Legal Risks and Practical Considerations for Company Directors During the COVID-19 Crisis

John W Gibson; Thomas Shortland; Ashley Collins

Introduction

The COVID-19 pandemic presents directors of all business entities\footnote{In this article we use the term ‘Directors’ to cover, in general terms, executive and non-executive directors, senior officers, private owners of corporate entities registered in England & Wales and LLP partners in this jurisdiction. However, the scope and applicability of legal provisions discussed may vary depending on the context.} with a profound and unprecedented set of challenges. Now more than ever, key decision-takers in businesses appreciate that their actions will be carefully judged following the crisis. Scrutiny of their actions will come from a range of interested and affected parties including creditors, employees, trades unions, landlords, customers, regulators, insolvency practitioners and possibly even law enforcement.

Amidst their present challenges, directors could be forgiven for anticipating condemnation whatever action they decide to take. Whether to make redundancies or furlough staff? Whether to take up government business continuity schemes or soldier on without? Whether to negotiate immediate business tenancy rent reductions or rent holidays? How to ensure costs are minimised while cash flow is challenged? Whether to take-up risky but potentially lucrative opportunities arising from tectonic shifts in markets?

In exercising their functions, directors must plan for all eventualities and take practical steps to ensure that robust systems of monitoring and review are firmly in place. They must pay close attention to the scope of their duties and liabilities. Directors must undertake contingency planning or deploy their contingency plans to ensure that they are best-prepared when decisions taken during the COVID-19 pandemic are examined.

A functioning, disciplined, transparent, and fully informed Board is essential, as is the contemporaneous recording of key decisions and the rationale for those decisions. This may seem trite, but clear evidence of an informed and reasoned decision making process will prove invaluable during ex post facto analysis of a business decision that, at the time made, was perfectly justifiable but which turned out later to be simply the “wrong call”.

This article outlines the species of scrutiny that directors must prepare for, together with some practical advice, informed by applicable legal principles, on navigating difficult business decisions during the crisis. Specifically, we address:

1. Key areas of potential legal risk for directors during the COVID-19 pandemic;

2. Key considerations for directors when taking business decisions during the COVID-19 pandemic; and
3. Practical steps that directors can take now to ensure that, in the event of a business failure arising from the COVID-19 pandemic, they are adequately protected in the event of scrutiny of their management and supervisory actions.

Key Areas of Potential Legal Risk

1. Civil Liability

Insolvency Law and Directors’ Duties

On 28 March 2020, the UK government announced there would be a range of measures designed to “improve the insolvency system” with the objective to “help UK companies which need to undergo a financial rescue or restructuring process” during the COVID-19 pandemic. To that end, it was announced that the “wrongful trading” provisions of the Insolvency Act 1986 (the “1986 Act”) would be suspended for three months, taking effect from 1 March 2020.

The 1986 Act stipulates that a director (or former director) of a company can be found liable for wrongful trading if they continue to trade in circumstances where they knew, or ought to have known, at some point before the company’s entry into administration or liquidation, that there was no reasonable prospect that the company would avoid going into administration or liquidation, and failed to take every step to minimise future losses to the company’s assets and creditors. The director may be required to make a contribution to the company’s assets for an amount which the court sees fit. The amount which the court may order the director to pay is discretionary and calculated on the losses accrued as a result of the company continuing to trade.

Whilst the suspension of the wrongful trading provisions may provide some comfort and reassurance to directors, it will remain essential for them to closely monitor the financial position of the company for a number of reasons:

- At the time of writing, details of the suspension are yet to be published. Parliament remains in recess until 21 April 2020. The government is currently silent on whether the suspension will be applicable to every business. Directors should remain cautious until the legislation has been passed.

- As far as we know, the suspension is a temporary measure and the wrongful trading provisions will be reinstated from June (unless Parliament extends the deadline). Directors should therefore be taking steps during the suspension period to ensure they do not fall foul of the wrongful trading provisions once they are up and running again. It is unclear at this stage what consequences there would be for a director who knew, or ought to have known, that the company was at risk of entering administration towards the end of the suspension period, and the company continued to trade once the wrongful trading provisions are reinstated. It is difficult to predict at this stage how the court will interpret cases such as this and what steps, if any, a director is expected to take.

