

COVID-19 : Risk of mismanagement claims – recommendations for directors

Company directors are advised to be aware of the increasing risk of disputes regarding mismanagement in response to Covid-19.

Please note, due to the pace at which the impact of the present coronavirus pandemic is evolving, this article can only seek to offer insights as at the date of publication.

The speed and unpredictable nature of Covid-19 caught us all off guard, meaning that we have had to be reactive for most of the year. However, as we are getting more acclimatised to this new reality it is likely that companies and specifically their directors will be called to account in relation to their response to Covid-19, leading to a rise in corporate disputes.

Unfair prejudice and derivative claims

In the face of the pandemic, many directors will have been caught in a 'Catch-22' predicament – having to make business critical decisions with little or no time to consult or fully inform themselves of the implications of these decisions. Unfortunately, this type of fast paced decision-making could open directors up to claims of mismanagement where such decisions have negatively impacted their company.

For example, with a view to keeping their companies afloat, directors may have applied for emergency funding. However, now the dust has settled, and stakeholders have had the opportunity to review the financial position of their companies, it may turn out that the funding was not necessary. Alternatively, when the funding was applied for, the director may not have appreciated the high interest rates involved which could have resulted in a different decision being made.

If a shareholder considers that a decision taken by a director has been prejudicial to the interests of themselves and other members of the company, they could make an unfair prejudice petition to the court (Companies Act 2006, s.994).

Alternatively, they could bring a derivative claim (Companies Act 2006, s.265) on the basis that the director breached their duty to act in the interests of the company, with this action being a protective measure.

In both of types of action the court could take into account the circumstances surrounding the decision made by the director – but could equally hold the director to account where they find that a poor decision was just that and not a result of Covid-19.

Directors may therefore not be able to hide behind Covid-19 and the panic that may have influenced their decision making.

Wrongful trading

A claim of wrongful trading (Insolvency Act 1986, s.214) may also be brought against a director.

Wrongful trading occurs where the decision is taken that a company should continue to trade in circumstances where there is no prospect of the company avoiding insolvency. Where a director is found to have committed wrongful trading, the court can order the individual director to contribute an amount that it deems appropriate which could be the sum deemed necessary to put the company back into the position it would have been had the wrongful trading not taken place.

Personal liability for wrongful trading was temporarily suspended as a result of the introduction of the Corporate Insolvency and Governance Act 2020 - a piece of legislation introduced by the UK Government to prevent the collapse of businesses amidst Covid-19. For several months directors did not face personal liability where their companies continued to trade – in the hope that when normal business resumed, so would their businesses. However, this suspension of personal liability lapsed on 30 September 2020, with the UK Government opting not to extend this protection any further.

It is now possible that either a liquidator or administrator could make a claim for wrongful trading where a director has directed a company to continue trading beyond 30 September 2020 where there was no prospect of avoiding insolvency. A claim could also be made where a director has taken the decision to bring staff back from furlough with their company incurring the costs of the same - when insolvency was unavoidable.

There is a defence to wrongful trading - where the director can show that they took every step with a view to minimising the potential loss to the company's creditors (Insolvency Act 1986, s.214(3)). However, the onus is on the director to satisfy the court that the defence applies.

The success of the defence in relation to actions raised amidst Covid-19 is currently unknown – however the court will take account of both objective and subjective considerations. This could mean that despite the pandemic being an unprecedented situation to everyone, an experienced director could be subject to more rigorous scrutiny when raising the defence than a newly appointed director with little experience to date.

It is therefore important that directors are fully aware of the financial position of their company and raise any concerns with fellow directors, shareholders and the company's accountants.

Directors should also be prepared to initiate insolvency proceedings where appropriate to avoid personal liability and keep in mind their duty to creditors when making decisions.

Breach of duty

Legally, directors owe a number of duties to their company, including for example, a duty to promote the success of their company and a duty to exercise reasonable care, skill and diligence.

In the context of Covid-19 this is likely to mean keeping up to date with the latest advice from UK and Scottish Government, regularly reviewing the impact of Covid-19 on the business and taking steps to protect the company to ensure its survival. With this in mind, it is quite possible that shareholders could, on behalf of the company, make a claim for breach of duty where a director has failed to take active steps in response to Covid-19.

A director could be found personally liable for omitting to do something – where the court considers that the director had a duty to act.



There is a great level of sympathy afforded to directors, who are trying to navigate their companies through this unprecedented situation.

In a bid to avoid potential shareholder claims, it is recommended that directors keep clear records of their business decisions and the reasoning behind them. It will be important to be able to justify decisions on sound business reasoning, to show that decisions have been communicated with shareholders and that there has been open and regular communication.

It is also important that directors keep up to date with UK and Scottish Government announcements regarding the suspension of wrongful trading and make sure they are fully aware of the company's financial position.

Whilst there will still be a risk of claims – these steps should minimise that risk.

For further information and guidance, you can contact:

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