



Insight

# D&O legislative and regulatory risks

The following examples illustrate the variety and breadth of the legislation and regulatory action that can apply to directors individually.



## Companies Act 2006

The key piece of legislation for directors is the Companies Act 2006. This sets out their duties and responsibilities, with sections 171 to 177 describing the scope and nature of their general duties.

These are as follows:

- Duty to act within powers.
- Duty to promote the success of the company.
- Duty to exercise independent judgement.
- Duty to exercise reasonable care, skill and diligence.

- Duty to avoid conflicts of interest.
- Duty not to accept benefits from third parties.
- Duty to declare interest in proposed transaction or arrangement.

**Of these the first two duties are the main areas that result in legal action being brought against directors.**

As an example, if a director takes the strategic decision to pull out of a particular market and this area subsequently performs well, shareholders could make a claim against the director for failing to act in the interests of the company.



## Employment law

Employees can bring claims against directors under the Employment Rights Act and the Equality Act if they feel they have been treated unfairly. Claims can include unfair dismissal, which is usually brought against the company, and harassment and discrimination, which are brought against the individual director and have uncapped awards.



The changing face of employment means that legislation in this area is constantly evolving and directors need to be aware of the implications for their company.

For example, the introduction in July 2013 of fees for employees lodging tribunals has significantly reduced the number of cases being brought, although the potential exposure has increased as fees are also awarded if the defendant loses.

Similarly, the use of early conciliation through the Advisory, Conciliation and Arbitration Service (Acas), which was introduced in April 2014, should help to resolve more cases before they reach court. But there is a risk that if the employer does not follow the procedures laid down, they could inadvertently weaken their position.

## The Modern Slavery Act 2015

This piece of legislation, which received Royal Assent in March 2015, consolidates and simplifies existing offences relating to slavery and human trafficking while providing greater protection to victims.

It also introduces a new reporting requirement for organisations with a global turnover of £36m or more that conduct any part of their business in the UK. This annual statement details the steps the organisation is taking to ensure modern slavery is not taking place within its own business and supply chains and it must be approved by the board and signed by a director.

Although the reporting requirement will be limited to larger organisations, as it applies to their supply chains too, smaller companies could also be affected. Failure to comply doesn't attract any fines or penalties but directors are unlikely to want the reputational damage that could flow from this.

## Criminal Finances Act 2017

The Criminal Finances Act 2017 gives law enforcement agencies further capabilities and powers to recover the proceeds of crime, tackle money laundering, tax evasion and corruption, and combat the financing of terrorism.

Importantly for senior executives, it creates new criminal offences for corporations who fail to prevent their staff from facilitating tax evasion. As a director could find him or herself liable for an employee's actions, it is prudent to have adequate safeguards in place to ensure these activities cannot take place.

This is also in keeping with the government's expansion of failure to prevent offences. The Bribery Act 2010 introduced this concept, making it an offence to fail to prevent an associated person such as an employee paying a bribe to secure business.



## Insolvency Act 1986

Although the number of insolvencies has fallen significantly since the peak in 2009, an estimated 16,502 companies entered insolvency in 2016, representing an increase of 12.6% on the previous year.

The threat of insolvency has ramifications for directors. Although their focus may be on safeguarding the future of their business, to avoid legal action being taken against them, directors need to be aware of their responsibilities, and particularly how these change once there is a risk of insolvency.



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Under the Insolvency Act, directors can find themselves dealing with claims from creditors if they do not act in their best interests. This is because, once there is a risk of insolvency to a business, the director's responsibilities switch from the shareholders to the creditors.

They will want to ensure their interests are protected and may pursue legal action if, for example, they believe a director has sold off assets at an undervalued price to raise capital to support the company. Another example could be if they have been involved in wrongful trading, knowing the company had no future but continuing to operate. This type of action can result in lengthy and expensive investigations.



### Defamation Act 2013

Directors can also find themselves facing claims under the Defamation Act if their company is found to have said or written anything that causes harm to an individual or corporate body.

Although claimants will have to show they have suffered 'serious harm' before they can take legal action, the risk of a claim is increasing as a result of the internet, which makes it much easier to put potentially defamatory statements into the public domain.

Where these types of claims are brought, understanding how to retract the statement quickly with no admission of guilt is essential.



### Environmental damage

Under the Environment Act 1995 and the Wildlife and Countryside Act 1980, there is a responsibility to protect the environment including wildlife and wild plants.

A company doesn't even have to be directly involved with the environment for one of its directors to find him or herself charged under either of these acts.

Examples include the disturbance of some bats during an office refurbishment and the mowing of a lawn that was home to a protected species of newt.

In both cases the director was arrested under the Wildlife and Countryside Act as bats, and their roosts, and this particular type of newt are endangered species and, therefore, legally protected.

## Regulatory investigation

An increase in the appetite for regulatory investigations over the past few years means it is increasingly common for directors to find themselves having to pull together responses for regulators. This can be an expensive, time-consuming and disruptive process, especially when deadlines are short and there is a lack of awareness of the regulator's rules.



Serious breaches could result in fines of up to **€20m**, or 4% of the company's worldwide annual turnover if higher.

## General Data Protection Regulation

The introduction of the General Data Protection Regulation (GDPR) in May 2018 will increase directors' and officers' liabilities in this area.

As well as stipulating how organisations must treat personal data, it also introduces tougher financial penalties for non-compliance. Serious breaches could result in fines of up to €20m, or 4% of the company's worldwide annual turnover if higher. With such large fines at stake, as well as the reputational damage associated with a data breach or personal data misuse, a claim could be brought against a director for failing to take reasonable measures to adequately protect data.

For more information, please speak to your insurance intermediary or visit:

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