



CORPORATE AND COMMERCIAL

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# Directors Duties' in a Challenging and Uncertain Trading Environment

by **Richard Curran, Jill Callanan, Paul Dineen**

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Despite the economy being on track for a full reopening sometime in 2021, many Irish companies will still be under financial and operational stress as a result of the challenging and uncertain trading environment brought about by the COVID-19 pandemic.

Difficult decisions probably had to be taken or delayed in virtual board rooms across the country over the last year and those challenges and uncertainties are likely to continue until the pandemic has fully abated.

In this article we provide an overview of the duties that Irish company directors are expected to comply with and how these apply in the context of the pandemic. We also outline some of the sanctions that can be imposed on directors for a breach of these duties.

## Role of Directors

The default position on the role of company directors under Irish company law is that the shareholders delegate the power to manage the company to the directors. This is subject to certain key decisions, such as amending the company's constitution, being reserved for the shareholders. In carrying out this role, the directors are classified as agents of the company and as a consequence are deemed to owe various fiduciary duties to the company.

## Sources of Directors' Duties

The source of directors' duties can be traced to the common law where they were developed over time through various cases that came before the Courts. Common law cases are still relevant in providing guidance on the application of directors' duties, but the principal fiduciary duties were codified and restated in the Companies Act 2014 (the 2014 Act). Additional duties can be imposed on directors through the constitution of a company and/or through additional pieces of legislation (Irish or EU).

## To Whom are the Duties Owed?

Under Irish company law, the general rule is that directors owe duties to the company and to the company alone, but they should also have regard to the interests of:

- shareholders
- employees
- creditors when a company is insolvent or close to insolvent

## Types of Directors Duties

**Section 228(1) of the 2014 Act provides for eight fiduciary duties.**

**1. Duty to act in good faith in what the director believes to be in the interests of the company**

This duty is judged on a subjective basis meaning that the intentions of a director are paramount in assessing whether or not a director has complied with this duty. However, where a belief held by a director is inconsistent of what is held to be reasonable it will most likely be determined as a belief which could not have been honestly held.

## **2. Duty to act honestly and responsibly in relation to the conduct of the affairs of the company**

An objective test applies when assessing an alleged breach of this duty. Case law suggests that to act 'dishonestly' implies something akin to improper dealing with money or other assets belonging to the company.

Case law further suggests acting 'responsibly' in relation to the conduct of the affairs of the company, involves not only ensuring compliance with the 2014 Act, but also acting prudently in the management of the company. An example of a failure to act responsibly would be a failure to maintain management accounts.

## **3. Duty to act in accordance with the company's constitution and law**

Directors are typically granted a wide range of powers under the constitution and by law.

Therefore, in deciding if a power was properly or improperly exercised by a director, the Courts will look at the 'substantial purpose' behind the exercise of the power. Consequently, before exercising a power, directors should understand what the intended purpose of the power is.

## **4. Duty not to use the company's property, information or opportunities for his or her own or anyone else's benefit**

This duty is strictly interpreted with the general principle being that directors should account to the company for any personal gains made from the exploitation of an opportunity belonging to the company and should also not disclose any confidential information of the company to any third party unless expressly permitted by the company's constitution or if permitted by a shareholders' resolution.

There is also some authority for the proposition that where a company bona fide rejects a business opportunity, and a director pursues the opportunity for himself or herself, then the director will not be liable to account for any profits made.

## **5. Duty not to agree to restrict the director's power to exercise an independent judgment**

Directors are not permitted to fetter their discretion to make an independent judgment, i.e. to agree that they will act in a particular way into the future unless permitted by an express provision of the company's constitution, a shareholders' resolution; or they collectively decide, in good faith, that it is in the interests of the company to fetter their discretion. This duty essentially requires directors to weigh up whether or not contracting or undertaking to exercise their discretion in a particular way will be in the best interests of the company.

## **6. Duty to avoid any conflict between the director's duties to the company and the director's other (including personal) interests**

This duty imposes a positive obligation on directors to avoid any conflict between their duties as directors and their other interests. Not an absolute duty – a director can be prospectively or retrospectively released in relation to a particular conflict if expressly permitted by the provisions of a company's constitution or by a shareholders' resolution.

