struggling to repay their bounce back loans, the Government launched Pay As You Grow (PAYG) in September 2020. The package of options included an extension of repayment terms from 6 to 10 years at the same fixed interest rate of 2.5%; a reduction in monthly repayments for 6 months by paying interest only and short-term repayment holidays.

Insolvency and the liquidator's enquiries

So what about those failing businesses that, in spite of the support on offer, find themselves with no prospect of ever repaying the amount borrowed? In the event of liquidation, what difficult questions may be asked by the appointed liquidator regarding the original reasons for the loan and the subsequent disposal of the funds? In addition, what consequences may arise if the bounce back loan scheme application did not provide an entirely truthful reflection of the business' financial status at the time or the monies had, for example, been used to clear a director's personal car loan rather than to service essential company overheads?

BBLS applications were subject to certain conditions; chiefly, that all monies borrowed must be used for the 'economic benefit' of the business; the amount advanced was based on the level of turnover generated in the year to 31 December 2019 and businesses must have been in operation as at 1 March 2020. Of course, no application evaluation process can be 100% water-tight and the pressure on bank staff to process high levels of applications at speed – amidst COVID sick absences and the overall turmoil of the pandemic - no doubt meant that not all submissions were scrutinised in as much depth as they should have been.

In addition to other areas of potential director misconduct, insolvency practitioners are now required to report to the Insolvency Service specifically on the use of bounce back loans. These investigations are heavily reliant on information provided by directors – who may or may not always be honest with us - and, most crucially, that common source of evidence for so many forms of monetary misconduct – historic bank statements.

The consequences of breaching BBLS conditions

We are now beginning to see reports of the enforcement actions taken by The Insolvency Service and the courts as a result of investigations that unearthed deliberately misleading BBLS applications and the use of loans for purposes other than 'economic benefit'. The penalties can be severe, with 12-year disqualification terms being imposed on the most serious offenders along with custodial sentences in the very worst cases. As would be expected, the length of the ban reflects the level of monies misused and the number of application conditions breached.

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One director was recently disqualified for 2 years and 6 months as she had 'abrogated her duties' by allowing a £50,000 loan to be invested in a third party's business and to pay for the completion of works for which no evidence could be produced. Her co-director, who presumably had a more direct role in the misconduct, received a 5-year ban.

At the more severe end of the scale, Brendan Gaughan of Glasgow was disqualified for 12 years – 15 years being the maximum term - as a result of borrowing a total of £135,000 via three companies but failing to meet the scheme's eligibility criteria, having not started trading until April 2020, i.e. after the required trading-as-at 1 March 2020 point. Undoubtedly more of an influential factor on the length of disqualification term was that Gaughan then transferred all the funds into a single account and proceeded to use the money to buy a property worth nearly £160,000 in August 2020. He sold the property in March 2021 for just over £140,000, and on the same day transferred £100,000 of the proceeds to his personal account.

Can directors pay themselves from Bounce Back Loan funds?

Whilst Gaughan's actions were clearly self-serving and in direct conflict with the purpose of the BBLS, what about the director who interpreted 'economic benefit' to include his or her own remuneration as an essential overhead? Furthermore, during the height of pandemic with its devastating impact on turnover across a range of sectors, it is perhaps understandable that some directors - out of desperation or ignorance – ended up relying on bounce back loan funds to directly or indirectly assist with their personal financial predicament. Whilst the scheme allows for payment of usual salaries, many directors will receive most of their personal income as dividends and unless the company has profits equal to the dividend paid – a tough challenge during the COVID era – the dividend is likely to be deemed illegal. Therefore, in the absence of reserves, the use of bounce back loan monies to finance such payments would certainly be a significant factor when deciding upon the severity of any penalty, particularly if dishonesty played a part in the application process. A stiff disqualification term of 11 years was, for example, recently imposed on a director who gave false information to obtain two loans and then used £50,000 for 'salary and dividends'.

In view of the extensive take-up of bounce back loans, the ongoing economic turbulence and the extraordinary circumstances of the pandemic with its destabilising effect on rational decision-making, we expect to see evidence of many more BBLS breaches as time goes on. If your clients are experiencing difficulties in repaying any form of Government-backed loans, BRI can help with free practical advice.

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