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Insights

UK COVID-19 AND THE PAYMENT OF DIVIDENDS

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SUMMARY

As the AGM season is upon us, many companies have already made the decision to withdraw the proposal to pay a final dividend in order to preserve cash and provide financial flexibility for the future. Other companies are considering paying a final dividend but reducing the amount originally proposed. This briefing will consider the options and key considerations.

Directors' duties

When recommending a final dividend or resolving to pay an interim dividend the directors must have regard to their duties to the company as well as to the ability of the company to make the proposed distribution. In particular, their duty to promote the success of the company - but also their other duties, such as the duty to exercise their powers for a proper purpose. So, for example, they should not recommend a dividend or pay an interim dividend where the payment would be contrary to the long term interests of the company (e.g. because it would starve the company of funds required for the successful running of its business) nor should they do so for an improper purpose (e.g. simply to prevent a takeover of the company).

Generally, the duty to promote the success of the company requires the directors to act in the interests of its members as a whole. But, if the company is experiencing financial difficulties which could result in insolvency issues (i.e. the inability to pay debts as they fall due), the directors' focus must shift to considering the interests of creditors of the company as a whole. This can be a difficult judgment and directors face a challenge in balancing duties to creditors and members depending on the financial position. When a director knew, or ought to have reasonably known, that a company has no reasonable prospect for avoiding an insolvent liquidation or administration, that director is under a duty to take every step which a reasonably diligent person would take to minimise potential losses to the company's creditors. Failure to take such action puts the director at risk of wrongful trading which carries personal liability for the director. Whilst the UK Government has announced certain suspensions to the wrongful trading regime as a result of COVID-19, legislation on the detail is still awaited and the expectation is that provisions in relation to misfeasance (being a breach of duty as a director) will not be altered.

Suspending payment of a final dividend

Companies that have sent out or are due to send out their AGM notice shortly will need to consider whether the recommendation of a dividend is appropriate given the current circumstances and the need to preserve cash. The FRC guidance recommends that "*the assessment of whether a dividend is appropriate should include consideration of current and likely operational and capital needs, contingency planning and the directors' legal duties, both in statute and common law*."

The Investment Association (IA) has previously stated that dividend reductions and suspensions are acceptable if it means the survival of an otherwise healthy business. But the IA reminds companies that they should bear in mind the millions of shareholders who are pensioners and workers and who rely on this vital income.

If the board proposes to withdraw an already published dividend resolution from the business of the meeting, it is advisable to announce this as soon as possible. If the AGM notice has not yet been published, the resolution recommending or declaring a dividend should be removed.

Where dividend payments are suspended or cancelled, boards and Remuneration Committees should consider how this should be reflected in their approach to executive pay. Shareholders will also expect companies to be transparent about their approach to dividends, particularly, if they are seeking additional capital (IA recommendations on executive pay and IA letter to FTSE 350 chairs).

Reducing the amount of the recommended dividend between posting the AGM notice and the AGM itself

Some companies may want to pay a final dividend but reduce its amount by amending the resolution proposing the dividend. The amendment of the resolution will not typically itself be subject to a resolution and will instead be a decision of the board (the articles of association usually contain provisions allowing amendments to ordinary resolutions if the proposed amendment does not materially alter the scope of the resolution).

The ISS (Institutional Shareholder Services) has stated that this year they will support broad discretion for boards that seek to set pay-out ratios that may fall below historic levels or customary market practice but they will look at whether boards disclose plans to use any preserved cash from dividend reductions to support and protect their business and workforce.

Proxies must vote in accordance with the instructions given by the member and where no instruction has been provided, the proxy can vote using his/her own discretion including on amendments to resolutions but should seek to give effect to his/her appointors' wishes as reasonably determined from the original instructions. Therefore if a proxy has been instructed to vote in favour of a dividend resolution as published in the notice of AGM, it is likely to be the case that the proxy can conclude that he/she should vote in favour of the amended resolution to pay a reduced dividend.

If the final dividend has been approved

For companies that have held their 2020 AGM and approved the payment of a final dividend the issue is more problematic as upon shareholder approval the final dividend becomes a debt payable to shareholders which cannot be withdrawn or cancelled. This is in contrast to interim dividends (if they are not approved by shareholders) which can be cancelled at any time before they are actually paid.

London Stock Exchange dividend procedure timetable

Dividends are currently paid to shareholders by reference to those on the register of members as of the record date. Ordinarily the London Stock Exchange (LSE) requires companies with shares on the Main Market or AIM to pay cash dividends within 30 business days of the record date and dividends with options within twenty business days of the election date. A few weeks ago, the LSE published an update confirming that with immediate effect it will permit a deferral period of up to 30 business days for payment of a dividend but no more than 60 business days after the record date. Any deferral should be notified without delay to the Stock Situations Team. After the deferral period the dividend must be paid or cancelled, where this is permissible, and be notified without delay.

Useful resources

BCLP note on shareholder expectations for executive remuneration
BCLP note on LSE dividend procedure timetable
ICSA guidance on withdrawal or amendment of dividend resolution to AGM
IA – dividends during COVID-19
IA letter to FTSE 350 chairs

RELATED PRACTICE AREAS

- M&A & Corporate Finance
- Corporate
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