

DIRECTORS AND OFFICERS LIABILITY

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Introduction

This paper is intended to provide a brief overview of potential liabilities of directors and officers under English law. The liabilities of directors and officers have changed significantly under the Companies Act 2006 ("the Act"), which came into force on 8 November 2006 and repeals and largely replaces the Companies Act 1985.

1 Structure of English corporate bodies

1.1 English corporate bodies exist in various forms. The most common form of corporate body in England is the company with limited liability regulated by the Act. It is this company that we have in mind in this paper. These companies can take two forms:

1.1.1 companies limited by shares - liability of the members for the debts of the company is limited to the amount unpaid on the shares which they own in the company; or

1.1.2 companies limited by guarantee - liability of the members is limited to the amount which they undertake to pay in the event of the company ceasing to exist.

Companies limited by shares may also be either private or public. The main distinction between the two lies in the company's ability to offer its shares for sale to the public as a whole.

Other less common forms of corporate entities are:

- (a) unlimited companies where the liability of the members is unlimited; and
- (b) companies not formed under the Act - these may be either chartered companies or statutory companies. Chartered companies are normally non-trading companies, usually incorporated for charitable or quasi-charitable purposes. Statutory companies are largely water supply companies.

2 Definition of "Directors" and "Officers"

2.1 Directors

2.1.1 The Act is unhelpful to anyone seeking a definition of a director. It states only that it includes "*any person occupying the position of a director by whatever name called*". The courts will therefore look at the

facts and circumstances of each situation and not just at a person's title. The Act makes no distinction between executive and non-executive directors. The principles of good faith and honesty and duties of care and skill (detailed further below) were developed by the courts largely in relation to non-executive directors, since an executive director's service contract will usually impose obligations on him that go beyond his basic duties as a director.

2.1.2 A non-executive director is not involved in the day to day management of the company, but this does not alter the duties and responsibilities owed by such director to the company. However, it **may** be that more will be expected of an executive director under English law (since he will usually have a greater knowledge of the management of the company and its affairs).

2.1.3 The Act also defines a "shadow director" as a person "*in accordance with whose directions or instructions the directors of the company are accustomed to act*". However, a person will not be a shadow director if the directors act on advice given by that person in a professional capacity (eg legal; accountancy).

2.2 **Officer**

The term "*officer*" is similarly unclear under English law, The Act defines an officer in relation to a body corporate as "*including a director, manager or secretary*". Given the imprecise nature of this definition, regard should be had to an individual's function, duties and responsibilities. Case law tends to suggest that an officer will also include a member of senior management who formulates the company's decisions and policies and carries them out.

3 **Duties and responsibilities of a Director**

The scope of a director's duty under English law was previously governed by general principles rather than specific rules (such as laid down in certain jurisdictions, for example, the United States of America). However, the Act has now for the first time codified directors' duties, albeit it provides that regard should still be had to common law rules and equitable principles when interpreting the general duties codified in the Act.

3.1 General duties of Directors under the Act

The Act provides for seven main statutory directors' duties¹:

3.1.1 To act within powers (ie in accordance with the company's constitution) and to only exercise powers for the purposes that they are conferred.

3.1.2 To promote the success of the company for the benefit of its members having consideration to:

3.1.2.1 the likely consequences of any decision in the long-term;

3.1.2.2 the interests of the company's employees;

3.1.2.3 the need to foster the company's business relationships with suppliers, customers and others;

3.1.2.4 the impact of the company's operations on the community and the environment;

3.1.2.5 the desirability of the company maintaining a reputation for high standards of business conduct; and

3.1.2.6 the need to act fairly as between members of the company.

These six factors may expand directors' duties particularly as a duty to "*promote the success of the company*" (ie make money) is wider than the previous duty to maintain the company's financial standing. However, arguably the six factors are based on the common law rule to act in good faith (as discussed below at paragraphs 3.4 - 3.4.2.8) and consequently, do not change the scope of directors' duties.

3.1.3 To exercise independent judgment.

3.1.4 To exercise reasonable care, skill and diligence. The test for this duty includes an objective test as well as a subjective test. Consequently, a director must exercise the care, skill and diligence that would be exercised by a reasonably diligent person with the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company and the general knowledge, skill and experience that the

¹ The general duties also apply to shadow directors where, and to the extent that, the corresponding common law rules or equitable principles apply.

director usually has. The subjective element in this test will broaden directors' duties depending on the general knowledge, skill and experience of the director in question.

