

The Directors and Officers (including the Senior Employees if they can bind the company) of all companies are now held, at an unprecedented level, to be personally responsible for any actions and decisions they make on behalf of the company – putting their personal assets at risk if those decisions are tested in the courts.

The multitude of duties and obligations of UK directors and officers is well known; and the legislation and regulation with which they have to contend increases daily. Directors and Officers face significant scrutiny of their actions by fellow directors, employees and shareholders.

The duties imposed on Directors and Officers are numerous –

### ***Common Law Duties***

- Legal principles established from hundreds of years of case law.

### ***Fiduciary Duties***

- To act Honestly
- To act in Good Faith
- To act in the best interests of the company at all times
- Not allowing personal interest to conflict with that of the company

### ***Duties of Skill & Care***

- Directors are the mind and will of the company. They are the driving force behind the company and are responsible for their own actions.
- Duty to exercise the same level of care that an ordinary man would use in the management of his own affairs.
- Duty to exercise the skill expected from a man with his knowledge and experience.

### ***Statutory Duties***

- Where an offence under an Act is committed by a Company with the consent or connivance of a director, or is attributable to his neglect, that director is also guilty of the same criminal offence and can be punished accordingly

More specifically, directors face the threat of personal liability from actions/allegations as a result of –

- ***Breach of fiduciary duty:*** directors have an obligation not to permit their personal interests to conflict with those of the company and to act in the company's best interests. Problem areas include secret profits, unauthorised payments, and loans to directors.
- ***Wrongful trading:*** directors may be personally liable to contribute to the assets of a company in insolvent liquidation if they allow the company to continue trading when at any time before the commencement of the winding-up they knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into liquidation, worsening the position of creditors.
- ***Employment disputes:*** claims against directors by employees alleging wrongful dismissal, sexual, racial or disability discrimination etc.
- ***Disqualification proceedings:*** defence of a director in an action which might lead to them being disqualified as a director of a company from 2 – 15 years.
- ***Infringement of intellectual property rights:*** claims arising from infringement of patents, trademarks or copyright etc.
- ***Libel and slander:*** this can apply particularly during hostile take-over battles; if a director makes a statement in relation to the situation.
- ***Breach of trust:*** disclosure of information without consent
- ***Breach of warranty of authority:*** making loans without security or acting in any way outside their powers as directors
- ***Breach of contract:*** customers suing an individual director for breach of contract caused by them
- ***Breach of statutory duty:*** provisions contained in, for example, the Companies Act 1985 and 1989, Insolvency Act 1986, Data Protection Act 1984, Health & Safety at Work Act 1974, Environment protection Act 1990.
- ***Breach of EU directives***

- **Mis-statement/misleading statement:** causing loss to a third party who relies upon the accuracy of that information
- **Failure to exercise reasonable skill and care:** in carrying out the duties of a director
- **Mismanagement:** shareholders may bring an action, alleging the value of their shares has been adversely affected
- **Or any other act wrongfully committed or attempted by a director or officer in the course of performing the duties of that office.**

With increasingly powerful and active stakeholders, numerous risks associated with global expansion and stricter corporate governance standards, today's directors and officers face a far greater likelihood of being personally sued or investigated by the following –

- **Competitors:** breach of trade practices, anti-trust allegations
- **Creditors:** wrongful / fraudulent trading
- **Employees:** wrongful termination of employment, discrimination, health & safety issues
- **Government & Regulators:** breach of regulations, tax issues, industry standards
- **Liquidators/Receivers:** claims arising from the insolvency of a company frequently brought on behalf of creditors.
- **Purchasers:** allegations of misrepresentation regarding existing and future valuations of the company.
- **Shareholders:** allegations of mismanagement which adversely affects the value of their investment in the company

#### How likely is it that a claim will be made?

- Between 1989 and 2001 Employment related claims increased 176%. The EU recently estimated that 30% of women have experienced sexual harassment in the workplace.
- Wrongful termination, discrimination, dishonesty, fraud, domestic marketing issues and financial reporting are responsible for 75% of D&O liability claims.
- Recent legislation makes directors personally responsible in a number of areas including health & safety, fair-trading, data protection etc.

There is some limited protection under Sections 310 and 727 of the Companies Acts (where the companies have agreed to indemnify the directors) but because of the inadequacies of this protection many companies have realised that the risks to a director's or officer's personal wealth are too great to ignore and have decided to transfer the risk and buy D&O Liability Insurance.

