

## Directors' Duties in England and Wales Amid COVID-19

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Directors need to consider how to comply with their existing obligations and respond effectively to the challenges posed by COVID-19. This update provides a high-level overview of the issues and some practical considerations for directors of companies incorporated in England and Wales.

### Discharging the s172 duty during the COVID-19 pandemic

Under the Companies Act 2006, the directors of a company incorporated in England and Wales have a general duty to exercise reasonable care, skill and diligence. They also have a duty under s172 of the Companies Act 2006 to act in the way they consider, in good faith, would be most likely to promote the success of the company for the benefit of shareholders as a whole and, in so doing, having regard to the following non-exclusive s172(1) factors:

- a. The likely consequences of any decision in the long-term
- b. The interests of the company's employees
- c. The need to foster the company's business relationships with suppliers, customers and others
- d. The impact of the company's operations on the community and the environment
- e. The desirability of the company maintaining a reputation for high standards of business conduct
- f. The need to act fairly between shareholders

Whilst the s172 duty is owed to the company itself, this list of factors requires directors to consider the effect of their decision-making on a wider range of stakeholders. Ultimately, directors need to use s172 as a tool to steer judgement and make decisions that will promote the success of the company having regard to the long-term. Directors should bear in mind that court decisions are based on the specific facts of a case. The rapidly changing circumstances that have arisen due to COVID-19 will therefore likely be highly relevant. The s172 duty is a "good faith" duty which means that provided directors' decisions are made honestly and with the view to securing both the immediate and long-term survival of the company, the duty is not likely to be breached. Courts in England and Wales do not look to unpick the commercial judgement of directors.

### Decisions relating to employees

A key issue for companies currently involves making decisions about the treatment of employees. These can include decisions as to the necessity of out-of-home working, decisions around when and how employees who have been working remotely should return to the workplace and associated changes to policies and procedures. Some businesses are having to consider whether to reduce employee and contractor numbers and make redundancies and/or furlough employees, impose hiring freezes and/or seek to renegotiate salaries.

Directors will need to consider the conflicting stakeholder interests and ultimately make a decision based on the courses of action

which will, in their opinion, promote the success of the company having regard to the long-term.

The Institute of Directors has noted that communications and policies should be in place to protect employee wellbeing and act responsibly to slow the spread of the virus. The board of directors has a duty to both the company and to society as a whole to closely monitor the guidance and requirements of government and the authorities and to ensure that they are fully complied with at all levels of the organisation. The Institute of Chartered Accountants in England and Wales has commented that at the moment health and safety overshadows all other considerations.

## **Decisions relating to suppliers, customers and other counterparties**

COVID-19 will impact each business differently. Similar consideration should be given to supplier and customer breaches, requests for changes to payment terms and/or other requests. The company's interests in the long-term may lie in seeking alternative solutions to mitigate damage to relationships with suppliers, customers and other counterparties.

Again, directors should take the course of action which will in their opinion promote the success of the company, having regard to the long term.

## **Practical considerations**

To make effective decisions that discharge the s172 duty, boards can consider taking the following practical steps.

### **1. Increasing communication**

Boards can enhance communication between directors and with other stakeholders through:

- Holding more regular board meetings to make key decisions and record the reasoning behind them in detail (particularly when usual company practices are departed from)
- Receiving more regular updates from management between board meetings to ensure rapidly changing circumstances impacting the business are addressed
- Adopting measures to encourage shareholder participation during annual general meetings (for more on this, please see our [article](#))
- Reviewing the effectiveness of current stakeholder engagement mechanisms to ensure regular communication with customers, suppliers and other stakeholders

### **2. Utilising non-executive directors**

Non-executive directors are not involved in the day-to-day management of the company and therefore using the company's non-executive directors can provide a useful bigger-picture perspective and objective sounding board when making significant decisions.