- Whilst the trading provisions are suspended, directors’ duties to creditors will remain. It is likely that, as a result of the suspension, creditors will want to know more than ever whether a company is at risk of becoming insolvent. Directors will need to understand and continually assess the parties to whom duties are owed. Ordinarily, a director must act in the way they consider, in good faith, would be most likely to promote the success of the company for the benefit of its shareholders. However, when it becomes probable that the company will become insolvent, directors are then required to act in the best interests of the company’s creditors.

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2 Sections 214 and 246ZB, Insolvency Act 1986
3 Section 172(1), Companies Act 2006
4 Sequana S.A. v BAT Industries Plc and others [2019] EWCA Civ 112
• Despite the suspension of the wrongful trading provisions, there has been no suggestion of a relaxation of other insolvency law provisions which regulate the conduct of directors of insolvent (or potentially insolvent) companies, including the offence of fraudulent trading (where a director continues trading with the intention of defrauding creditors or for any fraudulent purpose) and the potential liability of former directors for certain prior transactions (including transactions at an undervalue, preferences, transactions on extortionate credit terms, and transactions intended to defraud creditors) and/or misfeasance. Directors must continue to observe their actions and obligations in this regard.

• The regime governing director disqualification will continue to apply, meaning that a director (or former director) of an insolvent company may be disqualified or restricted from acting as a director where it is determined that they engaged in conduct which made them unfit to be concerned in the management of a company. Whilst the suspension means that a director is currently protected from personal liability for wrongful trading, this does not prevent their actions during the three month suspension period being examined and investigated by regulators and/or the UK Insolvency Service in the event of a business collapse.

Notwithstanding the temporary relaxation of the wrongful trading provisions, directors should continue to consider closely the financial position of the company at all times to ensure that, in the event of financial instability within the company, there is a clear understanding of the parties to whom directors’ duties are owed, and to facilitate reasoned decision regarding whether to continue trading.

Civil Proceedings Following Business Failure

Directors should also consider the risk of follow-on civil proceedings in the event of a business failure. Such claims can often “piggy back” onto findings by regulatory authorities or evidence disclosed in criminal or other public proceedings. The nature of civil claims within this context can vary but may include claims by the company, the company’s shareholders or other stakeholders (subject to reflective loss issues) against directors personally for negligence, breach of duty, and/or misfeasance. In addition, directors run the risk of claims by insolvency office holders (administrators/liquidators) for forfeiture of director remuneration or clawback claims for remuneration already received.

2. Regulatory Liability

Under the Company Directors Disqualification Act 1987 (‘CCDA’), following investigation by The Insolvency Service (“TIS”) and upon the recommendation of the Secretary of State, a court may make a disqualification order against a director or shadow director of a company that becomes insolvent if their conduct as a director makes them unfit to be concerned in the management of a company. The disqualification regime under the CCDA also extends to a range of office holders including members of Partnerships and LLPs. The minimum period for disqualification is two years and the maximum is 15 years. TIS investigations can be prolonged and expensive and the publicity associated with contested disqualification proceedings can be reputationally damaging. In addition, where a director is disqualified,
that director may be made subject to a compensation order requiring the director to pay an amount for the benefit of ordered to pay compensation to the creditors of the insolvent company.\textsuperscript{14}

In navigating the difficult and unprecedented circumstances faced by directors during the COVID-19 pandemic, care should be taken to ensure that they are acting as fit and proper officers. A central pillar of this standard is the requirement that, at all times, the director honestly believes that their actions or omissions are in the best interests of the company.\textsuperscript{15} The director’s conduct will be viewed cumulatively and, importantly during this period, will take account any extenuating circumstances.\textsuperscript{16} Throughout the director’s tenure, the director is required to “inform [themselves] about [the company’s] affairs and to join with [their] co-directors in supervising and controlling them”\textsuperscript{17}.

