“The Zone of Insolvency During a Business Failure”

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When the company is operating normally, and there is no threat of failure or need for a turnaround, the business leaders can prioritize the needs of the business over those of the creditors. However, when a company enters a period that is near a potential failure, the legal system identifies a term called “The Zone of Insolvency.”

Inside the zone of insolvency (or near it, since it is not strictly defined), fiduciary duties change, and the goals of the creditors must be balanced with those of the company.

Note that in times of severe economic duress, company assets can undergo drastic changes in value (real estate for example), so it becomes more critical that the business leader have a good understanding of the true value of assets so that liability is not induced inadvertently.

Some assets are also difficult to calculate a fair value on, goodwill for example. For these reasons, it is critical that business leaders get up-to-date asset valuations and document every transaction more than the might do so at other times. There must be no malicious actions, plans of fraud, or dishonesty.

Since determining insolvency is not an accurate science, it is best that when a company is close to the zone of insolvency, the business leader act as though the zone has been entered. This is necessary to avoid possible problems related to civil and criminal liability.

One this is certain: you have to operate carefully during the Zone of Insolvency lest you ultimately end up being charged for your actions either in criminal court or civil court.