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Directors' duties and liabilities in financial distress during Covid-19

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A global perspective

Uncertain times give rise to many questions

The Covid-19 pandemic and the ensuing economic crisis has a significant impact, both financial and otherwise, on companies around the world. Boards are struggling to ensure survival in the short term and preserve cash, whilst planning for the future, in a world full of uncertainties.

Many directors are uncertain about their responsibilities and the liability risks in these circumstances. They are facing questions such as:

- If the company has limited financial means, is it allowed to pay critical suppliers and leave other creditors as yet unpaid? Are there personal liability risks for 'creditor stretching'?
- Can you enter into new contracts if it is increasingly uncertain that the company will be able to meet its obligations?
- Can directors be held liable as 'shadow directors' by influencing the policy of subsidiaries in other jurisdictions?
- What is the 'tipping point' where the board must let creditor interest take precedence over creating and preserving shareholder value?
- What happens to intragroup receivables subordinated in the face of financial difficulties?
- At what stage must the board consult its shareholders in case of financial distress and does it have a duty to file for insolvency protection?
- Do special laws apply in the face of Covid-19 that suspend, mitigate or, to the contrary, aggravate directors' duties and liability risks?

There are more jurisdictions involved than you think

Most directors are generally aware of their duties under the governing laws of the country from which the company is run. However, individuals may also be directors of subsidiaries in other jurisdictions, either personally or indirectly through holding or management entities of which they are directors. And even if they are not, the laws that govern the subsidiaries may classify them as shadow directors of the subsidiary. All this may expose directors to duties and liability risks at local levels.

To complicate matters, liability may not only arise under local company law, but also under tort laws of countries where contracts are entered into that later cannot be performed, causing damages to the company's counterparties. Insolvency proceedings may be opened in yet more jurisdictions where the company or its subsidiaries do business and local insolvency laws may contain specific directors' duties and liability regimes.

Guidance to navigating these risks

We have put together an overview of the main issues facing directors in financially uncertain times in a number of key jurisdictions across the globe. This includes a brief general description of directors' duties and key areas of potential directors' liability in each country, as well as some answers to the questions listed above.

Obviously, the duties and liabilities that may arise will always be dependent on the circumstances. Therefore, this publication should not be used as legal advice when faced with a specific dilemma. However, we hope it may help to alert directors and their in-house advisors to the duties, pitfalls and liability risks that exist in major jurisdictions across the globe.

Poland

No.	Question	Answer
Directors' Duties		
1.	Do directors have to act primarily in the interest of their shareholders or do they have to take in account other stakeholders' interests as well? Does that regime change in case of financial distress?	While a company is solvent and trading normally, the directors' primary consideration is that of the interests of the company itself. Under Polish law, the interests of the company are not the equivalent of the interests of the shareholders. The interest of the company should be determined on a case-by-case basis, depending on the purpose of the company described in its articles of association, the shareholding structure of the company, the interests of shareholders and other factors which may be relevant to the company and its operations. Moreover, the management board is under no (legal) obligation to implement shareholders' resolutions, directions or suggestions. The management board may even refuse to provide explanations to the shareholders or to make the books and documents of the company available for inspection if there are reasonable grounds to believe that the shareholders will use the same for purposes contrary to the company's interest, thus causing material damage to the company. When a company finds itself in financial difficulty (either insolvent or likely to become insolvent), there should be a re examination of the company's interests which takes into account the interests of the creditors as well. Where a company is likely to become insolvent, the creditors' interests should, at the very least, be considered and taken into account.
2.	What are the key areas of potential liability for directors when a company is in financial difficulties?	**Civil Liability** There is a distinction between the internal and external liability of managing directors. Internal liability exists vis-à-vis the company and arises from the corporate relationship between the managing directors on the one hand, and the company on the other. Internal liability may be individual or joint (of all or some of the management board members) depending on the situation. Under the Polish Commercial Companies Code (the CCC), management board members are liable to the company for any damage caused as a result of their: (i) unlawful act; or (ii) a breach of the company's articles of association, unless such damage was caused unintentionally. Furthermore, management board members are obliged to perform their duties with due professional care. The CCC sets out only general standards of due care, therefore any assessment of whether due professional care has been exercised or not must take account of all specific circumstances. Importantly, management board members cannot avoid liability by claiming that they have merely implemented a resolution of the general meeting, as the management board is under no obligation to implement a resolution if the board decides that the resolution violates the law, the company's articles of association or good practice, or is detrimental to the company's interests. In such case, the management board has the right to bring a court action for the resolution to be declared invalid or revoked. The management board members are also liable towards the company under various (specific) legal regulations. For example, under the Accountancy Act, management board members are obliged to ensure that the financial statements and management reports are compliant with the Accountancy Act regulations. Management board members are liable to the company for the damage caused by their actions or lack of action in breach of the above obligation.

