Focus on
COVID-19
Coronavirus

A&L Goodbody

Board Business: *Directors' duties, practical mitigation steps and assessment of financing arrangements*

The outbreak of COVID-19 continues to have a deep impact on businesses across all sectors. A growing number of companies are warning that they will fail to meet financial and commercial targets and global supply chains are being disrupted. The legal implications of this are wide ranging, complex and evolving.

In this edition of our series "Responding to COVID-19 – Board Business" we take a look at directors' duties in the context of the current uncertain environment. In particular, we explore the position of directors of companies with solvency issues and actions that should be taken by a board to best mitigate any solvency risks. We also identify some practical steps directors can take to mitigate against potential risks.

Many companies are also considering how the pandemic will affect their existing and future financing arrangements. We identify some of the areas where financing and related agreements may be affected and look at some questions which should be considered at board level.

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

A&L Goodbody

Directors' duties

It is important for directors to obtain all necessary information to assess and understand the business and legal risks posed by COVID-19 and to discuss and test management's strategies for mitigating these risks. In addition to looking at financing arrangements covered in Part 3 below, boards should also take steps to protect cashflow and ensure viability throughout this period.

Companies may be facing liquidity issues and/or default. In addition to engaging with funders, directors of affected companies also need to be aware of their legal duties, especially around decisions they may be considering making to get through current difficulties.

Directors have a range of fiduciary and other duties, chief among which is to act in the best interests of the company. Where a business is solvent and trading as normal, the company's directors owe their fiduciary duties to the company.

In circumstances where a breach of duty is proven, a director may be required to: (a) account to the company for any personal gain made from the breach; and (b) indemnify the company for any loss or damage resulting from the breach. A Northern Irish court may 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.

During times of uncertainty

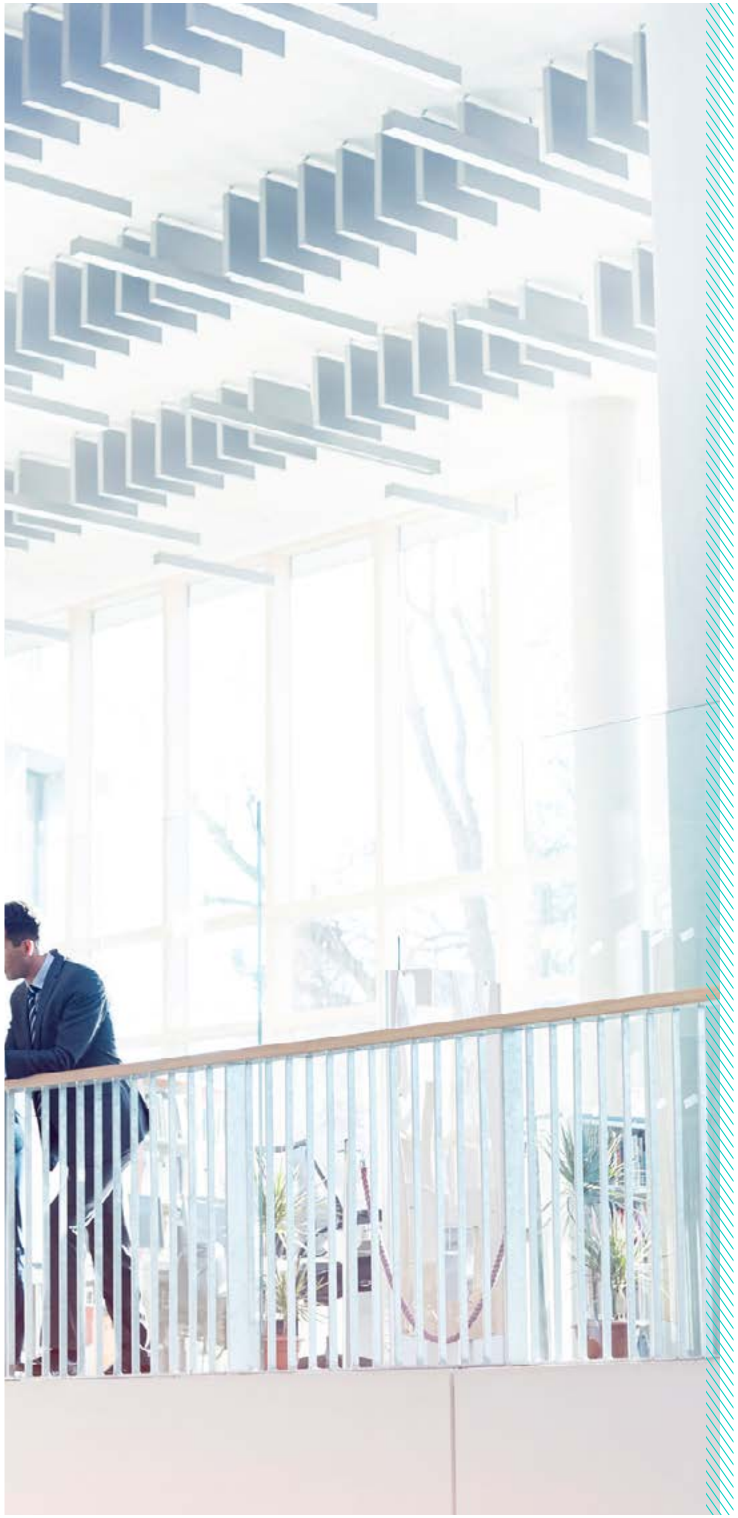
In addition to their ongoing statutory duties in "normal" times, directors should also be aware of their duties and to whom they are owed during times of financial uncertainty for the business. This will assist directors in actively managing their risk of personal exposure, where the company is insolvent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

