UK Directors COVID-19 Update

Skadden

April 3, 2020

If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

Dominic McCahill
Partner / London
44.20.7519.7018
dominic.mccahill@skadden.com

Peter Newman
Partner / London
44.20.7519.7061
peter.newman@skadden.com

James D. Falconer
Counsel / London
44.20.7519.7214
james.falconer@skadden.com

One Manhattan West
New York, NY 10001
212.735.3000

40 Bank St., Canary Wharf
London, E14 5DS, UK
44.20.7519.7000

As the coronavirus/COVID-19 crisis deepens, U.K. businesses are facing significant challenges. Many companies are having to react to mandatory operating restrictions, dramatic drops in demand, strained liquidity and supply-chain interruptions.

Directors of U.K. companies must navigate through these unprecedented times to best protect their businesses while also complying with their duties. Steps they should be considering include:

- drawing down existing credit lines;
- applying for government-backed loans, such as the Coronavirus Business Interruption Loan Scheme for businesses with up to £45 million in turnover or the COVID Corporate Financing Facility for investment-grade corporates;
- putting employees on furlough under the Coronavirus Job Retention Scheme;
- deferring rent payments following the suspension of landlords' ability to forfeit leases through at least the end of June; and
- deferring VAT payments due between 20 March 2020 and 30 June 2020 until 31 March 2021.

Suspension of Insolvency Act's Wrongful-Trading Provisions

In considering these options, directors should be aware that on 28 March 2020, the U.K. government announced that it would suspend the application of the wrongful-trading provisions in the Insolvency Act 1986 from 1 March 2020 until 31 May 2020. These provisions ordinarily provide that if a director has or should have concluded that there was no reasonable prospect of the business avoiding an insolvent liquidation or administration, the director has a duty to take every step with a view to minimising the potential loss to the company's creditors that a reasonably diligent director would take. Breach of this duty may lead to an order that the director contribute personally to the assets of the company. The government also announced that new insolvency reforms would be introduced at the earliest opportunity to further strengthen the ability to rescue businesses in distress.

The government's aim in suspending these provisions is to reassure directors — who must make difficult decisions about the future of their businesses in the midst of substantial uncertainty about the length and impact of the ongoing crisis — that they will not face personal liability if, in hindsight, their decision regarding the prospect of their business avoiding insolvent liquidation is not considered reasonable. This should help preserve otherwise viable businesses where directors may have felt compelled to cease trading out of an abundance of caution. However, directors should consider the following points:

- Directors will continue to be subject to their normal duties, including the duty to exercise reasonable care and skill and to take account of the interests of creditors where the company is more likely than not to become insolvent.
- The courts also should be slow to criticize the decisions of directors made in the face of a crisis, simply because ultimately the business could not be saved.

How Can Directors Avoid Liability?

Faced with significant uncertainties and a rapidly changing environment, directors should more than ever follow a disciplined process of recording decisions and the reasons for them. This will provide a clear paper trail that in most cases should significantly reduce the risk of a claim being brought in the future. Directors should:

- maintain and regularly review up-to-date financial information and forecasts;
- obtain professional financial and legal advice in writing for key decisions; and
- hold regular board meetings and keep full minutes.

Directors should still consider, where relevant, whether insolvency can be avoided. If it cannot, then directors should still take all reasonable steps to minimise losses to creditors. The impact of the change is that where directors find it difficult or impossible to judge the likelihood of survival, they are less likely to be criticized if they form the view that the best approach is to continue trading in the hope that they will return to solvency.

Directors also should be aware that an administration may offer the best chance of preserving the business. The primary aim of administration is to save the business as a going concern. An administrator may allow directors to continue to manage the business subject to specified limits and overall supervision by the administrator. This is known as a "light touch" administration, and although rare in ordinary circumstances, in the current crisis it could be a valuable tool, particularly where a business or part of a business needs to be "mothballed" for a period. It also would significantly reduce the risk of personal liability for directors in relation to decisions made during the administration.

For more on the issues facing boards of directors, please see Skadden's 20 March 2020 client alert, "Thoughts for Boards of Directors on the COVID-19 Crisis."