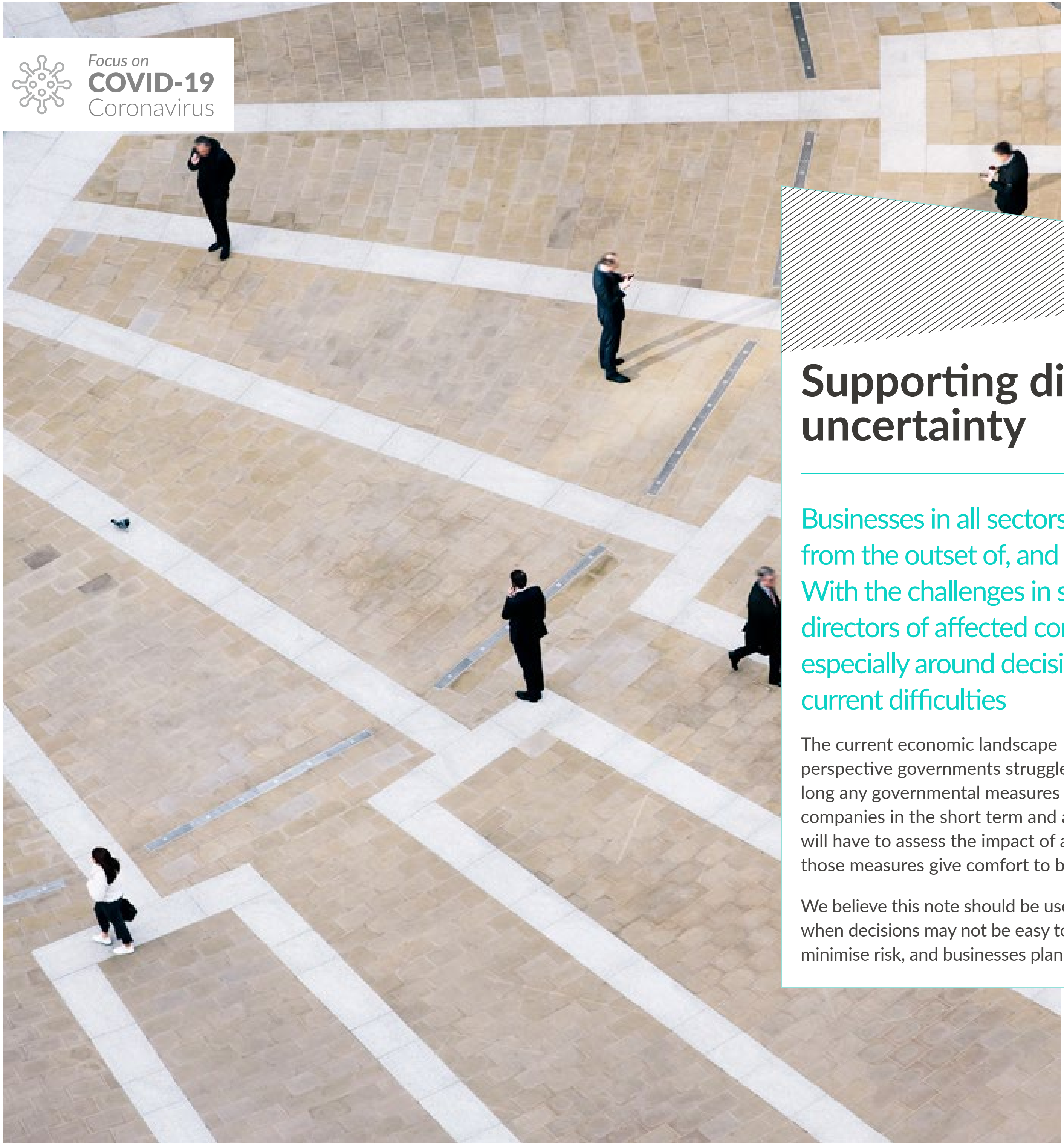


Focus on
COVID-19
Coronavirus

A&L Goodbody

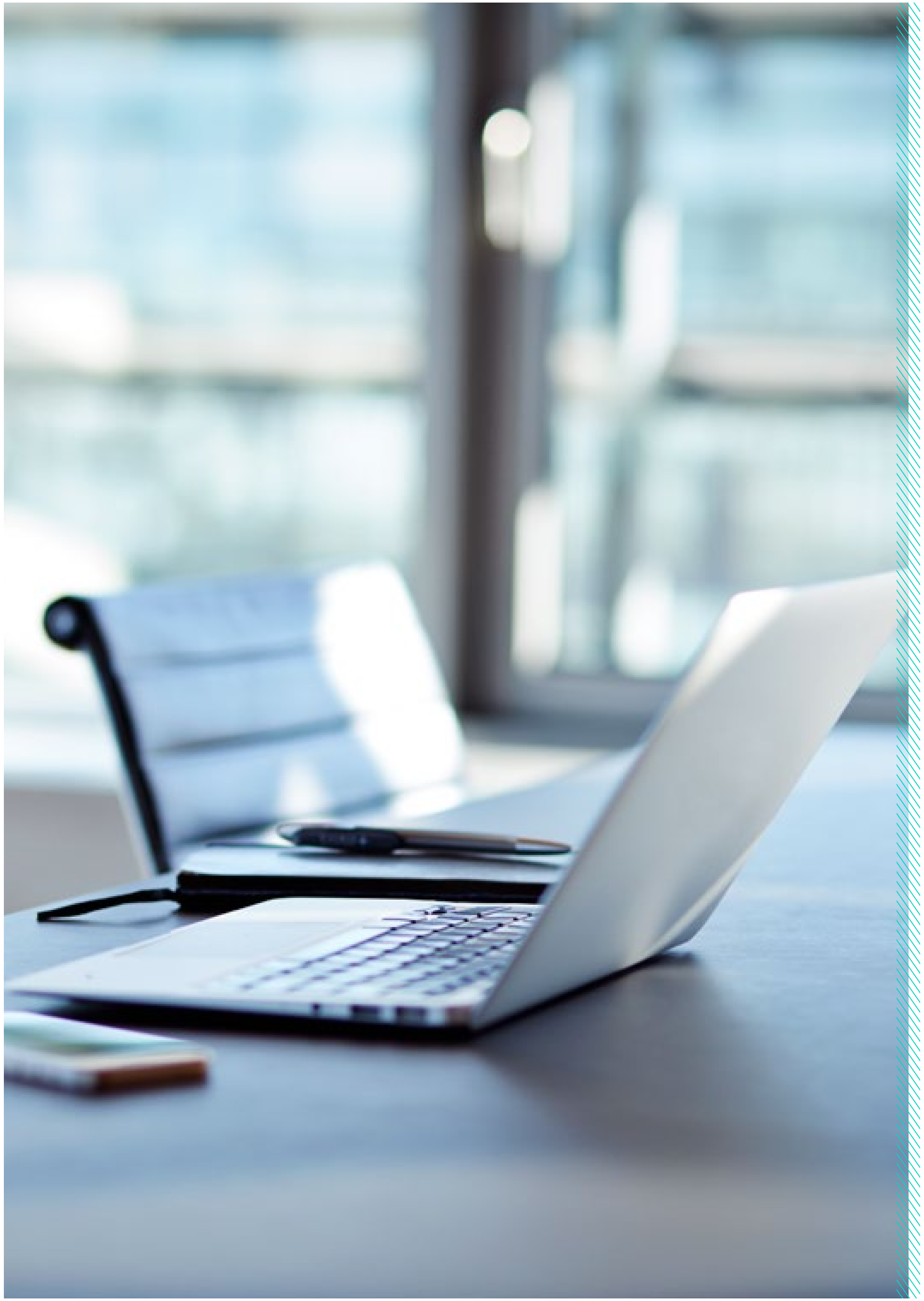
Supporting directors during financial uncertainty

Businesses in all sectors are facing very challenging times arising from the outset of, and reaction to, the Coronavirus (**COVID-19**). With the challenges in some instances being unprecedented, directors of affected companies need to be cognisant of their duties especially around decisions they are looking at making to get through current difficulties

The current economic landscape is changing from day to day as companies and from a wider perspective governments struggle to deal with the issues being thrown up. It is unknown how long any governmental measures introduced will remain in place, or what their impact may be for companies in the short term and also moving forward. Individual companies and their directors will have to assess the impact of any such measures on their company's position and whether those measures give comfort to be able to continue to trade through the difficulties being faced.