3.1.5 To avoid conflicts of interest; this duty also applies to former directors.

3.1.6 Not to accept benefits from third parties; this duty also applies to former directors.

3.1.7 To declare any interest in any proposed transaction or arrangement.

3.2 These general duties are owed by a director of a company to the company; therefore, only the company can enforce these general duties. There are three main ways in which the company can take legal action against a director for breach of duty - (a) if the board of directors decides to commence proceedings; (b) if the liquidator or administrator following the commencement of a formal insolvency procedure decides to commence proceedings; and (c) through a derivative action brought by one or more members to enforce a right which is vested not in himself, but in the company. Points (a) and (b) are discussed further below.

3.3 The Act makes it clear that the civil consequences of a breach are the same as would apply if the corresponding common law rule or equitable principles applied; in other words they are enforceable in the same way as any other fiduciary duty owed to a company by its directors (apart from the duty to exercise reasonable care, skill and diligence which is not considered to be a fiduciary duty). In the case of fiduciary duties the consequences of breach may include:

3.3.1 damages or compensation where the company has suffered loss;

3.3.2 restoration of the company's property;

3.3.3 an account of profits made by the director; and/or

3.3.4 rescission of a contract where the director failed to disclose an interest.

3.4 **Common Law duties**

3.4.1 We include a discussion of common law duties in this paper as the statutory code is not exhaustive and the Act calls for the general duties of directors to be interpreted in line with common law rules. At common law, a director is obliged to exercise a reasonable degree of skill and care in carrying out his/her duties. The standard of care involves both an objective and subjective element. In other words, the director is

required to exercise that degree of skill which might be expected from someone having both:

- 3.4.1.1 his own particular knowledge and experience; and
 - 3.4.1.2 the general knowledge and experience which might be expected of a person carrying out the same functions as those carried out by that particular director.
- 3.4.2 There is a fiduciary duty to act in good faith. Examples of this duty include:
- 3.4.2.1 A director must act bona fide in the interests of the company. This is basically a subjective test. The court will only interfere in the management of a company if it is satisfied that no reasonable director could have come to the conclusion that the director's actions were in the best interests of the company (it therefore does not interfere where it is a question of bad judgment), but a director acting in bad faith will not have the benefit of this carve out.
 - 3.4.2.2 Duty to exercise powers for their proper purpose. Even if a director is acting in good faith, he must use his powers for the intended purposes and for the benefit of the company - eg an issue of shares designed to defeat a takeover of the company might be considered to be an improper exercise of his powers even though he honestly believed the defeat of the takeover was in the company's best interests.
 - 3.4.2.3 Duty to avoid conflicts of interest. The general rule is that a director must not place himself in conflict with the company (eg by having a financial interest in a competing company). This will oblige a director to make disclosures in respect of a company in which he has personal interests, and, unless otherwise allowed by the company's articles of association, this will require shareholder approval. Often the articles of association will allow directors to act, notwithstanding a conflict of interest provided the conflict is disclosed to the board.
 - 3.4.2.4 Duty not to make personal profit. A director must not make a secret profit for himself if the opportunity results from his directorship. This applies even if the director is acting

honestly and for the good of the company, and even if the company would have been unable to take advantage of the profit. Any profit derived by the director must be paid to the company.

3.4.2.5 Duty not to fetter discretion. A director must exercise his full discretion when carrying out his duties as a director and no factors or influences must limit his discretion.

3.4.2.6 Duty not to exceed powers. A director must not do any act which is unlawful, or outside the company's powers or outside the powers conferred on him by the company's memorandum and articles of association. This is so even if he is acting honestly, believing that what he is doing is in the best interests of the company.

3.4.2.7 Duty to deal fairly as between different groups of shareholders. Subject to the provisions of the company's memorandum and articles of association, a director must treat all shareholders equally and fairly, irrespective of the class of share which they hold.

3.4.2.8 Duty not to compete. A director must not use the company's assets for a competing company's benefit and if he does so, he will be liable to account to the company for any profit made. It should be noted that a director will not breach his fiduciary duty simply by being a director of a competing company.

4 **To whom are the Directors' Duties owed?**

4.1 As mentioned above, the directors' duties are owed to the company. This means that the directors should have regard to the interests of the shareholders as a whole but there is no duty to individual shareholders (although see further below on this point). An action may be brought against a director in certain circumstances as discussed further below.