Whilst the courts have made clear that “a proper degree of delegation and division of responsibility is permissible and often necessary, but not total abrogation of responsibility”,\textsuperscript{18} the question of whether a Director is ‘unfit’ will be assessed against whether the conduct fell below the standards of probity and competence.\textsuperscript{19} It is an established principle that a director’s alleged misconduct cannot be analysed by using the benefit of hindsight.\textsuperscript{20} Directors should take comfort that the law requires them to be judged from the standpoint of the situation as it was faced at the time. There is inherent opportunity here for a director to demonstrate that their actions at the time did not fall below the required standard even if, with hindsight, they would have done things differently.

Courts will likely have some sympathy for directors who have faced unprecedented issues arising from the COVID-19 crisis, which risk business survival. The principle of hindsight can therefore be harnessed and used as an advantage here. It provides a significant opportunity to prove that the decisions made by a director were well made and reasonable. To that end, the more a director can evidence the decision making processes, the closer a court or investigative authority will get to placing themselves in the director’s shoes at the time of the conduct under examination. Clear and contemporaneous records of the decision making which accurately reflect the rationale of the director’s thought process and the options that were before them are crucial. Moreover, such records should include how and why, by making such decisions, the director considered the business would be sheltered from critical risks and the identification of those risks.

Where the director operates in a regulated sector, the director may, following a business failure, face investigations and inquiries from the authorities enforcing the regulation of that sector, for example the Financial Reporting Council (for auditors, accountants, and actuaries), or Financial Conduct Authority (the “FCA”) (for financial services professionals). Investigations and proceedings initiated by such authorities can be time-consuming and costly. Even where allegations (whether criminal, regulatory or civil) against the director are ultimately dismissed in other proceedings, regulatory authorities may consider the underlying substance of the allegations when considering applications for permission to perform other regulatory activities. For example, in the financial services context, in assessing whether an individual is “fit and proper” to perform a controlled or senior management function, the Financial Conduct Authority will take into account a range of matters which include:

\begin{itemize}
  \item Section 15B(a), Company Director Disqualification Act 1986
  \item See Regentcrest plc v Cohen [2001] BCC 494 per Jonathan Parker J at [120]
  \item Re Grayan Building Services Ltd [1995] Ch 241 per Hoffmann LJ at p.253
  \item Secretary of State for Business, Innovation and Skills v Akbar [2017] EWHC 2856 (Ch); [2018] BCC 448 per HHJ Davis-White QC at [113]
  \item Ibid
  \item Re Grayan Building Services Ltd [1995] Ch 241 per Hoffmann LJ at p.253
  \item Re Living Images [1996] 1 BCLC 348
\end{itemize}
• whether the person has been the subject of, or interviewed in the course of, any existing or previous investigation or disciplinary proceedings;21

• whether the person is or has been the subject of any proceedings of a disciplinary or criminal nature, or has been notified of any potential proceedings or of any investigation which might lead to those proceedings;22

• whether the person has been a director, partner, or concerned in the management of a business that has gone into insolvency, liquidation or administration while the person has been connected with that organisation or within one year of that connection;23 and

• whether the person, or any business with which the person has been involved has been investigated, disciplined, censured or suspended or criticised by a regulatory or professional body, a court or Tribunal, whether publicly or privately.24

3. Criminal Liability

Directors are exposed to a spectrum of potential criminal liability, ranging from those governing serious misconduct (for example, false accounting25 and fraudulent trading26, which carry maximum sentences of, respectively, ten and seven years’ imprisonment) to those carrying less severe penalties. In cases in which financial impropriety is discovered, directors could also face liability for fraud27 and money laundering offences.28 Amid the COVID-19 pandemic, directors should be mindful, in particular, of the following three areas of potential criminal exposure.