We believe this note should be useful in the short-term in guiding directors through this trying time when decisions may not be easy to make. We are hopeful the note can help directors seeking to minimise risk, and businesses planning to avoid the need for a formal insolvency process.

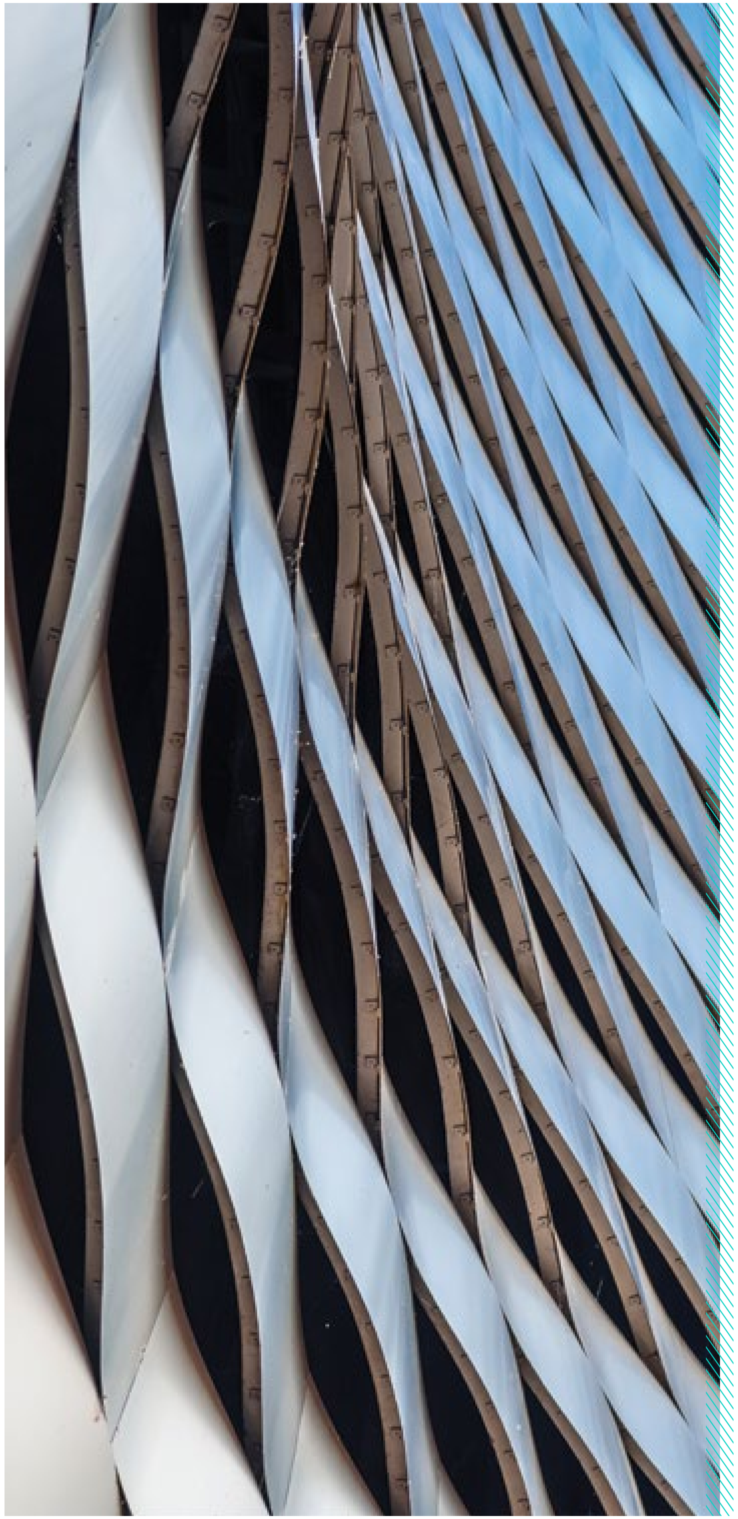
You will find a full range of timely materials for businesses in our dedicated **COVID-19 HUB** on our website.