If a company runs into financial difficulty and is unable to pay its debts in full as they fall due, directors continue to owe their duties to the company but must also act to protect the interests of company creditors. Typically, this means considering the impact of material decisions on 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:

a. mitigate any claim made that they have acted inappropriately and should be held liable for the debts of the company; and

b. ward off any attempt by an insolvency practitioner subsequently appointed who may seek to restrict them in acting as directors.



A&L Goodbody

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, directors do the following:

- 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, which may include holding such meetings remotely. Directors should ensure board meetings can be held (and properly recorded) remotely.
- 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.
- Document key decisions and the reasons for making them.

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 administration and/or liquidation. In such situation, it is important for the company and the directors to be aware of personal risks that can arise including **reckless and fraudulent trading, restriction and disqualification applications.**

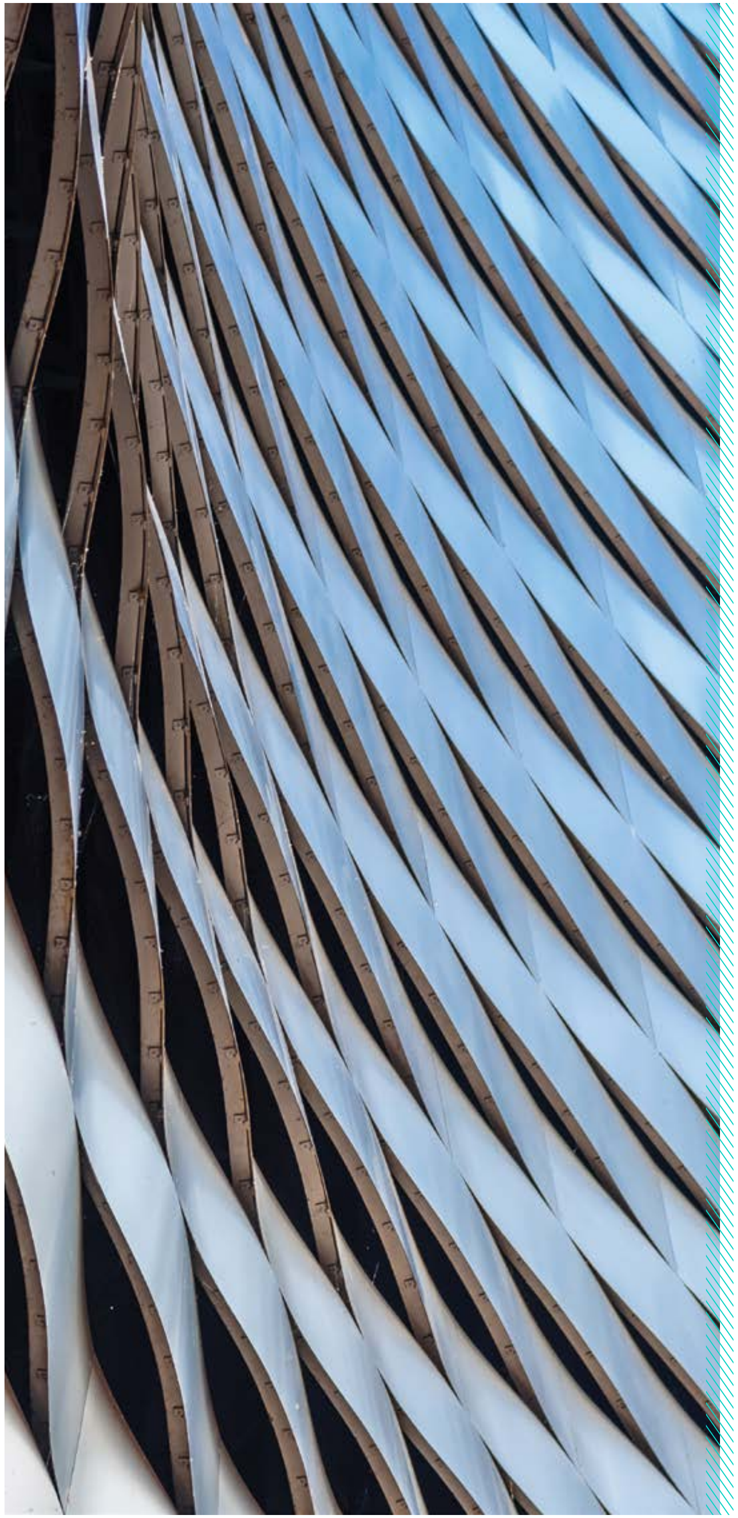
On 28 March 2020, the UK Government announced changes to insolvency laws including a temporary suspension on **"wrongful trading"** provisions to give company directors greater confidence to use their best endeavours to trade during the COVID-19 situation without the threat of personal liability should the company eventually fall into insolvency. This change is to be applied retrospectively from 1 March 2020. It is important for directors to note that other existing laws in relation to fraudulent trading and director disqualification will continue in full force and effect.

Practical steps for directors to mitigate against potential risk

