

COVID-19 Briefs

The effect of COVID-19 on Directors' Duties

COVID-19 will undoubtedly result in very significant financial pressure for businesses and may lead many to become insolvent.

It is therefore critical for directors to have a sound appreciation and understanding of their duties, both to the company and to the company's creditors. It is also important for creditors of companies that either are or may become insolvent, to understand whether recourse might be made against directors personally.

Directors' Duties

The duties owed by directors were codified and modernised by the Companies Act 2006 ('the 2006 Act'). The 2006 Act sets out (at sections 172-181) eight specific duties that a director will owe:

1. A duty to promote the success of the company;
2. A duty to exercise reasonable care, skill and diligence;
3. A duty to exercise independent judgment;
4. A duty to act within powers;
5. A duty to avoid conflicts of interest;
6. A duty to declare interests in proposed transactions;
7. A duty to declare interests in existing transactions; and
8. A duty not to accept benefits from third parties.

The most common duties relevant to directors are the duty to promote the success of the company and the duty to act with reasonable skill and care.

The Act will not only apply to directors that have been formally appointed as such ('*de jure*' directors) but it will apply equally to any person occupying the position of director by whatever name called. This means that in determining whether any person is or has been a director of a company, account must be taken not only of whether a person has been duly appointed and registered as a director in accordance with the prescribed procedures, but also of whether that

person is or has been exercising the actual legal functions of a director and taking part as a full member in the process of making the sort of decisions that directors routinely make. This person is typically referred to as a '*de facto*' director.

The Duty to Promote the Interests of the Company

A director is required to act in the way which they consider will be most likely to promote the success of the company for the benefit of its members (s172). In doing so they must take into account among other matters, the following six factors:

1. the long-term consequences of the action;
2. the interests of the company's employees;
3. the company's business relationships with suppliers and customers;
4. the impact of the company's activities on the community and the environment;
5. the advantages to the company of having a reputation for high standards of business conduct; and
6. the need to act fairly as between the company's shareholders.

The list is however mandatory. In other words, whatever other matters a director may take into account when making a decision, they must always consider those six factors.

In the extremely challenging COVID-19 times, directors will be faced with conflicting considerations in performing the duty to promote the interests of the company. For example, it may well be in the interests of the company's employees' health that they attempt to work from home if that is possible or if not, to not work at all.

It is salient to note that whilst the above six factors are mandatory – in that they must all be considered by a director in support of their duty to promote the interests of the company – the obligation is only that they be taken into account. It is clear that in the current climate there may be conflicts which will be irreconcilable. However, it is unlikely that a director will be held to be

in breach of duty as long as they have considered the relevant factors and concluded in good faith that it is necessary in the interests of the company to give priority to one factor over another.

Directors must carefully and diligently record decisions that they are taking and the reasons therefor. A paper trail recording the decisions taken is particularly important. This will include the preparation of board minutes and presentations.

The board minutes should contain a reference to the fact that the directors believe that the proposed action will promote the success of the company.

Although it will not normally be necessary for the minutes to record the fact that the directors have considered each of the six factors listed in the Act, if the proposed action has serious implications as regards any of those factors (for example, a decision may have a significant impact on the company's employees or on the environment and community), the minutes should record the directors' consideration of those factors.

Where a company is either insolvent or is likely to be unable to avoid insolvency, a director's duty to promote the interests of the company changes so that their duty is to act in the interests of the company's creditors. The duty to act in the interests of the company's creditors where the company is or is likely to become insolvent, applies in relation to directors' duties generally.

A director owes a duty pursuant to section 174 of the 2006 Act, to act with reasonable care, skill and diligence. In assessing whether a director has done so with skill and diligence, two tests must be applied:

- (a) Did they exercise the care, skill and diligence, which would be exercised by a reasonably diligent person with his general knowledge, skill and experience?

- (b) Did they exercise the care, skill and diligence, which would be exercised by a reasonably diligent person with the general knowledge, skill and experience which may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company?

The duty is therefore part objective and part subjective. It will follow that the director will not only be judged against the skill and experience that they have but by reference to the skill that they would be expected to have given his particular role. A financial director will be expected to

display the skill and experience of a person typically carrying out that role and whether or not they possess such experience or expertise.

The challenges faced by directors as a result of COVID-19 are clearly significant. There is uncertainty as to when the current lock-down will be significantly eased or ended.

In further articles, I propose to discuss the effect of COVID-19 on other important issues including wrongful trading, directors paying dividends and retention of title, respectively.

COVID-19 link: <https://www.jkwlaw.com/covid.html>