#### What cover is available?

A standard D&O Liability Insurance covers losses arising from claims brought against directors and officers for "wrongful acts" committed in the performance of their duties to ensure that their personal wealth is protected. Policies generally include cover for:

- **"Wrongful Acts":** Breaches of duty or trust, neglect, error, misstatement, misleading statements, omission, negligent act or any other act wrongfully committed.
- **Defence costs:** paid as the action proceeds, to ensure that individuals do not have to fund their own defence
- **Damages, judgement or settlement sums:** awarded against the director or officer including exemplary damages for Libel and Slander (Fines and damages uninsurable under law and con-compensatory damages are not included).
- **Company Reimbursement:** Company is reimbursed if it provides an indemnity to its director or officer
- **Investigation legal fees and expenses:** pays the legal fees and expenses involved in defending official investigation / examination into the affairs of the company even if there is no alleged wrongdoing on behalf of the directors and officers.
- **Blanket cover:** provides cover for any person deemed to be a director or officer, past, present and future.
- **Managerial/Supervisory staff**

## Further useful information

### Types of Director

- Executive: full time and hands on
- Non Executive: may be part time, may have more than one board appointment, may have particular expertise or experience
- Shadow: not appointed as Director, someone in accordance with whose directions or instructions the directors or officers of a company are accustomed to act

### Types of Officer

- Company Secretary
- Other persons who manage the affairs of a company and who are able to bind the company as a whole.

## Examples of D & O claims

### Creditors

- Under the “wrongful trading” provisions it is possible for a director to be held personally liable for some, or all, of a company’s debt. There are numerous actions arising from such situation and the legal defence costs provided by a D&O policy is of particular importance. Where directors are subsequently found guilty of “wrongful trading” any judgement awarded may be the subject of indemnity by the D&O policy.
- A Company went into liquidation shortly after one of its directors ran up a bill with a vehicle repairer for the cost of repairs carried out to a company vehicle. The costs were incurred on behalf of the company. The vehicle repairer brought an action for the outstanding invoices and there was a suggestion that the director was liable personally in view of the provisions of the Insolvency Act.
- A Director who signed a company cheque whilst the company was in receivership, found that the cheque was dishonoured and he was held personally liable to the payee.
- An affidavit given by a director contained a statement that the company had insufficient resources to meet a solicitors’ fee in respect of an action being brought against the company. Before the fee was paid, the company went into liquidation. The solicitors sought £300,000 directly from the director.
- A director made a speech at a conference stating that his company was making a bid for another company and that his company’s merchant bankers had disclosed details of the bid to another bidding company. A claim was brought by the bankers refuting that they had acted as described.
- A bank has taken action against the directors of a retail company for failure to disclose material facts when they entered into a financing agreement worth £8.5m with the bank. The projected cash flow for the subsidiary showed the loan was un-sustainable. The bank accused the directors of providing misleading information.
- A new shareholder purchased shares in a company even though the Report and Accounts showed the company to be making losses. Subsequently discovered that financial problems were much worse than the Report & Accounts indicated.

### Competitors

- A former director of a company was sued for alleged misappropriation of trade secrets, which he obtained from the company.
- A company sued the directors of one of its competitors for allegedly breaching trade practices.

### Contractors

- Directors of a construction company were successfully sued for losses incurred by an architect who relied on a director’s repeated assurances that a contract performance bond had been arranged.

### Customers

- A director who accepted an order at a trade fair but couldn’t recollect the details the following morning found himself being sued by his customer for breach of contract.

## Employee

- An action for breach of trust was brought against a director following the release of an employee's medical records.
- A director's service agreement was terminated by his employers (the insured) after alleging sexual harassment. The director successfully sued the company for wrongful dismissal and libel.
- An employee is seeking damages of between £200,000 and £250,000 for an alleged error in a notice of termination of service agreement.
- A director found himself personally defending an action, brought under sex discrimination legislation, following the dismissal of a pregnant employee.

