ReedSmith

Financial Industry Group

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# ReSearch Memo

## Negative Net Assets

When is a company in insolvent? When is a company's assets less than its liabilities (taking account of contingent and prospective liabilities)?

Under English law this is a commercial test and requires that a company has reached a "point of no return" and is not based solely on a review of the company's balance sheet:

> *It is only when it can be said that the company's use of its cash or other assets for current purposes amounts to what may be vernacularly characterised as a fraud on the future or contingent creditors that it can be said that it "has reached the point of no return"* (BNY Corporate Trustee Services Ltd v Eurosail-UK 2007-3BL Plc [2011] EWCA Civ 227c, per Lord Neuberger MR at paragraph 49, the "Eurosail Case").

Further, in the Eurosail Case, Lord Neuberger MR said that if the test was whether the company's aggregate liabilities exceeded its aggregate assets as shown on the balance sheet, then:

> *"many companies that were solvent and successful and many companies early on in their lives would be deemed to be unable to pay their debts… [it would be hard to] discern any conceivable policy reason why a company should be at risk of being wound up simply because the aggregate value (however calculated) of its liabilities exceeds that of its assets."* (paragraphs 44 and 47).

A factual determination that the company is at the point of no return is required - an exercise beyond simply looking at the numbers on the balance sheet.

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