Although COVID-19 is causing unprecedented challenges for many companies, there are practical steps directors can take now to assess and manage risks the business may face from falling revenues, damaged liquidity and turbulent market conditions.

Depending on the nature of the business, these may include the following.

- Review all material contracts, including insurance policies and key customer/supplier arrangements, to determine whether they are impacted by the current situation. Review how both the company's and the counterparties' rights might be affected.
- In particular, focus on financial covenants, events of default, termination provisions, frustrating events, force majeure, indemnities and guarantees. Force majeure clauses are particularly relevant during a crisis and a detailed analysis may be required. Here you can find our briefing on force majeure.
- To retain stakeholder confidence, open up an honest and regular dialogue with your key investors, suppliers, lenders, material creditors, and debtors (where applicable).
  - **Lenders:** 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.
  - **Debtors:** Renew efforts to collect any payment arrears where applicable to your business.
  - **Investors:** Consider whether the company needs new capital or investment to continue in business in the immediate term.
  - **Suppliers:** consider finding alternative supplies or tightening credit terms including retention of title clauses until payment has been made.
- The UK Government has introduced a number of supports to impacted businesses (e.g. the Coronavirus Job Retention Scheme and the Coronavirus Business Interruption Loan Scheme) and additional supports are also being provided from financial institutions and others. Consider these supports to see what impact such measures may have on your company.
- Consider what comfort can be taken from governmental support or lender engagement in decisions being made about the future of the business or the ability 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.
- 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.