Taking stock

While it is difficult to predict, at this stage, the impact COVID-19 may ultimately have on your business, there are very practical steps that directors can take now to assess, and try to manage, the risks their business may face from falling revenues, damaged liquidity, and turbulent market conditions. Depending on the nature of the business, these may include:

- review all business-critical contracts, including insurance policies, to determine whether they are impacted by the current situation; check, especially, financial covenants and provisions on termination, default and cross-default, material adverse change/effect, force majeure
- to retain the confidence of important stakeholders: open up an honest and regular dialogue with your key investors, suppliers, lenders, and material creditors
- where fundamental to your ongoing trading, you may have to consider having a commercial discussion with lenders or other counterparties about revising credit or contractual terms, or seeking payment deferrals, repayment holidays, rent moratoria, etc.
- consider whether the company needs new money or investment to continue in business in the immediate term.
- ensure the board is comfortable with the company's viability and continues to monitor the appropriateness of its current business plan. Consider whether CapEx and other discretionary expenditure are a priority, and whether there is a strategy to preserve value at this time
- where there is a real concern about liquidity or solvency, be proactive and involve your legal and financial advisors from an early stage, so they can take you through your options and possible solutions, and help you manage risk
- consider the measures being introduced by the Irish Government or indeed from a wider EU perspective to see what impact such measures may have on your company and what comfort can be taken from those measures in decisions being made about the future of the business or the ability to be able to continue to trade. Among such considerations could be to cease trading for a short period of time in order to preserve the value of the business, so as to avoid worsening the position of creditors until economic factors improve



Directors' duties in the ordinary course of business

Where a business is solvent and trading as normal, the company's directors owe their fiduciary duties to the company, meaning the interests of its members as a whole.

Directors have eight statutory fiduciary duties, as follows:

- to act in good faith in the interests of the company.
- to act honestly and responsibly in company affairs.
- to adhere to the company's constitution and exercise powers only for the purposes allowed by law.
- to not use the company's property, information or opportunities for their own or anyone else's benefit unless one of the exceptions in s. 228 (d) of the Companies Act 2014 applies
- to not agree to restrict the exercise of their independent judgment unless one of the exceptions in s. 228 (e) of the Companies Act 2014 applies
- to avoid conflict between their duties to the company and the director's other (including personal) interests, unless the director is released from his or her duty to the company in relation to the matter concerned
- to exercise the care, skill and diligence which would be exercised in the same circumstances by a reasonable person having both the knowledge and experience: (a) reasonably be expected of a person in the same position as the director; and (b) which the director has
- to have regard to the interests of the company's members, in addition to their duty to have regard to the interests of the company's employees in general

In addition, there are a number of other general statutory duties and responsibilities imposed on directors, such as the duty to disclose interests in contracts, shares and debentures. There is also an overall statutory duty on each director to comply with the Companies 2014 Act.

These duties are owed by de facto directors and by shadow directors, as well as by formally appointed directors.

In circumstances where a breach of duty is proven, a director may be required to:

- » account to the company for any personal gain made from the breach
- » indemnify the company for any loss or damage resulting from the breach.

The High Court of Ireland is empowered to relieve a director from personal liability if he or she has acted honestly and reasonably and where the court believes that, in the circumstances, the director ought to fairly be excused

Directors' duties during financial uncertainty

During a time of financial distress, including the unprecedented crisis we are experiencing, directors may feel a strain on their judgment and, accordingly, their ability to fulfil their duties. A prudent director, however, is unlikely to go far wrong where he or she is conscious in their daily business activities of adhering to their fiduciary duties.

In addition to their ongoing statutory duties, directors should also be aware of their duties and to whom they are owed during times of financial uncertainty for the business. This is as much so they can actively manage the risk of personal exposure for themselves, where the company is insolvent or close to becoming so, and can put in place prudent measures to protect themselves from liability.

In addition to exercising sound commercial judgment, key to ensuring directors can insulate themselves as much as possible from liability in the event of the business failing, they need to know:

- » how to properly assess the solvency of the company and whether the company is viable and can continue to trade
- » what the pitfalls are where inappropriate or imprudent steps are taken
- » what are the mitigating steps a prudent director would take in the circumstances.

To whom are directors' duties owed in a time of financial uncertainty?

Where uncertainty arises as to whether a company can trade through financial difficulties, directors continue to owe their duties to the company, but must take the interests of creditors into account.

Typically, this means considering the impact of material decisions on creditors. Material decisions can include:

- ongoing trading
- incurring additional material credit
- granting security
- discharging material creditors

Creditors do not have a direct right of action against a director for breach of fiduciary duties. Accordingly, only the relevant company (or its liquidator) may take an action for breach of duty against a director.

