



### **“Business Failures – Criminal Liability and the Zone of Insolvency”**

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When a business enters the failure zone, or even gets near it, those responsible for managing the daily business operations assume an additional amount of liability for their actions.

#### **Criminal Liability**

You need to be careful during this period. Along with being the subject of a civil action, if the actions you take related to the turnaround are deemed inappropriate in certain respects, you could find yourself the target of criminal charges.

#### **The Zone of Insolvency**

With respect to bankruptcy law, the owner of a business or a corporate director can be held liable for their actions when a business is having trouble. Simply put, the legal system recognizes a phrase called the “zone of insolvency.” This is a certain time period when a company leader (corporate director or small business owner) must not only take into consideration the goals of the business proponents, but the leader must also be concerned with the goals of the creditors.

This zone is defined, traditionally, by applying two tests to determine if the company is insolvent and has thus entered this “zone.” The first test considers cash flow, and specifies that a business enters the zone of insolvency when it can no longer meet its ongoing obligations—in other words, when it can no longer make payroll or pay its rent or other ongoing expenses.

The second test considers the balance sheet elements, and specifies that a business enters the zone of insolvency when liabilities exceed assets. However, these tests vary by state. It is important that a business owner understands that this zone exists, and when a company has entered into



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this zone, there is the possibility of liability on the part of the business leader.