02 Practical steps for directors to mitigate against potential risk

- 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.
- One particular point to note at this time - be alive to health and safety risks posed by COVID-19. Businesses should review risk assessments to address the impact on work practices of the ongoing public health crisis. Aside from the obvious health risks to employees, a failure to do so may put the business at risk of potential prosecution by the Health and Safety Executive or the Director of Public Prosecutions if a company suffers an outbreak, with resulting fatalities. Those businesses who continue to operate as "essential services" must also ensure they have appropriate policies and procedures in place to comply with statutory requirements in this respect. If failings are attributable to directors, officers or managers, they too could face personal risk for health and safety matters in certain circumstances and in particular where they are involved in day to day operational control and that control (or lack of) led directly to an incident.

03

A&L Goodbody

Financing arrangements

Debt funding is typically an important part of the capital structure for companies and following what has been an extremely challenging period for many companies liquidity is now key. Management teams and boards are actively considering their current and anticipated funding requirements, including assessing the terms of their existing finance arrangements.

To assist with the formulation and implementation of an appropriate strategy, we have considered the key aspects of some common financing arrangements entered into by Northern Irish and UK companies.

Planning and communication with your lenders

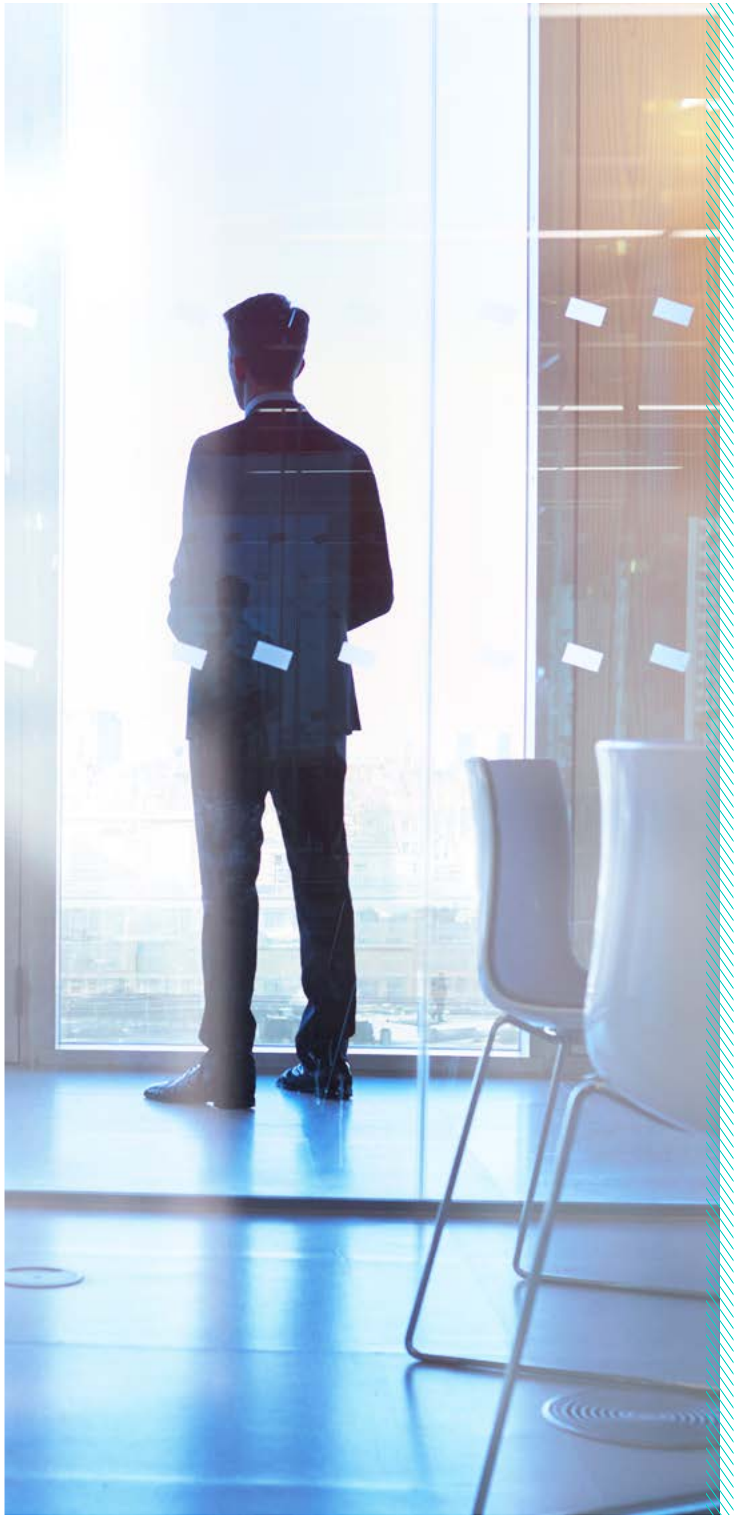
Preparing as detailed an analysis as is possible, in the current uncertain climate, of the company's immediate and medium term funding needs is naturally a key plank on which to plan. So too is having a clear understanding of the company's contractual rights, and obligations, under its existing credit arrangements.