The purpose of directors taking these steps and acting in the interest of creditors is to:

- mitigate any claim made that they have acted inappropriately and should be held liable for the debts of the company
- ward off any attempt by a insolvency practitioner subsequently appointed seeking to restrict them in acting as directors

If a company becomes aware that it is insolvent, then the board of directors holds the assets of the company on trust for the benefit of the company's creditors. Where it is clear that there is no prospect of the company surviving and returning to solvency, the directors should take advice on what would be the appropriate restructuring or insolvency processes for the company.

Solvency tests

There two tests in Ireland to determine solvency:

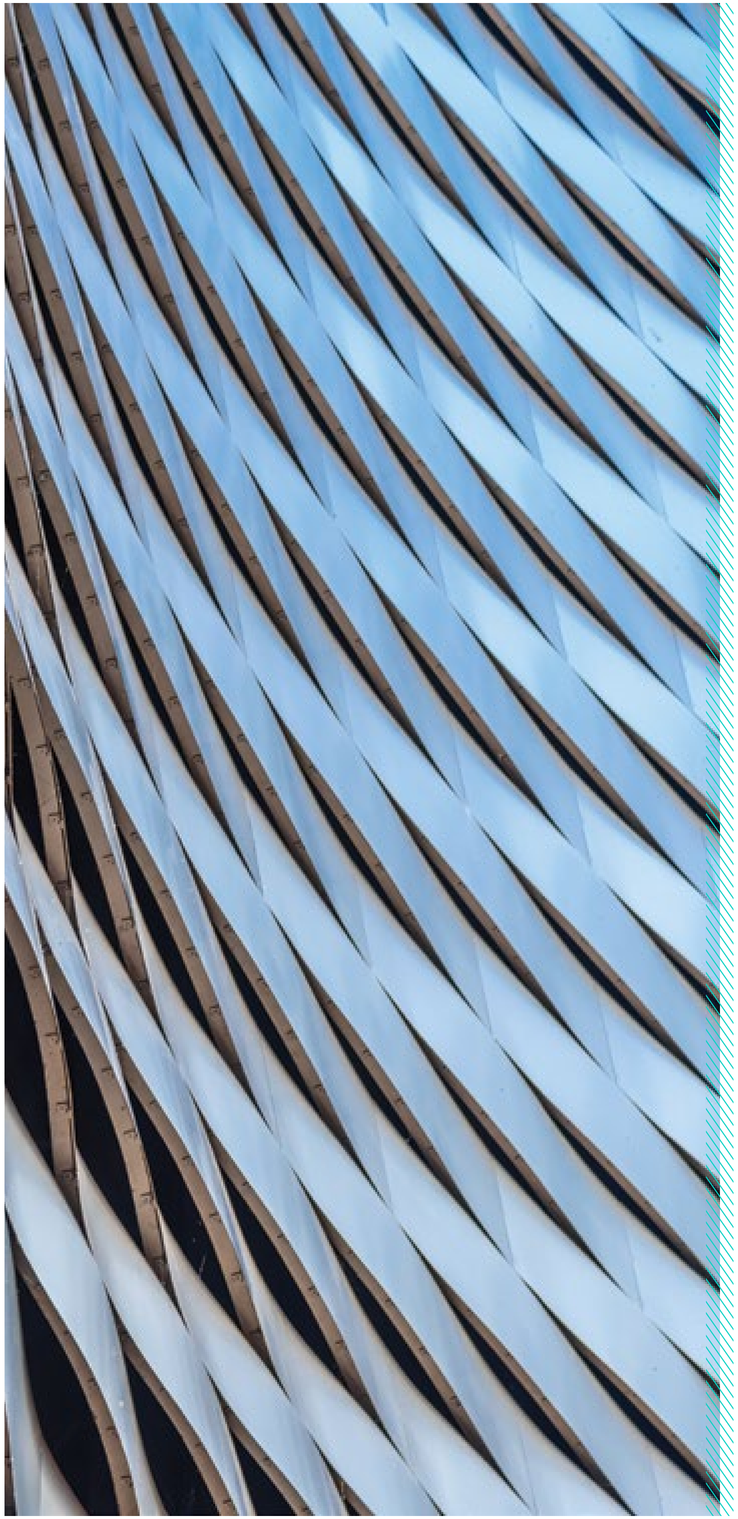
Cash flow test: Is the company able to pay its debts (current, contingent and prospective) as they fall due?