Business Formalities and Record Keeping

The Companies Act 2006 prescribes over 150 criminal offences which can be committed by directors. Whilst many of these offences address serious misconduct (for example, a failure to keep adequate accounting records29), the Act prescribes a number of strict liability offences for what might be perceived as comparatively minor breaches of company legislation, including a failure to inform the Companies registrar of changes to a company’s articles of association.30 These offences can be committed by the company and “every officer in default”31 and, if convicted, proceedings for disqualification as a director could follow. Whilst we consider that, in many cases, it would not be deemed by prosecution authorities to be in the public interest to prosecute directors for such breaches of company legislation, particularly where the breach arose at a time when the director was heavily pre-occupied with crisis-management strategies designed to save the business, directors should not expose themselves to unnecessary attention.

21 FCA Handbook, FIT 2.1.3, paragraph (3)
22 FCA Handbook, FIT 2.1.3, paragraph (4)
23 FCA Handbook, FIT 2.1.3, paragraph (9)
24 FCA Handbook, FIT 2.1.3, paragraph (10)
25 Section 993, Companies Act 2006
26 Section 17, Theft Act 1968
27 For example, under the Fraud Act 2006
28 For example, under the Proceeds of Crime Act 2002
29 Section 386, Companies Act 2006
30 Section 26(3), Companies Act 2006
31 “In this context, “officers” are defined as including “a a director, manager or (company) secretary, and any person who is to be treated as an officer of the company for the purposes of the provisions in question”. See Explanatory Notes to the Companies Act 2006.
Health and Safety

Given the clear potential health risks to employees whose jobs cannot be performed remotely, directors should be mindful of their obligations under health and safety legislation. In particular, the Health and Safety at Work Act 1974 (“HSWA”) requires a company to: (i) maintain a written health and safety policy; (ii) ensure that all employees are aware of this policy; (iii) conduct risk assessments where necessary; and (iv) maintain records of all identified significant risks. Where an offence under the HSWA is committed with the consent or connivance of, or is attributable to neglect on the part of any director, manager, secretary, or other similar officer, then that person, together with the company, can be prosecuted under the HSWA. Conviction for offences under the HSWA can also result in disqualification as a director.

Employment Offences

Where reductions to the number of operating staff are being considered, directors should be mindful of their obligations under employment legislation. For example, section 193 of the Trade Union and Labour Relations (Consolidation) Act 1992, pursuant to which a company and any “director, manager, secretary or other similar officer” who has contributed to the company’s failure to notify, can be charged for failure to notify the Secretary of State for Business, Innovation and Skills within 90 days in the event that the company seeks to make more than 20 employees redundant.

Cooperation with Criminal Proceedings

Separately, where misconduct is identified within a company which results in criminal proceedings, even where no misconduct is alleged against directors directly, such individuals may nevertheless be required to cooperate with law enforcement as a witness. Particularly in cases arising out of large and high-profile business, or those which concern complex misconduct, the cooperation required from the director may be extensive, and include:

- responding to compulsory document requests (including disclosure of communications and financial records);
- attending interviews with law enforcement authorities which, in many cases, are recorded and subsequently used as evidence at trial (and which, if misleading or incorrect evidence is knowingly given by the director, can lead to prosecution);
- a requirement (or tactical necessity) for detailed written witness evidence to be prepared; and
- a requirement for the director to give public evidence in person at trial.

The obligations which can be imposed by law enforcement upon a co-operating director can be extensive, often require the director to obtain separate legal representation, and in some cases, generate satellite litigation to ensure that the directors’ interests are sufficiently protected.

Practical Interim Considerations for Directors

Given the broad range of potential legal exposure for directors potentially arising out of business decisions taken during this period, directors should consider the following issues, among others, when taking business decisions during this period:

1. Employment Decisions. We have witnessed mass furloughing and redundancy of employees thus far during the COVID-19 crisis. In some cases, companies may face criticism from stakeholders, including trade unions, on how they have treated their staff during this time. Whilst it may seem to be a sensible course of action to take, directors should bear in mind the adverse effect from the Court of Public Opinion which carries the risk of reputationally destroying the company. Following the crisis,
customers may seek to boycott, for example, a business that decided to dismiss its entire workforce without pay.

