

Directors' Duties

MAKING DECISIONS DURING COVID-19

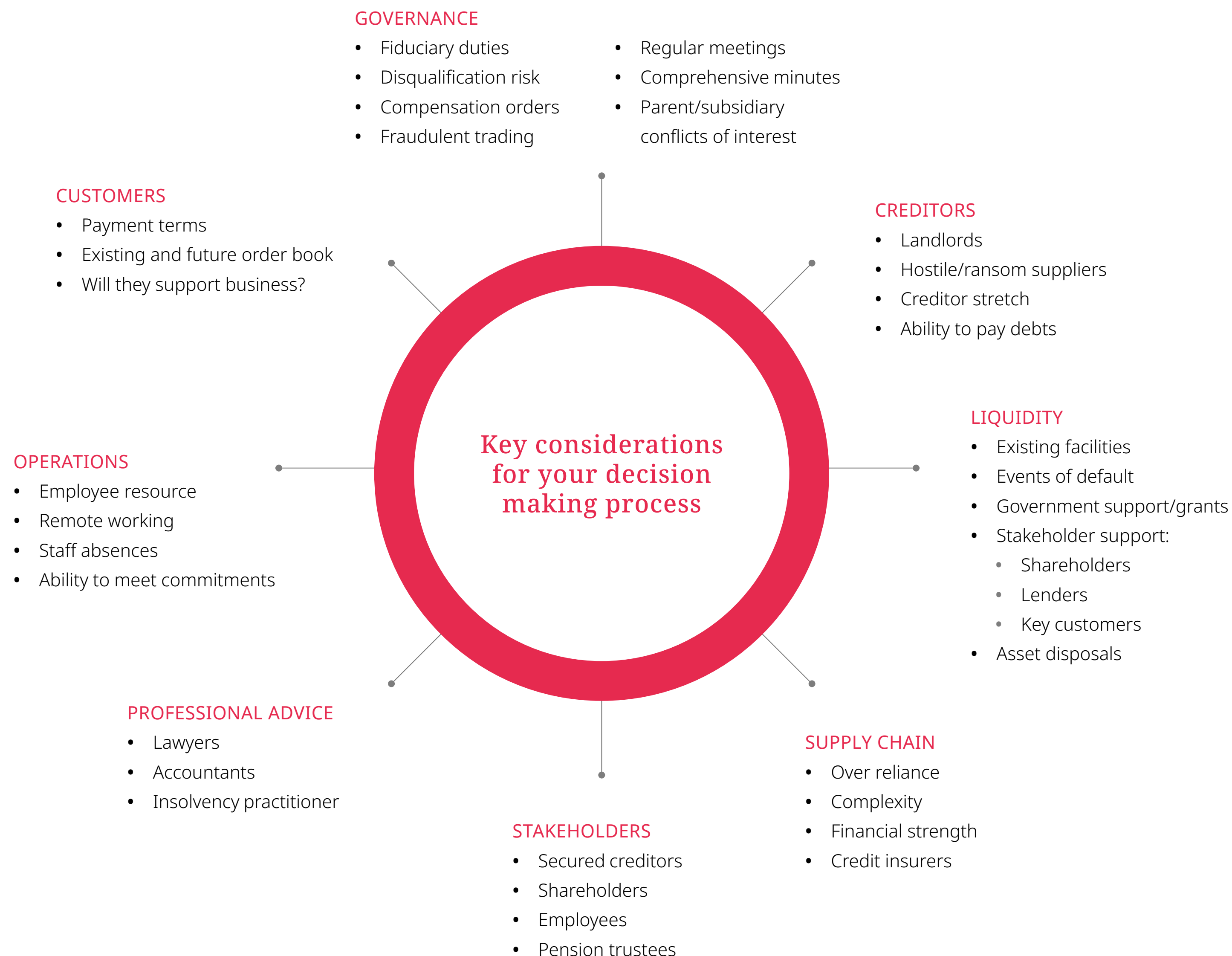
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Decision making in a crisis

Directors need to carefully consider how to address the risks of the ongoing Covid-19 pandemic within their business, given its impact on the global economy. As many companies are continuing to face significant, and increasing, cash flow pressure, directors should carefully consider their actions in the context of the legal framework (please see Key Legal Considerations on page 4). Although the Corporate Insolvency and Governance Act 2020 included provisions that temporarily suspended liability for wrongful trading this temporary suspension lapsed on 30 September 2020. A second suspension on wrongful trading was announced on 26 November 2020 and initially applied for the period between 26 November 2020 and 30 April 2021. The suspension has subsequently been extended to end on 30 June 2021.

