



COVID-19 LOANS AND THE RESPONSIBILITY OF THE BOARD

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Introduction

The Danish Government has passed several bills related to the Covid-19 situation with the purpose of supporting Danish trade and industry in order to ease the pressure on the liquidity of Danish businesses.

VAT loans and payroll tax loans are some of the measures introduced to help businesses. Many companies have used the opportunity to take out VAT loans (in Danish: “*momslån*”) to maintain the company's liquidity during periods in which it has been affected by the national lockdown. Moalem Weitemeyer advises a wide range of companies and board members, and so our Disputes department has taken a closer look at what the board of directors should be aware of in relation to such loans in light of its responsibilities and potential liability.

The VAT Loan in brief

The Danish state gave several companies opportunities to postpone their VAT reporting due to the Covid-19 crisis. The deadline for reporting VAT was 1 March 2021.

In order to strengthen the liquidity of Danish companies during the Covid-19 crisis, the Danish government has made it possible for small and medium-sized companies to apply for an interest-free loan corresponding to the VAT that the company was to report in March. The loan must be repaid no later than 1 February 2022.

Larger companies have the opportunity to borrow an amount corresponding to the amount which the company has reported in A-tax (i.e. tax deducted from income at source) and labor market contributions for September 2020 and March 2021. If the company does not repay the loan on time, the company will accrue debt to the Danish state, including interests on the loan.

Duties and Obligations of Management

Directors and officers have a wide range of statutory duties and obligations according to the Danish Companies Act. It is the responsibility of the board of directors to look after the interests of the company and the shareholders with care and with due regard for investors and other stakeholders.

The board of directors must ensure value creation in the company, both in the short and long term, and it is responsible for the company's strategy. In addition to the tasks stipulated in Danish legislation, the board of directors must ensure that the company has the necessary financial prerequisites and competence to achieve the set goals.

Pursuant to Section 115, no. 5 of the Danish Companies Act, the board of directors must ensure that the capital resources are sound at all times, including that there is sufficient liquidity to fulfill the company's current and future obligations as they fall due, and the company is thus obliged to assess the financial situation and ensure that the capital resources present are sufficient.

Hence, it is the board of directors' duty to supervise the company's finances, including the duty to ensure that the company has the necessary liquid re-sources. This assessment is becoming more relevant in light of the ongoing pandemic and the unpredictability that accompanies it.

Directors and Officers' Liability

It follows from the Danish Companies Act, Section 361(1) that members of management who, during the performance of their duties, have intentionally or negligently inflicted damage on the

company are obliged to compensate it. The same applies when the damage is added to shareholders or third parties.

The board of directors' responsibility implies that the company must have sufficient liquidity and equity to be able to withstand temporary declines in earnings. It is both the management's right and duty to continue a company in a financial crisis and to try to overcome it. However, the management must not incur any further obligations for the company which it realistically cannot cover.

The board of directors' responsibility for the company's sound capital re-sources also entails a responsibility for operations and thus a duty to stop the company's operations if its sound continuation is no longer possible (in Danish: "*håbløshedstidspunkter*").

When a company is in a situation where it does not have sufficient liquidity, the main task of the board of directors is to protect and/or increase the creditors' expected payments from the company. This is where the VAT loans from the state can turn out to have negative and liable consequences for the management of the company.

If the company takes out a VAT loan in a situation where the company does not have sufficient liquidity, and bankruptcy is unavoidable, then the company's management may be taking a risk for taking out a loan to pay certain creditors ahead of others. Management must therefore assess whether the continued operation is a real possibility.

The Business Judgment Rule is a principle of Danish law and it implies that the company's management is given a certain margin of discretion to make business judgments without being held liable – even if the decision in question later proves to be inappropriate and result in a loss. However, this pre-supposes that the decision must have been made in the company's interest and that the decision has been made on a fully informed basis.

If, however, the company is experiencing liquidity problems, management will also have to make considerations to avoid unnecessary losses for the company's creditors. If the company is at a point where it should be clear to the management that the company's bankruptcy is inevitable and that a continuation of operations will only result in further losses for the creditors, then the company's management must be especially careful in their decisions. If the management continues the operation after this time, the management is in principle responsible for any loss that follows.

Our Comments

The loans offered by the Danish government provide a good foundation for companies that are under heavy pressure on liquidity due to the Covid-19 pandemic as they can secure liquidity and get through lockdowns until normal cash flow returns.

In the current situation due to Covid-19, it can, however, be particularly difficult for the management to make a correct assessment of the company's future development. Many crucial factors are currently out of the hands of the management, such as recurring national or local lockdowns and other factors that could contribute to the company's survival.

To a certain extent, the management is allowed to assess what is best for the company and which solution is the right path to take to ensure that the company's interest is protected. Management shall use efforts on securing documentation for the decisions made, e.g. by preparing board minutes or similar, and ensure that their decisions and considerations are duly documented. It is important that management make decisions on a thoroughly informed basis and update the company's accounting and obtain necessary information.

It is also important that management does not uncritically push the company forward with a continuing increasing deficit, incurring further debt through government assistance packages, such as the VAT loan, if bankruptcy is un-avoidable.

An additional consideration to be made is also if appropriate liability insurance for the management has been taken out, which insures against claims for compensation in connection with the board work. The company should also consider whether the insurance sum is sufficiently high compared to the company's risk profile.

If in doubt about the company's continued operation and liquidity, we recommend that external advice (e.g. the company's lawyer or auditor) be included to the extent necessary.

Moalem Weitemeyer has extensive knowledge and experience in advising on management responsibilities and the various issues that may arise as a result of market economy influences. If you have any questions about this, including the impact of Covid-19, you are welcome to contact us:



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