2. **Accounting Treatment.** On 21 March 2020, the FCA announced that it was requesting all listed companies to observe a moratorium on the publication of preliminary financial statements for at least the next two weeks, noting that “the unprecedented events of the last couple of weeks mean that the basis on which companies are reporting and planning is changing rapidly” and adding that “it is important that due consideration is given by companies to these events in preparing their disclosures”. Whilst the FCA likely recognises the uncertainty presented by COVID-19, and the likelihood of decreased (or even eliminated) revenue for the foreseeable future, it is nevertheless incumbent upon directors to ensure that the company’s financial position is recorded accurately and that sufficient internal monitoring takes place to ensure that accounts are carefully prepared by those charged with such responsibilities.

3. **Listing Particulars and Public Disclosures.** Given the widespread financial uncertainty, directors of listed companies should ensure that, in any listing particulars or public disclosures issued during the COVID-19 pandemic, very careful attention is paid to ensuring the accuracy of statements made and, in particular, that proper disclosure is made of material risk factors.

4. **Insurance Recovery.** Many businesses will maintain insurance covering, at least ostensibly, losses arising from business interruption. The unprecedented nature of the COVID-19 pandemic has generated uncertainty among insurers and insured parties as to whether losses caused by the pandemic are covered under particular policies. Whilst the scope of an insurance policy will depend on its particular terms, directors should ensure that proper enquiries are made regarding potential insurance recoveries. Given the widespread uncertainty, such proper enquiries will include scrutinising the terms of potentially applicable insurance policies and, where necessary, challenging the assertions of insurers and brokers regarding the scope of such policies.

5. **Protect Cash Flow.** As explained above, directors will, at all times, be expected to have informed themselves as to the company’s affairs, and directors should take all appropriate measures to protect cash flow and business continuity. In particular, directors should consider the sources of financial support potentially available to their business whether it is by regular commercial lending or by the UK Government’s Coronavirus Business Interruption Loan Scheme. Whilst such public support may provide valuable support to struggling businesses, there were initially suggestions of potentially-onerous conditions being attached to such funding, including a requirement for directors to personally guarantee the company’s liabilities.

6. **Payment of Dividends.** Directors should consider whether it is appropriate to reduce or eliminate dividends, or reduce or eliminate bonus payments, where doing so would preserve, or improve, the financial health of the company. In relation to dividends already declared, on 25 March 2020, the London Stock Exchange announced that, for listed issuers, deferral of payment will be permitted for up to 30 business days, up to a maximum of 60 days after the record date. At all times, the director must believe that their actions are in the best interests of the company and consider the adverse public attention as a result of paying large bonuses, which in turn could affect the company’s reputation.

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7. **Investment Opportunities.** Despite the fact that the downturn in financial markets may be perceived to provide viable investment opportunities, caution should be taken when reviewing existing investment opportunities and deciding to invest in other markets. Priority ought to be on preservation of assets. Investment in high-risk markets may be considered to stray beyond a mere ‘commercial misjudgment’\(^{36}\) when having regard to the ‘unfitness’ test.

8. **Capital Projects.** Directors should consider whether ongoing or anticipated projects which require sizeable upfront capital investment should continue to be progressed during the COVID-19 pandemic, particularly where the required capital expenditure involves investment in assets whose valuation may be uncertain given the current circumstances. Directors will need to weigh the consequences of continuing such projects against the consequences of deferral or cancellation and a decision will need to be made in the best interests of the company.