It is important that a company revises its financial plans to present as clear a picture as possible of what those needs are and where difficulties may arise in the context of its existing credit arrangements (with respect, in particular, to financial and other covenants and repayment obligations). That will allow the company to formulate what it's 'ask' may be of its funders. Companies facing liquidity issues and / or default should consider engaging with their funders as soon as possible following that analysis.

The company has revolving credit facilities – will these be affected?

Companies anticipating financial difficulties may wish to take proactive steps to draw down any undrawn commitments in the short term to maximise financial resources, notwithstanding the additional interest costs of doing so. Companies with revolving credit facilities should review the terms of those facilities as soon as possible. Generally, the drawing of additional funds will be conditional on there being no default or event of default outstanding and the continued accuracy of the repeating representations referenced in the credit agreement.

Boards should carefully consider the timing of any borrowing and the impact that COVID-19 may have on the covenants and representations contained in the credit agreement into the future. Before drawing additional facilities, company directors should also familiarise themselves with any 'clean-down' requirements in their finance documents (being requirements to pay down fully a facility for a short period of time rather than just rollover outstanding loans).



A&L Goodbody

Should we look to amend, or have waived, certain terms of our financing arrangements?

This will depend on the factual position and the specific terms of your financing agreements. If an amendment or waiver is advisable, two practical elements to consider are:

- the procedures which may need to be followed in the finance documents; and
- what percentage of consenting lenders may be required for the waiver/amendment.

The board should also be aware that the costs and expenses of the lenders/agent/trustee in connection with amendments/waivers will typically be for the borrower and there may be amendment or waiver fees charged. In addition, lenders may apply other conditions to the giving of an amendment or waiver, which could include additional capital being obtained, the provision of (additional) collateral or other requirements.

In this regard, the board should consider on a pro-active basis what “gives” or concessions that it can offer to lenders to secure the necessary waivers and amendments (if needed). Examples might include additional collateral, further oversight or reporting structures, additional margin (arising at a later date) or further covenant restrictions.

From a practical perspective the logistics of executing amendments to existing financing agreements in the current environment, ie electronic signatures, requirements for witnesses etc, will need to be considered and factored in from a timing perspective. This is likely to be particularly relevant in the context of syndicated facilities where you have multiple lenders a majority or all of whom may have to consent to any such amendments, depending on the terms of the financing agreement.