## **7. Duty to exercise care, skill and diligence**

Directors owe a positive duty of care, skill and diligence to their company. This duty will be judged on an objective and subjective basis: (i) the knowledge and experience that may reasonably be expected of a

person in the same position as the director being the objective element; and (ii) the knowledge and experience which the director has being the subjective element.

Case law provides that while qualifications or commercial experience are not necessarily relevant when accessing to compliance with this duty, their presence will raise the standard of care which an educated or commercially experienced director will be expected to exercise versus that of a less educated or less commercially experienced director.

## **8. Duty to have regard to the interests of the company's shareholders**

The existence of this duty does not *per se* mean that directors owe fiduciary duties to the shareholders or a particular shareholder of a company, as the directors' duties are first and foremost owed to the company itself. Whether or not such a fiduciary duty exists will depend upon the circumstances of each case.

## **Statutory Duties**

In addition to the above listed fiduciary duties, the 2014 Act imposes a number of statutory duties on directors, including:

- general duty to ensure compliance by the company with the 2014 Act
- duty to maintain proper books of accounts
- duty to prepare and approve annual accounts
- duty to have an annual audit performed (unless the company avails of an audit exemption)
- duty to maintain certain registers and other documents
- duty to file certain documents with the Registrar of Companies.

## **Do the Duties Apply to all Forms of Directors?**

Irish company law does not differentiate between the various forms of directors (e.g. executive directors, non-executive directors, passive/token directors, nominee directors, shadow directors and de facto directors) in the application of directors' duties and liabilities. Therefore, even though each case will be ultimately judged on its own facts, all directors should be aware of their duties and liabilities that attach to the role of director irrespective of the form of directorship they hold.

For instance, non-executive directors have previously been found personally liable for debts of an insolvent company and passive directors have previously been the subject of restriction orders (discussed below).

## **Proper Plaintiff for Alleged Breach of Duty**

As a director owes his/her duties to the company, the general rule is that it is only the company acting through its directors that has a cause of action against a director for a breach of duty rather than the shareholders. Similarly, in insolvency situations, it is the liquidator who is the proper plaintiff and not individual creditors.

However, shareholders can, in certain circumstances, seek redress against the company's directors and officers (or third parties implicated in any breach of duty) for wrongs committed against the company through what is known as a 'derivative action'.

## **Forms of Directors' Liability**

A director can incur civil liability where they breach their duties. The possible remedies available where civil liability is imposed for a breach of duty, include the company suing the director(s) for damages, seeking an indemnity for losses incurred or seeking an account for profits.

A director can also incur criminal liability if: (1) the director's company commits an offence under the 2014 Act and that he or she either authorised the default, or, in breach of his or her duty, permitted the default and (2) where the director's company commits an offence under another statute and it is shown that the offence was committed with the connivance of or attributable to any neglect on the part of the director, for

example, where the company has been found in breach of health and safety laws or data protection laws.

## **Forms of Directors' Offences**

### **Reckless and Fraudulent Trading**

While the concept of limited liability generally provides that the debts and liabilities of a registered limited liability company will be its own, where certain offences are committed under the 2014 Act, a company's directors can be made personally liable for some or all of the company's debts. The most common of these offences include the offences of reckless trading and fraudulent trading. A claim for reckless trading or fraudulent trading can be brought by a liquidator, a creditor (provided they have suffered a loss), contributories (provided they have suffered a loss), an examiner or a receiver.

To make a finding of reckless trading against a director the court must determine that the director was either knowingly a party to the carrying on of any business of the company in a reckless manner; or the director knew or ought to have known that their actions or those of the company would result in losses to creditors; or the director was a party to the contracting of a debt by the company and did not honestly believe on reasonable grounds that the company would be able to pay the debt when it fell due for payment.

To make a finding of fraudulent trading against a director the court must determine that the director was knowingly a party to the carrying on of any business of the company with intent to defraud creditors of the company.

Reckless trading is a more popular offence of choice for plaintiffs as there is no requirement to prove that the director intended to trade recklessly, as is the case with fraudulent trading, where an intention to defraud creditors must be proven for a claim for fraudulent trading to be successful.