Non-executive directors will want and need to get closer to operational management than usual, for example they will want greater visibility around human resources. The Institute of Chartered Accountants in England and Wales notes that non-executive directors should seek reassurance that those working on the frontline feel safe and sufficiently empowered and that reporting lines are efficient and flexible. Contingency plans for any sickness absence is critical, including the absence of the chief executive officer or other key personnel.

### **3. Social media**

Reviewing the company's social media strategy can help ensure consistency in published messages. Companies can consider

publishing a message from the chief executive officer as a low-cost but effective tool for boosting employee morale and customer confidence in the brand.

Public relations advisors should be consulted during this time as thoughtful and calm external and internal communications are needed.

#### **4. Risk management**

Companies should be alert to factors such as cyber risk. If a company has a risk committee then their skills should be utilised. Audit committees may also have a role to play. Depending on the nature of the risk impact, there may be key new roles for one or more board sub-committees and/or a need for newly formed committees specifically targeted on aspects of the pandemic.

Highly regulated companies will also need to stay alert to compliance risks. The usual reporting mechanisms and protections for whistleblowers for example must be maintained as their insights could be particularly valuable at this time.

#### **5. Disclosure**

The boards of publicly listed companies will need to remain mindful to:

- Disclose unpublished price sensitive (or "inside") information under the EU Market Abuse Regulation, and for AIM companies, the AIM Rules for Companies. Relevant inside information may include adverse changes in a company's trading/expectations of performance due to the COVID-19 pandemic (such as from supply chain disruption). It could also include deterioration in financial condition.
- Where subject to the UK Corporate Governance Code, follow relevant code provisions. In particular the code requires issuers to describe in their annual report how opportunities and risks to the future success of the business have been considered and addressed.

#### **6. Reporting**

For financial periods beginning on or after 1 January 2019, the strategic report section of the Annual Report must include a "s172(1) statement" on how the board has had regard to the non-exclusive s172(1) factors above when performing their s172 duty. The s172(1) statement should include information regarding:

- Issues, factors and stakeholders the board considers relevant and how they have formed that opinion (citing long-term initiatives and engagement with key stakeholders)
- Main methods used to engage with stakeholders including employees
- Effect on decisions and strategies (principal decisions, capital allocation & dividend policy, corporate culture and environmental, social and governance disclosures)

Decision-making should be carried out with regards to these disclosure requirements. This is in addition to a number of other new disclosure requirements in the annual report, including the obligation to report on engagement with employees, suppliers, customers and others.

#### **7. Insolvency**

Wrongful trading provisions will be temporarily suspended with retrospective effect from 1 March 2020 so that directors would not be personally liable for continuing to trade under those provisions. The Corporate Insolvency and Governance Bill has been introduced on an emergency basis in an attempt to ensure that otherwise financially viable companies survive during the COVID-19 pandemic and is currently passing through Parliament.

Despite these measures, companies should be aware that if the continued solvency of a company looks doubtful, the focus of the

duties of directors switches from promoting the success of the company to acting in the best interests of the creditors of the company as a whole, as equity value is eliminated. It is at this point that the potential for personal exposure becomes much more acute for company directors. The board of directors should regularly review with management the near-term, mid-term and longer-term financial impact of COVID-19 on the business and management assumptions underlying projections or forecast (in particular of revenue or cash) should be understood and stress-tested. Alternative financing arrangements should be explored, alongside restructuring of current debt obligations as applicable.

Directors of companies facing financial difficulties should seek appropriate professional advice as soon as possible.

## Going forward

Directors can consider ways to be prepared for future uncertainty as we hopefully move out of the current phase of the pandemic. Options to consider include:

- Exploring supply chain protection strategies. Supply chains could have greater protection from future shocks if for example alternative suppliers were found
- Directors may want to propose amendments to their articles of association in order to allow hybrid/wholly-virtual shareholder meetings and to protect investor and stakeholder engagement in annual general meetings in the future
- Reviewing indemnification and insurance for directors
- Reviewing significant contracts for force majeure clauses

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