Events of default

Financing agreements typically contain events of default. Borrowers and lenders will need to re-assess these events of default in light of the material impact that COVID-19 is having on businesses and the economy more generally.

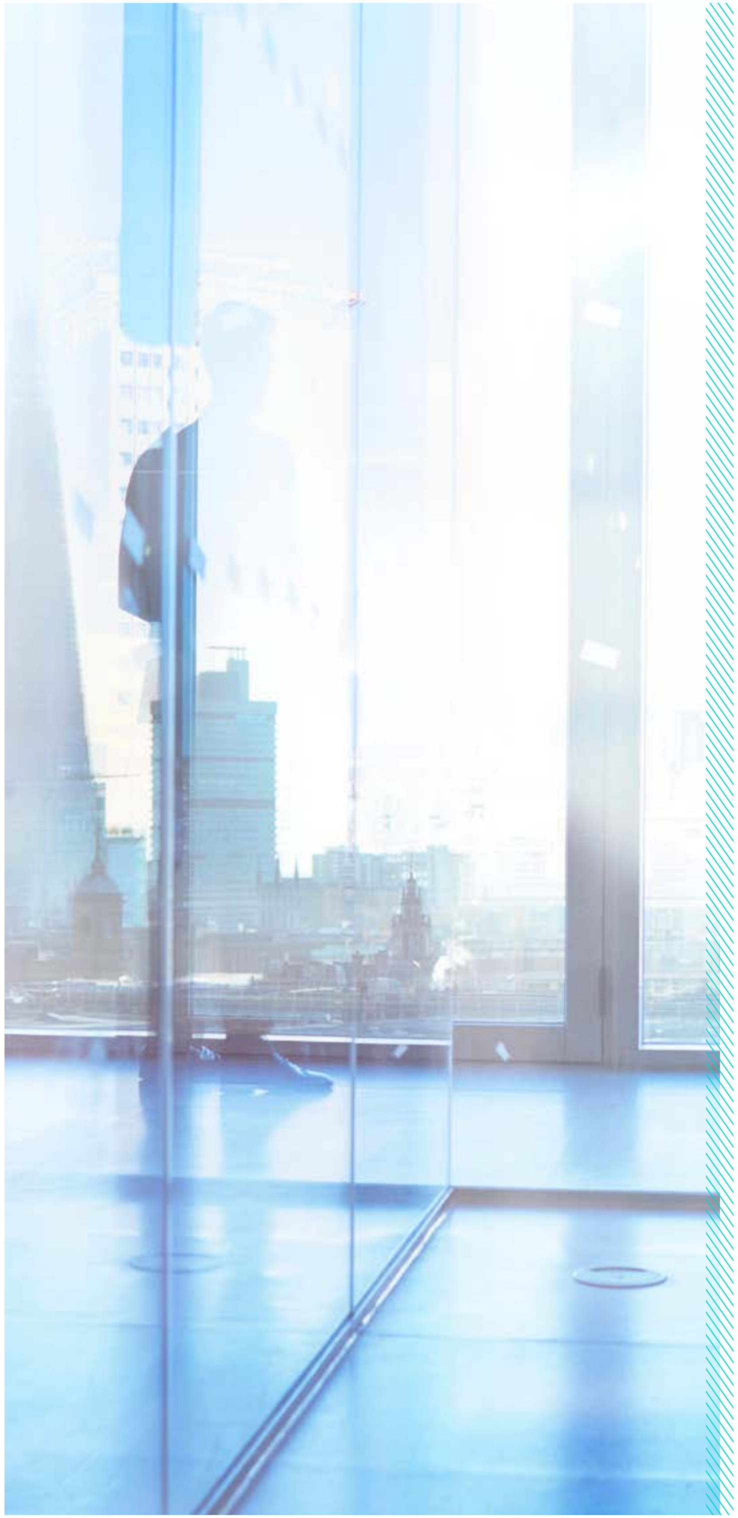
The range of potential breaches contained in finance documents is wide, complex and also evolving; however, some examples are set out below. It should be noted that whether or not there is a breach will depend on the drafting of the documents and the facts of the case. Borrowers may seek to avoid triggering an event of default by anticipating at an early stage what defaults are likely to arise and (i) taking steps to avoid this (including exercising any cure rights) and/or (ii) applying ahead of time for a waiver or amendment to the finance documents.