Balance sheet test: Does the company's assets exceed its liabilities?

While the Irish courts have not determined the appropriateness of one test over the other, in practice, the cash-flow test has tended to be relied on more by creditors when seeking to put a company into liquidation.

Directors should consider whether there are reasonable grounds to conclude that the company can trade though its difficulties, and apply a common-sense approach taking into account:

- inability to pay debts as they fall due
- whether value can be realised from balance sheet assets
- whether future funding via refinancing is credible



Steps to take when the company is facing insolvency

Where, through best efforts, it is has not been possible to avoid serious liquidity issues, and there is a clear risk of insolvency, the directors owe a duty to the company's creditors not to conduct business in such a way as to prejudice their interests. To manage this, and to ensure the directors are properly fulfilling their duties where they continue trading while in the zone of insolvency, the board should ensure that, at a minimum, the following occurs:

- closely investigate the financial position and the future prospects for the company
- continuously monitor the company's financial position.
- stress-test the financial information being relied on
- support the view that the company can continue to trade through its financial difficulties with documentary evidence and independent advice
- get an independent view on any proposed material transaction from an insolvency practitioner (e.g. disposals, acquisitions, group restructuring)
- obtain legal advice on the implications of any proposed material action (e.g. disposals, acquisitions, group restructuring).
- hold frequent board meetings
- prepare regular management accounts
- ensure that the company's books and records are current and accurate
- take material decisions only after considering the impact on creditors
- stress-test the rationale for making payments to creditors, especially ones within the same group unless it can be justified as being in the ordinary course of business

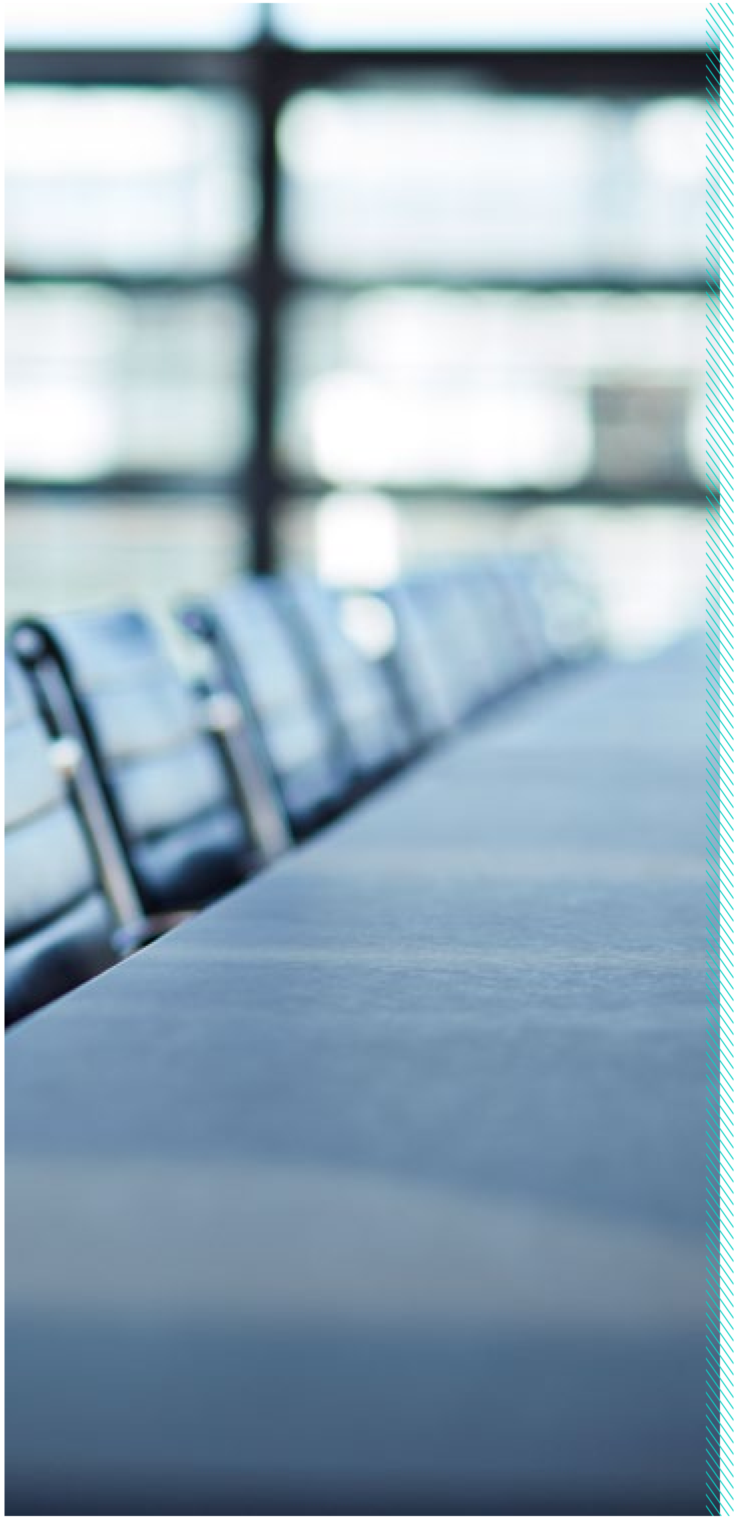
Risks for directors of an insolvent company

