The responsibility of directors in the use of AI in insolvency prevention decision-making

Francisco da Cunha Matos discusses the use of AI tools in insolvency

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Artificial intelligence as a tool for controlling and preventing insolvency risk - data-driven management

In the digital age, artificial intelligence (**AI**) is a transformative force across multiple sectors, reinventing processes, services and decision-making. In the business field, AI promises to revolutionise the way companies operate, analyse data and anticipate and mitigate financial risk.

Technological advances in big data analytics allow AI systems to interpret sets of information, from financial transactions to market trends, with a precision and speed unattainable by human effort alone. This analytical capability is invaluable in predicting the risk of insolvency, offering companies a unique opportunity to intervene strategically before financial challenges develop into unrecoverable crises.

However, the implementation of these disruptive technologies is not without its challenges. The effective integration of predictive AI systems requires careful consideration of the legal, regulatory and ethical implications. In Portugal, the existing legal framework is being tested by the new dynamics introduced by AI, particularly with regard to the liability of directors for automated decisions or those based on data provided by AI.

In fact, predictive AI models enable companies to process large data sets, providing a detailed and proactive understanding of the financial health of companies. Advanced machine learning techniques and big data analytics have revolutionised the way directors can assess a company's risk of insolvency. By incorporating algorithms, organisations can refine the accuracy of existing models, allowing for a more detailed and personalised risk assessment. This increases the effectiveness of identifying early signs of insolvency and provides deeper insight into the causes of insolvency and the emergence of potential remedies.

Data-driven management is more rational, less likely to repeat mistakes and more focused on the long-term strategic interests of the company and its stakeholders. It is thus essential that predictive AI models that assist managers are based on transparent algorithms (for ethical and regulatory reasons) and that they are democratically and widely accessible, to ensure a level playing field). Small and medium-sized companies, in particular, face significant barriers due to the high costs associated with implementing and maintaining these advanced technologies.

For example, predictive models generated by AI are an essential tool for directors to prevent company insolvency, by constantly monitoring financial indicators, analysing market trends and implementing effective risk management strategies. Active insolvency prevention is vital for the sustainability and growth of businesses, as well as for the Portuguese and European economies.

The director's responsibility for the use of AI in decisions to prevent insolvency

Under Anglo-American influence, Portuguese law (Article 64 of the Companies Code) has adopted a version of the *duty of care* and the *duty of loyalty*, establishing them as fundamental duties of directors. If the duty of care or the duty of loyalty is not fulfilled, directors can be held liable based on their fault. It is the requirement of fault that makes current liability systems inadequate to deal with damage caused by AI-enabled companies.

The duty of care requires the director to have availability, technical capacity and knowledge of the activities of the company he manages. The general duty of care can take the following forms: duty of organisational and functional control,[1] duty to act with due process,[2] duty to make reasonable decisions,[3] and general duty to prevent risks.[4]

In the performance of his or her their duties, the director may use AI mechanisms to support the decisions to prevent the company's insolvency. If this decision causes damage to the company, the director could be held liable. In addition, the director may also be held liable for taking the decision to use AI to support his or her decision.

However, the current liability rules for directors, based on fault

(Article 72 of the Companies Code), are insufficient to cover situations where the obligation to compensate is shifted to the AI, due to the lack of liability of the robot (AI mechanism).

Note: if the decision to use AI is rational, the business judgment rule exempts the director from liability for the damage caused, without any compensation to the company. On the other hand, if the interpretation of the business judgment rule is narrow and it is considered irrational to take the decision with the help of AI, the director may be liable for the decision not to use predictive AI mechanisms.

With regards to the objective liability of the producer, it cannot currently be used by the director to avoid his or her responsibility, since this system does not apply to cases of professional use and does not cover purely financial damage.

The system of liability for risk - being an objective type of liability - is not flexible enough to be applied to decision-making using AI. In order to apply no-fault liability to robots, it needs to be explicitly enshrined in law. Nor can joint and several liability, subsidiary liability or third-party liability be applied, as AI mechanisms have no sphere of liability.

With regard to the application of the business judgment rule, it will be necessary to determine the extent to which the courts will be prepared to extend this rule accept to the rationality of the decision. Depending on the scope followed by the courts, the business judgment rule could be used by rational directors using AI to prevent company insolvency.

D&O insurance as a transitional solution for a new era of liability (management liability)

The Portuguese business community is largely made up of small and medium-sized companies with a family structure. This makes Portugal a less favourable country for liability claims against directors, as they are usually family members or people trusted by the shareholders. However, with the integration of AI into management tasks, Portuguese directors will be more exposed to the risk of liability.

The precautionary principle states that the director must anticipate and take the necessary measures to prevent damage from occurring (and, often, the insolvency of the company), given the unknown potential for severe damage. Following this principle and having demonstrated the numerous benefits of AI-assisted management, we argue that the adoption of D&O insurance tailored to the needs of those who take out such policies it, could be the initial balancing solution to face a new era in which AI plays a supporting role.

The exercise of management functions presupposes the assumption of responsibility. Taking out D&O insurance can ensure that directors are not stifled by a civil liability regime based on a precautionary principle.

We believe that taking out D&O insurance should be a transitional solution in a world where AI will play an increasingly important role. Therefore, we advocate the necessary legislative intervention to create a system of liability for the damages of those who benefit from AI as its operators, albeit professionally.

Conclusions

Data-driven management and AI are useful tools for making decisions to prevent company insolvency. Decisions can be made more confidently, with fewer errors, lower costs and more in line with the interests of stakeholders.

The current liability mechanisms for directors are not sufficient to cover all the risks involved in making insolvency prevention decisions with the help of AI. D&O insurance guarantees an adequate level of risk, leading to increased management dynamism. However, the legislature must intervene to provide a definitive solution, regulating the liability of the AI operator or a compulsory insurance scheme for AI mechanisms. ■

> *"Data-driven management and AI are useful tools for making decisions to prevent company insolvency"*

Footnotes:

1 This sub-delegation obliges the director to pay attention to the financial development of the company and to collect the all the necessary information.

2 The director must gather and process the reasonably available information on which to base the decision.

3 Directors have a duty not to dissipate the company's assets and not to take unreasonable risks. Directors deserve legal censure because they have a technical and diligent duty not to commit these illegal acts.

4 Although it is not expressly provided for by law (it is covered by Articles 483 and 486 of the Civil Code), this is an extremely important duty in terms of preventing insolvency. The director has a duty to remedy the particular situation of danger in which the company finds itself and is liable for the damage caused by his or her failure to do so.