Much of the UK regime revolves around directors acting "reasonably". What may or may not be considered "reasonable" will in any case be considered by reference to the prevailing circumstances.

Directors should carefully consider the implications of taking on additional credit (and deferring settlement of existing liabilities). They should rationalise whether adding additional burden to the balance sheet will ultimately benefit its stakeholders. This is often a difficult decision to make, but is likely to be particularly challenging during this period given the continued uncertainty over market conditions. Directors will need to act responsibly and reasonably, to protect value and minimise loss and evaluate carefully whether continuing to trade is in accordance with their duties as directors.



We strongly recommend that directors take practical steps to protect their business as follows:

Governance: Hold regular board meetings with the benefit of professional and legal advice to consider the company's current financial position and directors' duties. Ensure comprehensive minutes are taken.

Consider viable alternatives: Directors should ensure they have considered all available options and carefully analyse their respective merits and cost.

Liquidity and creditors:

- Prepare up to date cash flow statements, management accounts and projections, consider availability of existing facilities (e.g. checking events of default which may prevent drawdown).
- Consider alternative means of support (e.g. stakeholders, key customers, government backed facilities, disposals of assets).
- Consider whether outflow of cash to creditors can be managed/delayed. In particular speak to landlords, HMRC and key suppliers.

Operations: Analyse the basis on which business can continue to operate. Are staff able to work remotely? Is workforce size sustainable?

Customers/suppliers: Trading partners are facing their own challenges. Take into account the likely size of future orders and robustness of supply chain.

Seek professional advice: From your lawyers, your accountants and potentially from a licensed insolvency practitioner.

Plan:

- Companies have been entitled to defer VAT due between 20 March 2020 and 30 June 2020 to 31 March 2021. Companies may also opt to split deferred VAT into 11 smaller interest free payments to be paid during the 2021-2022 financial year. Companies need to budget to pay this deferred VAT in full no later than 31 March 2022.
- The government has extended support to prevent business evictions until 30 June 2021, but companies will need to budget to pay their rent in full when the restrictions are lifted (unless this date is further extended or other agreement is reached with landlords).
- Businesses in the retail, hospitality and leisure sectors in England do not have to pay business rates for the 2020-2021 tax year or from 1 April 2021 to 30 June 2021, after which rates will be discounted by two-thirds from 1 July 2021 until 31 March 2022 but companies will need to budget for the full liability for the following tax year.
- Other key creditors (including lending banks) might also be willing to grant "breathing space" to companies facing a liquidity squeeze brought on by the current crisis. Directors will be best placed to take advantage of any such assistance if they can present a clear plan as to how their business will weather the storm.

Experience demonstrates that a proactive and consensual approach, with early engagement, presents the best prospect of a successful resolution, protecting directors and preserving value for stakeholders.

Role of directors

Key legal considerations

- **General duties of directors:** Directors are subject to statutory duties which will apply to them whether or not the company is, or is likely to become, insolvent. Directors should continue to comply with these duties and seek advice as to how they should do so in circumstances of uncertain insolvency, as the approach they should take may be different to the approach they would take when the company is solvent.
- **Duties during insolvency or potential insolvency:** Under solvent circumstances, directors are generally obliged to consider their duties by reference to the company's shareholders. Once the directors know, or should know, that the company is or is likely to become insolvent, the interests of the company's creditors need to be taken into account. The weight that must be given to such interests is difficult to pinpoint – prudent directors will err on the side of caution.
- **Non-executive directors:** Non-executive directors are subject to the same standards of care as executive directors but the application may differ due to differences in role and function. Also, directors with a greater level of experience will be subject to higher standards of care.
- **What if I've not been formally appointed as a director?** Persons who may have played a role in the company's management could be deemed to be shadow or de facto directors. A de facto director is treated as a director as a result of his actions and functions regardless that he has not been formally appointed to the role. A shadow director is a person in accordance with whose instructions the board is accustomed to act e.g. someone is "pulling the strings" behind the scenes. Both involve the exercise of real influence and both are subject to the same duties as formally appointed directors.