Where it is clear that a company cannot trade out of its difficulties, and it does not have a prospect of survival, the directors should take steps to put the company into liquidation. In such situation, it is important for the company and the directors to be aware of the (below) risks that can arise on a company's insolvency and subsequent liquidation.

Reckless Trading - directors may be made personally liable for the debts of an insolvent company if they have knowingly carried on the business in a reckless manner. A director acts in a reckless manner where he/she ought to have known that his/her actions would cause loss to the creditors or where he/she allows the company to incur debt when he/she knows it is unlikely that debt will be paid as it falls due. In considering recklessness, the courts will have regard to the directors' position and experience. One defence would be to prove that the director acted honestly and responsibly. The courts have set the reckless trading hurdle reasonably high and the Irish judiciary has some appreciation for entrepreneurial risk.

Fraudulent Trading - directors may be made personally liable for the liabilities of an insolvent company where he/she knowingly carries on the business with intent to defraud creditors. The courts have set a high standard of proof for fraudulent trading and successful prosecutions are relatively rare.

Fraudulent Disposition of Property - a liquidator or creditor can seek the return of property where the disposal of the property had defrauded the company, its creditors or members. There is no need to prove any intent to defraud. The effect of the disposal is what is relevant, and there is no temporal limitation on the lookback period.

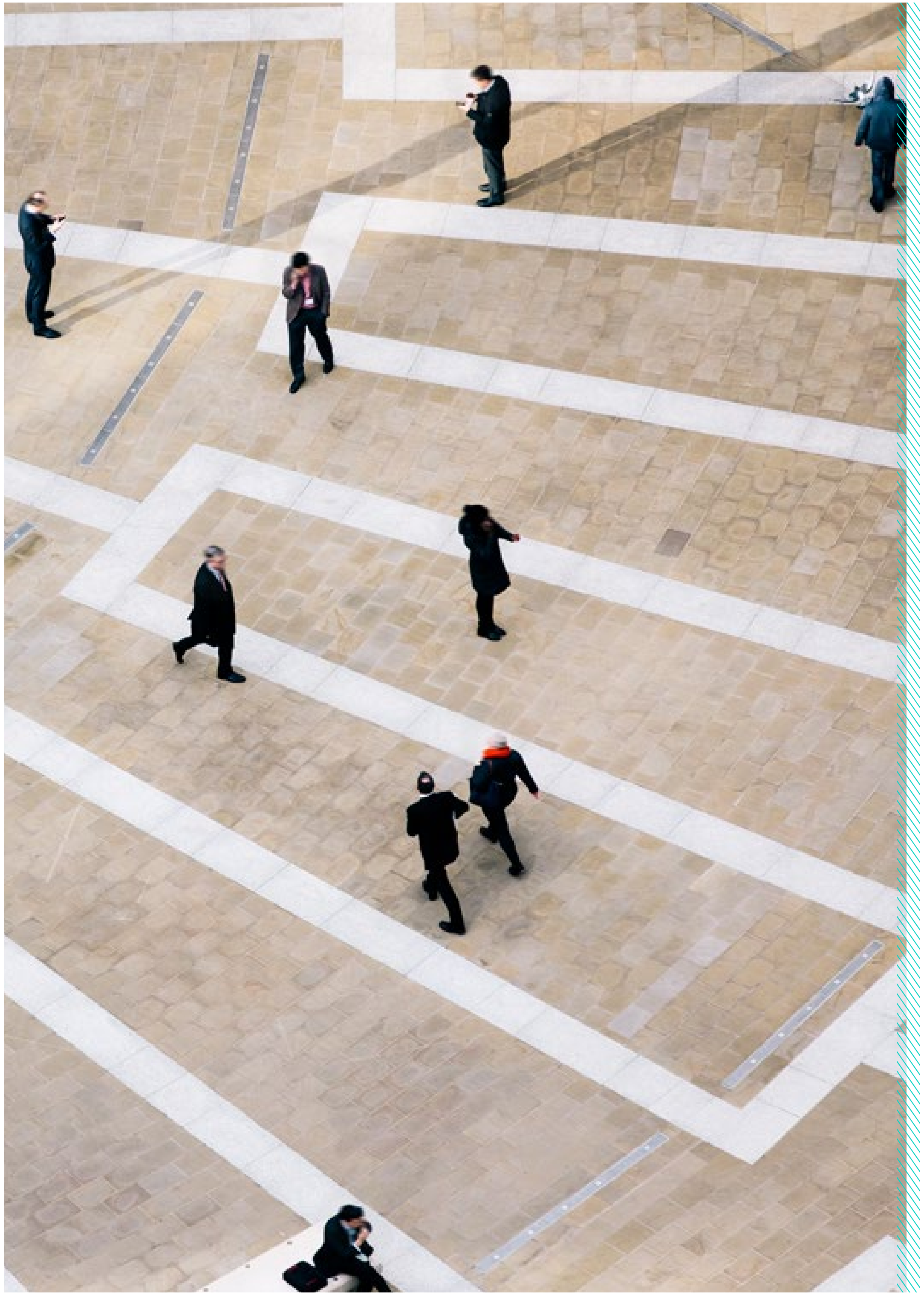


Unfair Preference - a liquidator can apply to court to have declared void the transfer of company property to creditors made in the six months prior to the insolvent winding up. The liquidator must prove that the directors intended to prefer that creditor to the detriment of other creditors. This six month period extends to two years where the transaction was made in favour of a connected person. A connected person includes directors and related companies.

Failure to maintain proper books of account - a director can be made personally liable for all the debts of the company where his/her failure to maintain proper books of account has contributed to the company's insolvency, has resulted in a substantial uncertainty as to the assets and liabilities of the company or has impeded an orderly winding up, then. Prosecutions for failure to maintain proper books of account are not uncommon as it is relatively easy to prove.