No.	Question	Answer
		External liability of managing directors is liability towards third parties, such as creditors, individual shareholders, employees and the tax or other administrative authorities. Such external liability may be individual or joint (of all or some of the management board members) depending on the situation. Individual liability of managing directors towards third parties is based on the general rules of the Polish civil law (torts). Under those rules, anyone who intentionally inflicts damage on another person is obliged to redress such damage. The Civil Code stipulates that the injured person is responsible for proving the damage, the fault of the person who caused it and the causal link between the action or omission to act by the perpetrator and the occurrence of damage. On the other hand, pursuant to the CCC, management board members are jointly and severally liable with the company for the company's obligations if the enforcement against the company has proved to be ineffective. Joint and several liability means that the creditors may seek satisfaction directly from a management board member's assets. A management board member may be released from this liability if it is able to prove that: – a petition to declare the company bankrupt was filed at the appropriate time; – a decision on initiating restructuring proceedings with respect to the company was issued by the competent authority at the appropriate time; – a decision approving an arrangement was issued by the competent court as described in the Polish restructuring law; – failure to file a bankruptcy petition was not due to any fault on such member's part; or – despite: (i) the failure to file a bankruptcy petition; (ii) the competent authority not issuing a decision to open restructuring proceedings; or (iii) the court not approving the arrangement, the creditor has not incurred any damage. Notwithstanding any liability a management board member may incur under civil law in relation to their failure to file a bankruptcy petition in a timely manner, management board members may also be held criminally liable in connection with the company's bankruptcy. **Criminal Liability** The criminal liability of management board members is regulated by the relevant provisions of the CCC and the Criminal Code; however, specific regulations providing for criminal liability of management board members can also be found in certain other acts. The Criminal Code identifies a number of offences for which members of the management board of a limited liability company may be liable, which may be directly or indirectly related to the function performed by a member or the type of activity conducted by the company. Such offences include: – acting to the detriment of the company by abusing one's powers, failure to meet one's obligations, or engaging in corruption practices; – acting to the detriment of the company's creditors in the event of threatened insolvency by making it impossible for the creditors to satisfy their claims or reducing the company's assets (for instance by divesting, donating, destroying, or actually or purportedly pledging or damaging the company's assets, or transferring the company's assets to another company); and – failing to maintain the company's business documentation or maintaining such documentation in an unreliable manner or inaccurately.

No.	Question	Answer
3.	Does liability rest only with formally appointed directors, or also with (other) officers or de facto directors? If so, what are the standards to qualify as such?	A director's liability generally rests on the formally appointed management board members or liquidators of the company. However, other persons may bear similar liability depending on their function and the powers they have in/towards the company. The liability of such persons must always result from the specific provision of law or must be based on the general rules of civil law (torts).
4.	What are the standards for directors' liability for the company having entered into contracts that the company can later not perform ('wrongful trading')?	The general rules of a director's liability shall apply. In particular, the management board members may bear civil liability towards the company and/or the creditor if they intentionally conclude an agreement or borrow new money to the detriment of the company or the creditor, or potentially even if they should have known that the company would not be able to repay or perform its obligations.
5.	What are the liability risks in the case of 'creditor stretching'?	The analysis is very much dependent on the circumstances. Depending on the given scenario, a director might be held liable under the general rules of the Civil Code or might be criminally liable under the Criminal Code. Please refer to question No. 2 for more details.