In addition, defaults, and the notification of them, may have effects on other agreements, or licenses if applicable, that the company has entered into. It should also be noted that upon the occurence of an event of default the lender often has a relatively unrestricted right to transfer the debt during the period where an event of default continues to exist. This again emphasises the need to engage with lenders as soon as possible.

Material Adverse Change provisions

It is relatively common for financing agreements to contain an event of default on the occurrence of a ‘material adverse change’ (MAC). The purpose of a MAC clause is to capture certain risks that cannot be anticipated at the time the loan agreement is signed.

The ability of a lender to invoke a MAC clause will depend on the wording of the clause and the specific facts (as it is ultimately a question of fact as to whether it has occurred). A MAC can be difficult to prove in practice and therefore has (traditionally) seldom been used by lenders. However, the practise with respect to COVID-19 may well evolve over time.



Cessation of business

It should be considered whether the 'cessation of business' event of default could be triggered by mandatory or voluntary closure of a business or activities as a result of the pandemic.

Non-compliance with financial covenants

The majority of business sectors are already seeing a slowdown in business activity as a result of the pandemic. If this results in a material deterioration of the financial position of a company, it may not be able to meet its financial covenants. How immediate an issue this is will depend on how frequently the covenants are tested and when the next test date is (in addition to the materiality of the impact of the pandemic on business).

Failure to comply with information undertakings

Borrowers will likely have obligations to notify their lenders of the occurrence of certain events under their financing agreements (including the occurrence of a default). A failure to do so will amount (subject to any remedy period) to an event of default. Defaults, and the notification of them, may have effects (such as a cross default) on other agreements or licenses of a borrower.

Default

A default or an event of default will typically be a drawstop (i.e. prevent the drawing of further loans), which can be particularly relevant on revolving facilities as noted above. It will also (subject to any grace periods and cures) permit a lender to accelerate and enforce. While such a drawstop may well have negative consequences for a borrower regardless of the industry they are engaged in it is likely to be particulalry relevant for borrowers engaged in the construction sector. In these circumstances any such drawstop is likley to have knock on consequences such as an inability of the borrower to make required payments to contractors etc which may lead to claims against the borrower as a direct result of the drawstop.

