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Client Update

Shaping the future of insurance law

# COVID-19 and D&O liability

24 MARCH 2020

## AT A GLANCE

- The *Coronavirus Economic Response Package Omnibus Bill 2020* (CERPO Bill) and recent ASIC statements have put focus on management liability issues arising from the COVID-19 crisis.
- The CERPO Bill provides some temporary relief for directors as they navigate the uncharted territory caused by COVID-19.
- One of the measures is a new safe harbour provision in respect of liability for trading while insolvent.
- However, there remains a heightened risk of claims against directors for breach of directors' duties for failing to take steps to sufficiently prepare a company for a pandemic.

The coronavirus impact has cut across nearly every insurance policy on the market. While the effects of COVID-19 on the D&O space have been largely undocumented at this early stage, the urgent presentation by the Commonwealth Government of the *Coronavirus Economic Response Package Omnibus Bill 2020* (CERPO Bill), coupled with recent press releases by ASIC, puts management liability issues in the spotlight.

## HOW DOES THE CERPO BILL AFFECT THE LIABILITY OF DIRECTORS & OFFICERS?

The CERPO Bill, now passed by both houses (but awaits Royal Assent), grants the Minister power during a specified six month period to exempt classes of persons from the operation of specified provisions of the *Corporations Act 2001* (Cth) (Act) or *Corporations Regulations 2001* (Cth) (Regulations), or modify specified provisions of the Act or Regulations regarding certain classes of persons.

The Minister must only exercise that power if the Minister is satisfied that:

- it would not be reasonable for people within that specific class to comply with the provisions "*because of the impact of the coronavirus known as COVID-19*", or
- the exemption/modification is otherwise necessary or appropriate to either:
    - "facilitate continuation of business in circumstances relating to the coronavirus", or
    - "mitigate the economic impact of the coronavirus".

The CERPO Bill inserts a new safe harbour provision, 588GAAA, titled "*Safe harbour – temporary relief in response to the coronavirus*".

It operates by essentially eradicating the application of section 588G(2) of the Act if the debt is incurred:

- in the ordinary course of the company's business,
- during the prescribed six month period (or any longer period prescribed by the regulations), and
- before the appointment during that six month period of an administrator or liquidator of the company.

The evidentiary burden is on the individual relying on the safe harbour provision in relation to any proceeding concerning a contravention of the insolvent trading provisions. The Regulations may prescribe certain circumstances in which this safe harbour provision "*is taken never to have applied*".

The CERPO Bill also amends the Regulations to temporarily increase the minimum amount for the issue of a statutory demand to $20,000 and increases the time in which a company has to comply with a statutory demand from 21 days to six months.

In essence, the CERPO Bill provides some temporary relief for directors as they navigate the uncharted territory caused by COVID-19. The CERPO Bill does not absolve directors and officers of broader misconduct during the six month relief period.

## WHAT MESSAGES HAS ASIC PROVIDED FOR DIRECTORS?

ASIC has indicated that it is presently "recalibrating its regulatory priorities to focus on COVID-19 challenges" [1], with the only other areas of priority being matters:

- where there is a serious risk of harm,
- involving serious breaches of the law,
- involving risks to market integrity, and
- that are time-critical.

ASIC has suspended non-time critical matters, including consultation, regulatory reports and reviews. It will, however, maintain its enforcement activities focussing the areas of priority listed above. ASIC has also recently relaxed AGM requirements[2] by encouraging (through the issue of "no action" positions) companies with financial year ends of 31 December 2019 to extend their AGMs to July and to hold them either virtually or in a hybrid fashion.

Finally, ASIC has reminded insurers that:

> *"ASIC encourages fair and efficient insurance claims handling. ASIC expects firms involved in handling insurance claims to act with the utmost good faith. ASIC expects industry to communicate clearly and accurately to customers about their cover recognising the changing situation they may be facing."*

## DOES THE CERPO BILL REMOVE RISKS FOR D&O AND MANAGEMENT LIABILITY INSURERS?

The CERPO Bill partly addresses what is obviously the biggest risk to D&O and management liability insurers arising out of COVID-19, being insolvency risk. However, there is undoubtedly a heightened risk of claims against directors for breach of directors' duties for failing to take steps to sufficiently prepare a company for such an event, whether it be IT solutions and workplace flexibility, contingency planning, insurance arrangements or prudent management of working capital.

Accordingly, while the safe harbour provisions provide a six month "liability-free" window in a strict insolvency context, they do not address the broader exposures that may confront directors and officers of companies who fail to navigate their way through the current environment.

These broader exposures must be tempered against the unprecedented nature of how COVID-19 has confronted the business community and, specifically, directors and officers. A likely battle ground in the D&O liability space will be assessing businesses' preparedness, under the guidance of their directors and officers, for what can only be described as an unprecedented and unforeseen event.

[1] See ASIC Media Release 20-070MR of 23 March 2020: *ASIC recalibrates its regulatory priorities to focus on COVID-19 challenges*

[2] See ASIC Media Release 20-068MR of 20 March 2020, *Guidelines for meeting upcoming AGM and financial reporting requirements*

## NEED TO KNOW MORE?

For more information please contact us.

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