No.	Question	Answer
6.	What are the liability risks in case of selective payments to some but not all creditors in case of liquidity issues? Is there a stage at which directors must treat all creditors equally?	In principle, if there are no financial difficulties, there are no strict rules for satisfying the claims of the individual creditors and the order of their satisfaction (payment waterfall). However, individual legal actions causing harm to the creditors may be challenged under the Civil Code. If a company is declared bankrupt or restructuring proceedings with respect to the company are initiated, the legal actions carried out on the verge of bankruptcy/restructuring causing harm to the creditors may be declared invalid/annulled with respect to the bankruptcy/arrangement estate, and as a result the assets fraudulently conveyed out of the company's property are restored to the estate and are designated to be utilised to satisfy the creditors' claims. The Bankruptcy Law and the Restructuring Law include the principle of equal treatment of all creditors. A claim that arose before the bankruptcy/restructuring proceedings are initiated must not be satisfied selectively. The payment waterfall in bankruptcy proceedings is set out in the Bankruptcy Law. In the restructuring proceedings the terms on which the creditors are satisfied are set out in the arrangement. Under the arrangement, the creditors may be split into groups and the individual group's claims may be satisfied on different terms. Under the Restructuring Law, in certain events a creditor may be granted more favourable terms of having its claims satisfied, eg when following the initiation of the restructuring proceedings such a creditor has granted or is about to grant to its debtor the funding necessary to implement the arrangement. Claims arising in the course of the restructuring proceedings should be satisfied on an ongoing basis. The company's failure to satisfy its current liabilities in the course of the restructuring proceedings is the reason to discontinue the proceedings. As far as the liability of the directors, ie the Management Board members, is concerned, the selective satisfaction of individual creditors' claims might be subject to criminal liability under the Criminal Code, so long as the statutory requirements are met - please refer to question two above for details on these requirements.
7.	Is there a distinction in this regard between preferential treatment of related entities and the treatment of other creditors?	Legal actions in favour of related entities are subject to the special (easier) principles of their annulment. Namely, under Bankruptcy Law: – legal transactions executed by the bankrupt company within six months before the day of submission of a petition for bankruptcy with: (i) its shareholders or representatives or their spouses, (ii) the affiliated company or (iii) the shareholders or representatives (or their spouses) of the affiliated company, will be ineffective concerning the bankruptcy estate; and – the judge-commissioner supervising the bankruptcy proceedings may declare ineffective towards a bankruptcy estate a security established over the company's assets to secure a third party's debt if (i) this third party security is established between the date falling one year before the filing of the bankruptcy petition and the declaration of bankruptcy, and (ii) the companyhas received no consideration in return or the consideration received by the companyis of a lesser value than the security. If this third party security was established to secure the debt of a related entity, this third party security may be declared ineffective towards the bankruptcy estate regardless of the value of the consideration received by the company, unless the security receiver can prove that this transaction was not detrimental to the other company's creditors. Restructuring Law contains similar provisions relating to clawback.

No.	Question	Answer
8.	Is there an obligation in case of financial difficulties to convene a shareholders' meeting and. if so, at what stage of financial difficulties?	Yes, when the balance sheet drawn up by the management board shows a loss in excess of the total of the spare and reserve capital and one-half (limited liability company) or one-third (joint-stock company) of the share capital, the management board shall immediately convene a shareholders' meeting to adopt a resolution on the further existence of the company.
9.	Is there an obligation at some stage to file for bankruptcy or other statutory insolvency protection regimes?	Yes, bankruptcy should be declared regarding a debtor who becomes insolvent, ie fails to pay its due and payable obligations. There are two insolvency tests and it is sufficient if only one is satisfied: – the illiquidity test: the company is unable to meet its pecuniary obligations as they fall due, which is assumed if the company has ceased making payments on time for longer than three months; or – the over-indebtedness test: the company's assets no longer cover its liabilities for longer than 24 months, which is assumed if the company's balance sheet reveals such situation, even if the company performs its obligations on a day-to-day basis. The satisfaction of any of the above tests regarding the company would require its management board members to file an insolvency application within 30 days from the realisation of any grounds for insolvency. However, the management board members will not be liable if within that period restructuring proceedings were opened or an arrangement with creditors was approved.

No.	Question	Answer
10.	Are there special liability risks in respect of certain debts, such as tax debts, social security payments, and pension contributions?	Yes. Management board members of a limited liability company may be held personally liable for tax arrears of the company, jointly and severally with the company, up to the full value of their assets, if enforcement of any fiscal debt against the company's assets proves to be ineffective in whole or in part and there are no grounds for management board members to be released from the liability. The management board members may be released from liability if they are able to: – demonstrate that a petition in bankruptcy was filed or restructuring proceedings were initiated with respect to the company at the appropriate time or an arrangement was approved under Restructuring Law; – demonstrate that the failure to file a petition in bankruptcy was not their fault; or – indicate the company's assets from which enforcement will cover tax arrears to a large extent. The same principles of liability apply to arrears in the payment of other public dues (eg contributions to the Social Insurance Institution for the company's employees). Management board members may also incur liability under the Fiscal-Penal Code as persons responsible for the company's economic and financial affairs. For instance, management board members may be held liable for: (i) failure to submit a tax return or declaration to the tax authorities when due; (ii) persistently failing to pay due taxes; or (iii) failure to keep accounts or keeping accounts in an unreliable or incorrect manner, failure to store accounting books where required. The liability arising under the Fiscal-Penal Code is criminal liability: the catalogue of possible penalties includes a fine, limitation of liberty, and deprivation of liberty.
11.	Are the liability risks of the directors collective (i.e. the whole board is responsible/liable) or individual? On what grounds can a director exculpate themselves from other directors' acts or omissions?	Directors owe their duties individually as opposed to the board being collectively responsible. This means that each director has to form their own views independently as they consider appropriate. Directors may be allocated specific responsibilities – Finance Director or Sales Director, for example – and they will have primary responsibility in that area. But that does not absolve the other directors from responsibility for ensuring these duties are being discharged appropriately by the director concerned. This may involve challenging their actions and views in certain circumstances. The minimum standard required of a director is that of a reasonably diligent person having the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as that director. However, the actual standard by which a particular director is judged will be higher if that director's general knowledge, skill and experience are, in fact, greater. The type of liability (individual or joint and several) depends on the basis of such liability. The specific provisions of law differ to this end. However, in most cases, even if the liability is joint and several, the individual director may try to exculpate itself by proving that the given act or omission constituting the basis of liability occurred without their fault.