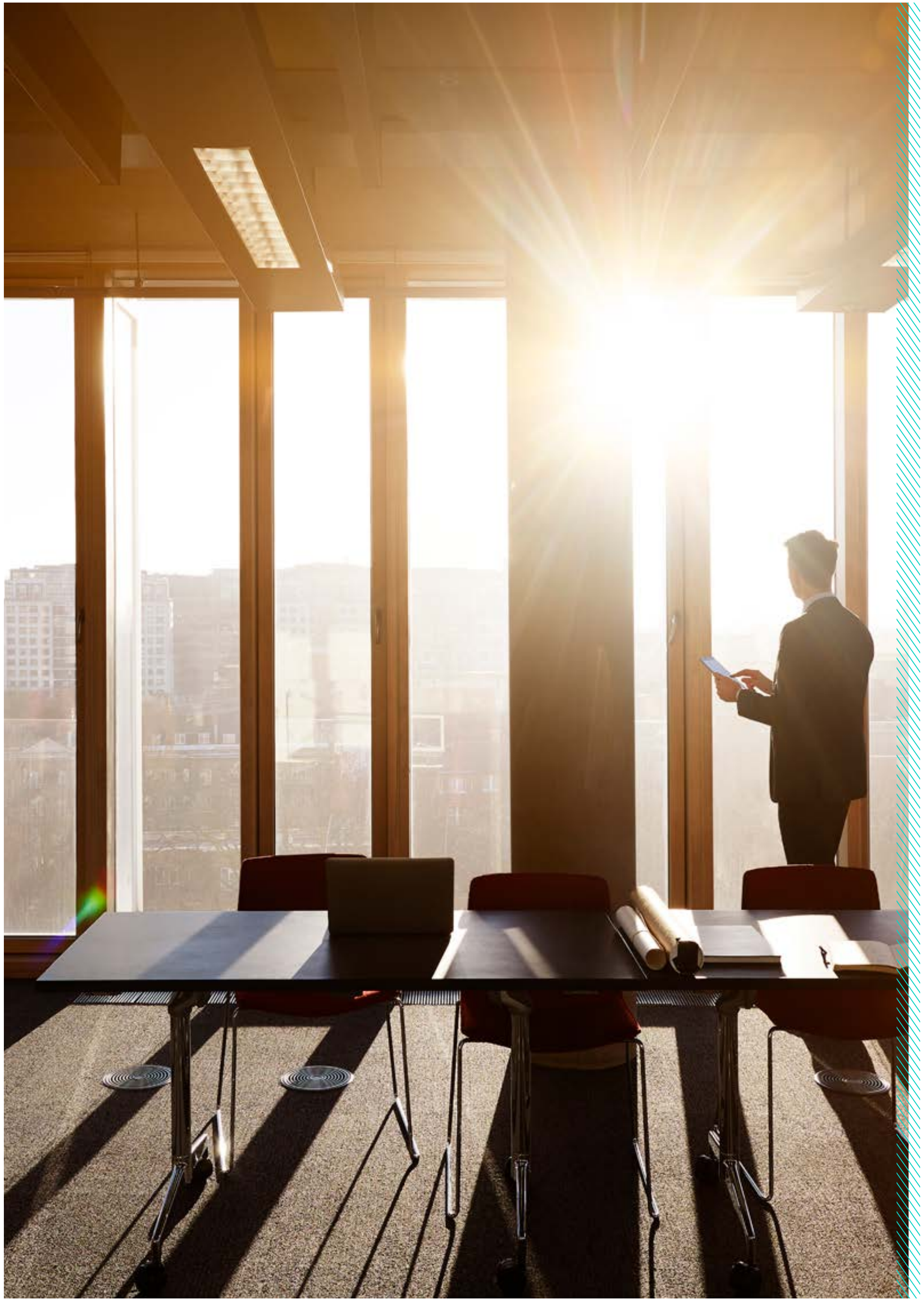
Our statutory financial statements will be delayed – will this have an impact on our financing arrangements?

Financing agreements may contain deadlines by which the audited financial statements must be provided. This is typically 120/150/180 days after the end of the relevant fiscal period.

Where a company expects to experience a delay in the finalisation of its audited financial statements, and if relevant, intends to avail of the COVID-19 extensions for publishing of audited financial statements which have now been provided for by a number of regulators, it may need to also seek a waiver from its lenders for any such delay.

Directors should be prepared, proactive and engaged

We are experiencing an unprecedented crisis and it is understandable that many directors may feel a strain on their judgement and their ability to perform 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 and obtaining specialist external advice where possible. Overall, directors should be prepared, proactive and remain fully engaged on all aspects of the business to navigate the road ahead.



A&L Goodbody

Please do not hesitate to contact A&L Goodbody if you wish to discuss any of the matters raised in this publication.

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

KEY CONTACTS

Alastair Keith
Partner
+44 28 90 727 418
akeith@algoodbody.com

Peter Stafford
Partner
+44 28 90 727 590
pstafford@algoodbody.com

Mark Thompson
Partner
+44 28 90 727 591
mthompson@algoodbody.com

David Rowan
Partner
+44 28 90 727 487
drowan@algoodbody.com

Mark Stockdale
Partner
+44 2890727456
mstockdale@algoodbody.com

DUBLIN / BELFAST / LONDON / NEW YORK / SAN FRANCISCO / PALO ALTO