## Government/Regulators

- A director was prosecuted in Europe for claiming an exports subsidy on meat, which was allegedly being exported to South Africa. The meat, in fact, was being exported elsewhere where no subsidy was available.
- The manager of a bank, which operated a discretionary currency portfolio, started to roll forward unprofitable deals, which then "closed" and lost the bank in excess of £21m. The Bank of England threatened to take away the bank's licence and disciplinary proceedings commenced against the directors. The disciplinary body has the power to debar the directors from holding office within the banking field. Legal costs, estimated to be a six-figure sum were incurred in representing directors before the disciplinary body of the Bank of England.
- The Company Secretary (as licensee) for all the bars owned by a leisure group was prosecuted as an individual for short measures being served at one of the bars.
- The directors of a company, which failed to comply with the time limit for delivery of accounts to the Registrar of Companies and then did not disclose certain directors' appointments, were prosecuted under the Companies Acts.
- Directors were prosecuted after their failure to identify the company correctly on the company's notepaper and invoices in breach of the Companies Act.
- The chairman of a company was investigated by FIMBRA for employing someone of "dubious character" and the failing to exercise proper control over him. He was acquitted and is now seeking costs for his defence from FIMBRA.
- The bar staff of a company were allegedly paid without deductions for tax (apparently without the knowledge of the directors). The Inland Revenue considered bringing proceedings against the directors.

## Liquidators/Receivers

- Two directors of a company, which was in liquidation, with a total deficit of £216,000, were held jointly liable for £75,000 damages (plus interest and costs) arising from wrongful trading whilst the company was insolvent.

## Other Third Parties

- Two directors signed a confidentiality agreement for receipt of papers from a company that was potentially the target of a bid by a third party. The papers were allegedly released and the target company intimated that the sale price was affected.
- After a disaster at sea a director accused a firm of solicitors of "ambulance chasing" at a press conference. The solicitors brought an action for defamation and defence costs were paid.
- A company, which had been the subject of a take-over bid, had a disappointing first year's trading. The purchase price for the company contained a performance adjustment clause. However, an oversight in drafting the contract meant that price could not be adjusted. The Board sued the solicitors. The solicitors counter claimed against the two directors who had signed the contract.

## Purchasers

- A Manchester based clothing manufacturer sought £12m in damages against five former directors of a company they purchased in 1987 alleging they were misled as to the value of that company.
- A company had issued proceedings against two directors of a company it acquired. It is alleged that the former directors made negligent misstatements and misrepresentations to the purchasers and substantial damages are pleaded as a result.
- Company A invested in Company B relying upon a statement of working capital that Company B made to its shareholders. Company B has subsequently gone into liquidation and the shares,

which cost £175,000, were now worthless. Company A contended that the statement was misleading and brought an action against B's directors.

- A company's directors made financial representations to identified bidders for their company, aware that and intending that bidders would rely on these, as they did. The Court of Appeal held that if the representations were proven negligent, the directors (and others) would be liable for this breach of their duty and care. Negligence was never established as the matter was settled out of court. Significant defence costs were however paid on behalf of the directors.

### **Shareholders**

- Shareholders brought an action for mis-management against the directors of a company which had suffered exceptional losses. The directors were able to successfully defend themselves but sizeable legal costs were incurred.
- Shareholders claimed for losses they incurred due to the premature sale of shares following allegedly misleading statements by the directors.
- Six shareholders claims misrepresentation by the directors of a company regarding the state of affairs of a subsidiary and the support the company would receive from its bank. The shareholders claimed that their preference shares could not be redeemed as a result.
- A Company breached its articles of association by payment of dividends out of capital profits opening itself up to potential claims from shareholders.
- A company held board meetings without the necessary quorum.
- Information contained in a prospectus issued by the company prior to a rights issue were found to be incorrect.

### **How Rowlands & Hames can assist you**

Please contact your usual Rowlands & Hames Account Director for further information or a no obligation quotation.

Premiums start from as little as £250 plus insurance premium tax.

*The information provided should be taken as general guidance only. It must not be inferred that any cover is automatically provided by every D&O insurance policy.*

**Please contact Rowlands & Hames for further information.**

**Rowlands & Hames Insurance Brokers Ltd.  
277 Dickson Road, Blackpool, Lancashire, FY1 2LG  
Tel: 01253 594211 Fax: 01253 358481 Email: [mail@rowlands-hames.co.uk](mailto:mail@rowlands-hames.co.uk)**

[www.rowlands-hames.co.uk](http://www.rowlands-hames.co.uk)

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