No.	Question	Answer
12.	Are there specific actions against directors under bankruptcy law?	Yes, board members can be held liable for damage caused by the failure to file an insolvency application within 30 days from the realisation of grounds for insolvency. However, a management board member may be released from the liability if they prove any of the following circumstances: – the failure to file an insolvency application was not their fault; and – restructuring proceedings were opened or an arrangement was approved. In addition, liability is excluded if enforcement has been carried out by way of administration or sale of the company's enterprise and the obligation to file an insolvency application arose at the time of such enforcement. Please also refer to question No. 14 for Covid-19 specific regulations.
13.	Are there specific duties of (or consequences for) shareholders or other group companies at some stage of the financial difficulties, such as an automatic subordination or conversion into equity of debt to parent companies?	In principle, there is no mechanism of automatic conversion of the shareholders' claims into the debtor's shares but such restructuring mode is often selected for this type of liabilities because it eliminates the need to make any distributions from the arrangement estate to the shareholders where the arrangement estate may be used to satisfy the claims of creditors other than the debtor's shareholders. Quite often the arrangement provides for cancelling the shareholders' claims, in full or in part. In the event of restructuring, the creditors who are shareholders have limited rights and are in a weaker position compared to the other creditors (limitations regarding sitting on the creditors council and requesting that the creditors council be appointed – the creditors council is the body that can significantly affect the course of the restructuring proceedings; limitations regarding the right to request that a supervisor/receiver be changed and limited ability to influence the contents of the arrangement proposals and the arrangement itself. The arrangement may provide for the conversion of claims into the debtor's shares. When such an arrangement becomes final and binding, they may be diluted. The legal writings and legal academics/scholars and commentators indicate that in certain events the procedure for initiating the restructuring proceedings and adopting an arrangement with the conversion of claims into the company's shares may be a tool of a hostile takeover. The arrangement may provide (and quite often it indeed does provide) for equity injections to the debtor/providing additional funds by the shareholders, which is the condition for adopting and implementing the arrangement. In the event of bankruptcy the claims of the creditors who are shareholders are usually included in the fourth (last) category of satisfaction. In practice, when the claims of the creditors included in the higher-raking categories have been satisfied, hardly anything is left for the creditors who are shareholders.

No.	Question	Answer
14.	Is there special legislation mitigating the liability risks of directors specifically in view of the Covid-19 crisis?	Yes. The special Covid-19 legislation introduced a number of amendments to the bankruptcy rules. For instance, it suspended the running of time limits for a debtor to file a bankruptcy petition during a state of epidemic emergency or state of epidemic, and also added a fifth type of restructuring proceedings, ie the simplified arrangement approval proceedings. These proceedings allow a debtor to obtain a moratorium for the repayment of debt and protection against enforcement for at least four months although the proceedings themselves are less formal and are conducted with the limited participation of a court. The relevant provisions will be valid until 30 June 2021. During this period of time, a debtor will be allowed to resort to the simplified restructuring proceedings only once. Moreover, management board members will not be liable for the late filing of bankruptcy petitions or the ineffective enforcement against the debtor's assets if they evidence that the simplified restructuring proceedings were instituted within 30 days from the realisation of any grounds for insolvency and: – the arrangement is approved; or – it files a simplified petition to institute remedial proceedings or a simplified bankruptcy petition within the time limit for filing a complaint against the decision refusing to approve an arrangement or within seven days of the discontinuation of the proceedings, if the proceedings are discontinued following the filing of the petition to approve an arrangement; or – within seven days of the date on which the proceedings are discontinued by virtue of law, ie when the court does not receive a petition to approve an arrangement within four months of the date on which the announcement on instituting the proceedings is published, it files a bankruptcy petition or a petition to institute the restructuring proceedings which triggered the instituting of such proceedings.

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