- **Group of companies:** Where a business operates via a number of companies, directors should also consider how conflicts may arise between those entities as they owe their duties to each separate entity (rather than the group as a whole). If any companies are in overseas jurisdictions, then the directors of those entities will be subject to the laws of that country.

WRONGFUL TRADING:

Directors will not be held liable for wrongful trading simply because the company was trading whilst insolvent. The main strand of the test is whether the directors know, or ought to have concluded, that there was no reasonable prospect of avoiding insolvent administration or liquidation.

Directors should therefore seek to implement a strategy which has a reasonable prospect of avoiding insolvency proceedings. Whilst we recommend that at all times they should protect value and minimise losses, legislation states that once there is no such reasonable prospect they should take every step with a view to minimising potential loss to creditors. In such circumstances they should consider carefully whether to continue trading. If they do trade on, this must be carefully justified and would require very careful navigation with the aid of expert advice from both their lawyers and an insolvency practitioner. In any case, the strategy and the reasons for it should be regularly monitored and properly minuted at board meetings.

Wrongful trading liability was temporarily suspended under the Corporate Insolvency and Governance Act 2020 which states that when considering the contribution a director is required to make to company assets, the court is to assume that a director is not responsible for any worsening of the financial position of the company or its creditors during the period 1 March 2020 to 30 September 2020 and during the period 26 November 2020 and 30 June 2021. Following the expiry of these periods directors can be held

personally liable for wrongful trading and should take this into account in their decision making.

FRAUDULENT TRADING:

Directors who are knowingly involved in the carrying on of a business with intent to defraud creditors can be held personally liable if the company becomes insolvent. Directors should therefore remain vigilant of their intentions when making and implementing financial and other business decisions.

DISQUALIFICATION:

Liquidators and administrators are obliged to report on the conduct of all persons who have been directors of an insolvent company within the previous three years. Such directors can be disqualified from acting as directors or being involved in being a director of or managing or setting up companies if it is found that their conduct makes them unfit to do so. Directors can also be found personally liable and made to financially account for the consequences of their unfit conduct.

ANTECEDENT TRANSACTIONS:

Directors should also beware of breaching their duties by entering into transactions at an undervalue or preferences. These can be set aside if entered into within relevant periods prior to the company entering insolvent administration or liquidation.

SHOULD I RESIGN?

Resignation is unlikely to be an effective defence to potential liability. A director in office has a voice at board meetings and the potential ability to influence a company's decisions; that voice and ability to influence will be lost upon resignation.

Key contacts



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Adding value through experience

Our experience includes advising:

- The board of a private equity-backed information management business on directors' duties during a turbulent financial period for the client and its subsidiaries. Throughout the interim period leading up to the refinance, we provided specific advice in relation to the mechanics of the group's existing finance documents, including with regard to the existing unitranche lender's ability to appoint a fixed charge receiver. We assisted the board in obtaining a new facility from the unitranche lender in order to help bridge the company to a solvent restructuring.
- A British fashion group following a breach of financial covenants under its banking agreements. This included negotiating an amendment and waiver letter with the group's lender, providing ongoing advice to the board of directors on their fiduciary duties and advising on the restructuring options available to the group.
- The directors of all of the member subsidiaries of Carillion plc (other than the six "Topco" entities which entered liquidation on 15 January 2018). This focussed on stabilisation of the group, orderly disposal of assets, including solvent sales of profitable corporate entities, sales of equity joint venture interests, advice to directors and placing entities into solvent liquidation.
- The directors of a global aviation business in relation to contingency planning across multiple jurisdictions, issues around US Chapter 11 proceedings and the disposal of one of the business' UK airlines.
- The UK subsidiaries of Aviator on all aspects of the controlled wind-down and transition of the group's UK operations including implementing an interim funding arrangement, directors' duties and wrongful trading advice, transition of the various aspects of the business to other providers and employee issues.
- The directors of a facilities management business on a number of matters, including their duties and the risks arising from a transaction which involved the termination of a Private Finance Initiative contract and commercial aspects of the future relationship.
- Allianz on defending the wrongful trading claims against the board of directors and supervisory board of an insolvent group of real estate companies.



Thank you



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