### **Restriction and Disqualification Orders**

In more serious cases of dishonesty and irresponsibility, restriction or disqualification orders may be sought against directors and other company officers.

## **Restriction**

Where an insolvent company goes into liquidation or receivership, and a director of the company fails to satisfy the court on application by the Office of the Director of Corporate Enforcement (ODCE), liquidator or receiver that he or she has acted honestly and responsibly in relation to the company's affairs, she/he may be restricted for a period of up to five years.

Such a restriction prevents a person from being appointed or acting in any way, directly or indirectly, as a director or secretary, or being involved in the formation or promotion of any company unless it is adequately capitalised. €100,000 is the capitalisation threshold for a private limited company and €500,000 for a public limited company.

## **Disqualification**

The ODCE, a liquidator and various other parties can apply to the courts seeking the disqualification of any person, including a director, on a number of grounds, such as: (1) for a breach of their directors' duties, (2) if found guilty of fraudulent or reckless trading while an officer of a company, and (3) their conduct makes them unfit to be concerned in the management of a company.

A person is also automatically disqualified if that person is convicted on indictment of: (a) any offence under the 2014 Act, or any other enactment/statute as may be prescribed, in relation to a company, or (b) any offence involving fraud or dishonesty.

A person disqualified by the court is subject to a disqualification order for a period of five years or other period as specified by the court and a person so disqualified cannot be appointed or act as a director or other officer.

## Reliefs and Defences

There is a relief available under the 2014 Act from personal liability for reckless and/or fraudulent trading and in the case of restriction orders, if a director can show that he or she 'acted honestly and responsibly in relation to the conduct of the affairs of the company'.

The court may also grant relief to a person subject to a disqualification order if it considers that it is 'just and equitable to do so and on such terms and conditions as it sees fit'.

For a director found to be an 'officer in default' there is relief available if she/he can show that she/he took all reasonable steps to prevent the default in question.

## Directors' Duties in Insolvency

At common law, it is well established that where directors become aware that the company is insolvent the following circumstances arise as regards to directors' duties:

- they have a duty to have regard to the interests of creditors
- they have a duty to put the company into creditors' voluntary liquidation if it is unlikely that the company will return to solvency
- they have a duty to preserve the company's assets so that they can be applied in discharge of its liabilities
- they have a duty not to make payments directly or indirectly to themselves to the detriment of creditors

## Directors' Duties and Liabilities in the Context of the COVID-19 Pandemic

Through the benefit of COVID-19 pandemic related government supports and temporary moratoriums on rent and loan payments, directors of many Irish companies will have taken the decision to continue to trade even though the company might be technically insolvent.

Directors who have taken this decision, whether consciously or not, are walking a tight rope where they could be found in breach of their directors duties and/or face personal liability for reckless trading should the company, ultimately, go into liquidation because it could not trade out of difficulty when the economy fully reopens and the government supports and payment moratoriums have fallen away.

The UK government suspended the reckless trading provisions in the UK from March to September 2020. The Irish government did not bring in a similar suspension, but the ODCE did issue guidance on directors' duties and personal liability in the context of the COVID-19 pandemic in June 2020, which we discussed in an earlier article: [Directors Duties and Liabilities: Statement from the ODCE](#).

The standards that will be applied to directors' duties and liabilities in the courts and by the ODCE will be an interesting focal point in any liquidations or cases involving companies that have been forced to cease trading and enter liquidation due to the pandemic.

## Tips to Assist Directors in the Fulfilment of their Duties where the Company is in Financial Difficulties

- closely investigate the financial position and the future prospects for the company
- continuously monitor the company's financial position
- support the view that the company can continue to trade through its financial difficulties with documentary evidence
- obtain legal advice on the implications of any proposed material action (e.g. disposals, acquisitions, group restructuring)
- hold frequent board meetings
- prepare regular management accounts
- ensure that the company's books and records are current and accurate

- make key material decisions only after considering the impact on creditors

## **Our Experience**

At LK Shields we have a wealth of experience and expertise in advising directors and other company officers in relation to corporate compliance matters. If you need specific advice or have some general concerns, it is always best to take action at an early stage. We would be very happy to discuss any of your concerns with you.

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