As a general matter, directors should take the opportunity to review the corporate governance measures in place and rectify any apparent deficiencies. This applies to companies of all sizes. In 2017, Sir James Wates CBE was invited by the UK Government to lead the development of corporate governance principles for large companies. This resulted in the publication of the Wates Principles in December 2018.\(^{37}\) Directors of all companies would be well-advised to think about the guidance contained in that publication at this time. Recommendations made in the Wates Principles include:

- Having a defined business purpose to articulate the business model and develop strategy. Directors to lead by example and consideration of whether there are internal mechanisms to allow individuals to raise concerns about misconduct;
- A balanced Board including assessing whether there are processes in place to manage conflicts of interest;
- Clear corporate governance structures and transparency on roles/accountability and identification of strengths/weaknesses of directors;
- Effective management to navigate emerging and current risks in order for the preservation and promotion of the long-term success of the company;
- Fair and balanced remuneration to secure and maintain a strong and qualitative workforce;
- Ensuring all information provided to stakeholders is balanced and representative of the company’s position.

**Contingency Planning**

Irrespective of the best efforts and reasonable actions of directors allegations of abrogation of duty or mismanagement will inevitably follow the current crisis period. The consequential investigations and proceedings that follow business failure can be complex, prolonged, costly and stressful. Practical difficulties often facing former directors in these circumstances can include the lack of access to documents from their former company and fitting in the commitments required to properly engage with those proceedings with new business commitments. There are measures that should be considered by directors to ensure that they are protected to the maximum extent in the event that, following a failure of the business, their acts and omissions during the COVID-19 pandemic are scrutinised. Such measures include:

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\(^{36}\) **Re Lo Line Electric Motors** [1988] Ch. 477

1. **Identifying and Recording Lines of Responsibility.** Directors should ensure that the company has in place clear, identified and recorded reporting lines including the levels of supervisory responsibility. An investigation following the failure of a business will seek to unearth any wrongdoing by employees or misconduct by directors. It is therefore crucial to have a cogent, accurate record of who is responsible for particular departments and areas of the business, including who has been delegated any particular responsibilities by the Board to perform particular tasks.

2. **Recording Decision Making.** All decision making processes should be recorded and represented in the company’s Board minutes. It is vital that all business critical decisions have a clear decision log that can be traced back to the Board and justified. Directors investigated following the insolvency of a company will find it hard to convince an investigating body that unrecorded decisions were legitimate and/or received higher Board approval. If a decision was made which did not require Board approval, it is equally important to ensure there is a written account of a decision being made, the reasons for that decision and who was associated or involved.

3. **Maintaining Adequate Directors and Officers Liability (“D&O”) Insurance.** Directors should ensure that adequate D&O insurance is in place to cover the actions of those individuals during the COVID pandemic. Existing policies should be reviewed to ensure that cover is valid, comprehensive and adequate. Directors should be aware of the scope of existing policies and identify if higher levels of indemnity are required.

4. **Remaining Fully Informed of the Company’s Financial Position.** To avoid an accusation of wrongful trading, directors should remain fully and continuously informed of the financial position of the company and should be ready to take advice from an insolvency practitioner regarding whether administrators or liquidators should be appointed. Weekly, accurate management accounts should be carefully reviewed.

5. **Obtaining Independent Advice Where Necessary.** Where fundamental disagreement exists on critical decisions directors may need to take independent legal advice. The company’s corporate advisers will be unable to advise a director in their personal capacity if there is the potential for a conflict of interest with the company.

**Conclusion**

During these unprecedented times, it may seem the commercial world is moving so fast that there is no time to send out agreed Board papers and minute Board meetings. Whilst the government has put in place a package of measures to assist companies, directors remain exposed to legal risks from many angles. In the unfortunate event that a business does not survive the crisis, it is possible that the actions of, and decisions taken by, directors and senior managers during the crisis will be heavily scrutinised. It is essential that a business has maintained full records of available facts on which those tough actions and decisions were made. Whilst this may seem impossible given the current pressure of time to try to ensure company survival, now, more than ever, is a time for directors to be rigorous and disciplined. Entire Boards must be engaged with full facts. Above all else, to protect from the metaphorical Court of Hindsight that will likely open for business in 2021, a contemporaneous decision log which records the rationale behind all key COVID-19 crisis era decisions should be maintained.

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New York | Seoul | Paris | Washington DC | London

www.cohengresser.com
info@cohengresser.com
+44 (0) 20 8037 2330

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