Covid19 and the company director

PROFESSOR CHRISTOPHER RILEY, MODULE CONVENOR FOR COMPANY LAW

TRANSCRIPT

Hello, I'm Chris Riley, and I'm the module leader for Company law.

The purpose of this short video is just to look at some of the problems that company directors are encountering because of the Covid crisis. We're going to focus in particular on the duties that directors are under if they find their companies facing financial difficulties, ...difficulties which hopefully will only be temporary in many cases, depending how quickly there is an effective response to the virus and how quickly the economy returns to something like normality.

Once a company is in financial difficulties, then the duty on directors really becomes to prioritise the interests of its creditors. And that obligation comes from two different legal rules.

So the first is Section 172 of the Companies Act. That's the duty that, remember, speaks in terms of directors having to promote the success of the company. When the company is in financial health that normally is seen as requiring directors to put shareholders first and essentially to try and make as much profit for the shareholders as the directors can.

But it's been long recognised that when a company is in financial difficulties, the interests of the creditors should come first under Section 172. And so Section 172 has been interpreted in cases like the *West Mercia Safetywear* case and the later *BTI* case as meaning that if a company is either already insolvent, or if insolvency is merely likely, then the directors' obligation is no longer to think about their shareholders, but instead to prioritise their creditors interests.

The second rule that requires this switch in the loyalty of directors away from shareholder towards doing what's best for creditors comes from Section 214 of the Insolvency Act, the so-called wrongful trading provision. And remember that that says that once insolvency is inevitable, directors must minimise the loss to creditors. And that normally is seen as requiring directors to cease trading.

If they don't and proceedings are taken against the director, she can be made to make such contribution to the assets of the company as the court thinks fit. The *Re Produce Marketing* case says that the amount of the contribution should be calculated on a compensatory basis. In other words, the court essentially asks, how much more did the creditors lose because you did not cease trading once insolvency was inevitable?

So all this is pushing directors to not take chances - to accept the inevitable and to cease trading quickly, if they don't do that, they're more likely to be sued under Section 214, and the amount they have to contribute will be greater because the loss to creditors will be greater as a result of their delays.

Against that background, once it became obvious how bad the Covid crisis was going to be and the severity of the economic damage that it was causing to companies, the Government had, I think, two concerns. The first was more of an economic concern that there could be a large increase – a large spike – in the number of cases, the number of insolvency proceedings, brought against companies. Creditors might lose patience and start insolvency proceedings quickly. And directors fearful of liability under Section 214 might not take a chance, hoping that the company could survive, but instead, to protect themselves, might put the company into winding up procedures.

And the government was therefore worried that too many companies would be wound up. Companies which might have been able to survive depending on how long the crisis lasts for.

The second concern was more about fairness to directors, I think. For those directors who do try to keep their company going - hoping that these problems will be temporary - if their best efforts fail and the company does eventually become insolvent and goes into liquidation, there was a fear that those directors might then be punished for their perseverance, for example, by being made liable for wrongful trading.

And so, in response to those two fears, the government introduced a number of measures. And we'll focus on two of the things that have been done. They've both been introduced in this *Corporate Insolvency and Governance Act of 2020*. That was very much rushed through Parliament once the severity of the crisis was clear.

And the first thing that was done was to introduce a moratorium on debts for companies. Companies can apply to the court for this moratorium, which initially lasts for 20 days, but can be extended for a further 20 days thereafter. And this is just giving companies a payment holiday period when they cannot be chased by their creditors and, in particular, creditors cannot begin insolvency proceedings against the company. So really very much a breathing space for companies, hoping that it will give them some protection from an impatient creditor determined to wind the company up.

Although it was introduced as a response to Covid, the change has been woven into the Insolvency Act of 1986, and it will remain in that Act and it will remain available to companies long after, hopefully the Covid crisis has passed. So that's the first change.

And then the second change that is being introduced is in Section 12 of that 2020 Act. And this essentially suspends the operation of the wrongful trading provision between the 1st of March and the 30th of September.

It does so by stipulating that a director cannot be considered responsible for any downturn - any worsening - of the company's financial position during this period. So even if a company does eventually become insolvent and even if wrongful trading [proceedings] were brought against a director, the amount of contribution they have to make cannot take into account any deterioration in the company's financial position between those dates. So that should give a degree of reassurance to directors.

Have these measures worked?

If we look at the figures of the number of insolvency proceedings, they do seem to have avoided that spike in companies being written off. We can see that from May onwards,

rather than there being an increase in the number of insolvency proceedings, there's actually been a decline. So the measures introduced might have helped to save a number of companies which could otherwise have been forced into insolvency proceedings. And that surely must be a good thing.

What about ensuring fairness for directors? Well, the suspension of s214 should certainly help, but there's good reason to think that it's not a complete protection for the dangers that directors are now facing as they agonise over whether or not to put the company into liquidation or to keep going, hoping that things will improve and the company may survive.

So there is nothing in the 2020 Act that I mentioned to give any protection against that first duty on directors, to put creditors first - the duty in Section 172 itself.

So there's nothing to prevent a liquidator of a company, that does eventually slip into insolvency, bringing proceedings against a director, arguing not that the director should be liable for wrongful trading, but arguing instead that the director has breached Section 172 by failing to prioritise the interests of creditors. I think it does mean that directors will have to be very careful when they're taking decisions about, for example, whether to pay themselves salaries or whether to pay dividends to their shareholders to ensure that they do think about their creditors first in deciding whether or not to make those payments. And that very often ought to mean that the payments will not be made.

The other reason why I think directors still have some cause for concern is that we know, of course, that directors can be disqualified from acting as directors in the future, under that 1986 legislation, the Company Directors Disqualification Act. And we also know that the most common ground for disqualification proceedings is that found in Section 6, where a director has been a director of a company that has gone into liquidation and their conduct in relation to the company shows that they are unfit to be a director.

Again, the 2020 legislation provides no protection against a director who faces disqualification proceedings. There has been no suspension of section 6 in the 2020 legislation.

Some help for directors in the exclusion of wrongful trading and some evidence there has not been a rush to liquidate companies, perhaps prematurely, but good reason for directors still to tread with some caution in responding to their company's financial difficulties.

Thank you very much for your time and attention in listening to this.