Restriction - a liquidator must bring a restriction application and the courts will restrict a director of an insolvent company unless the liquidator and the corporate regulator (ODCE) is satisfied that the director acted honestly and responsibly in relation to the affairs of the company, that he/she cooperated with the liquidator in winding up the company and that there is no other reason to restrict him/her. A restriction order results in a director being restricted from acting as an officer of a company unless that company has a paid up share capital of €100,000 in the case of private companies or €500,000 in the case of public companies. A restricted director who acts as director of a company which does not meet the minimum capital requirements may be made personally liable for the debts of that company if it goes into insolvent liquidation.
It should be noted that mere commercial misjudgment by a director will not usually suffice to merit an order of restriction

Disqualification - a disqualified director cannot act as an officer of a company or be involved in the promotion, formation or management of any company. A disqualification order is usually for a period of five years. A director will automatically be disqualified where he/she is convicted of an indictable criminal offence in relation to a company or where he/she is convicted on indictment of a fraud or dishonesty offence. A liquidator and certain other concerned parties may apply for a disqualification order if, for example, the director has former convictions for reckless or fraudulent trading in relation to the company or he/she considers the director "unfit to be concerned in the management of a company".



A&L Goodbody

Please do not hesitate to contact A&L Goodbody, including any member of the Restructuring & Insolvency team, if you wish to discuss the impact of COVID-19 or any of the matters raised in this publication.

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Disclaimer: A&L Goodbody 2020. The contents of this document are limited to general information and not detailed analysis of law or legal advice and are not intended to address specific legal queries arising in any particular set of circumstances.

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