4.2 A company can bring an action against a director for negligence in the performance of his duties as a director. Generally a company is liable for actions authorised or committed by a director, but it may be entitled to make a claim for contribution against the director in question (both under common law and statute). If the negligent act was sanctioned by the board, co-directors could in theory be liable in the same way.

4.3 Whilst courts impose stringent requirements as to honesty and fair dealing, the courts also acknowledge that entrepreneurial flair can be hamstrung by imposing onerous duties of care. Due to the low standard of care applied, there have been few findings of negligence against directors. However, many of the decisions involved non-executive directors placing reliance on executive directors. In this day and age, it seems fair to assume that executive directors employed on service contracts and exhibiting particular expertise are far more likely to be called to account.

4.4 Section 260 of the Act places the ability of shareholders to bring an action on behalf of the company on a statutory basis. A derivative claim may be brought under the Act by a shareholder if three conditions are met:

4.4.1 the action is brought by a member of the company;

4.4.2 the cause of action is vested in the company; and

4.4.3 relief is sought on the company's behalf.

A derivative claim may be brought either by the shareholder (provided the three factors detailed above are met) or pursuant to a court order as detailed in paragraph 4.6. A derivative claim may be brought only in respect of a cause of action arising from *"an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director"*. Consequently, a derivative claim may be brought in respect of an alleged breach of any of the general duties of a director described above. The Act also provides that a claim may be brought by a member in respect of wrongs committed prior to his becoming a member, which could potentially increase the number of derivative actions. However, section 261 of the Act provides that a member will need the court's permission to continue a derivative claim and the White Paper to the Act encouraged the judiciary to exercise control over derivative claims by respecting commercial judgments and encouraging members to resolve disputes under the company's constitution.

4.5 Section 239 of the Act provides directors (including former directors and shadow directors) with a bar to a derivative claim, provided that the company ratifies, by resolution of the members of the company, the director's conduct amounting to negligence, default, breach of duty or breach of trust in relation to the company.

4.6 Similar to section 459 of the Companies Act 1985, section 994 of the Act provides that the court may make any order as it thinks fit where a member petitions and shows that the affairs of the company are being or have been conducted in a manner which is unfairly prejudicial to the interests of its members generally or of

some part of its members (including at least himself). As the directors are agents of the company, the conduct normally complained of is the conduct of one or more directors. For this reason, one of the orders which the court may make in this connection is an order authorising the petitioner to bring a civil action against the wrongdoers on behalf of the company.

- 4.7 Employees. Directors have a statutory duty to pay regard to the interests of employees. This duty, however, is owed to the company and cannot be enforced by employees (unless they are shareholders).
- 4.8 Third parties. Where a director or other officer performs acts as a company's agent, they may have duties to third parties. Where the act is performed negligently or otherwise, normally a claimant will sue the company rather than the directors because the company's assets will exceed those of the director. Directors and other officers can in certain circumstances be considered the agents of the company and, under the principles of agency law, are jointly and severally liable with a company for torts committed. There is no legal reason therefore why a claimant should not sue the directors if they also have assets (which may include a Directors and Officers insurance policy). However, in the light of the House of Lords' decision in *Williams v Natural Life Foods Limited* [1998] 2 All ER 577 a director is only likely to be found liable if there has been a voluntary assumption of responsibility towards a third party. On the evidence in this case there had been no personal dealing between the director and the third party which could have conveyed to the third party that the director was prepared to assume personal liability. It is only in exceptional circumstances that directors can face personal liability to third parties, such as in the case of fraud. In the House of Lords case of *Standard Chartered Bank v Pakistan National Shipping Corporation (No 2)* [2002] 1 All ER 173 a director knowingly and deliberately made a false statement in order to obtain payment on a letter of credit. The House of Lords held that a director cannot escape liability for deceit on the ground that he acted on behalf of and for the benefit of the company.
- 4.9 In respect of a negligent act committed by an employee, liability could attach to each of:
- 4.9.1 the employee;
 - 4.9.2 the company (vicariously as employer); and
 - 4.9.3 the director who had authorised, directed or procured the negligent act.
- 4.10 Generally there is no duty of care to outsiders with whom the directors deal on the company's behalf. If, for example, they decide that the company shall break its

contracts the other parties cannot sue the directors in tort for inducing the breach. There is no direct duty to creditors and therefore they cannot sue for breach of contract, unless the company is insolvent and even then this point is undecided. There are limited circumstances in which a creditor can sue directors at common law where the director has assumed a duty of care to the creditors (or entered into a contract in his own name on behalf of the company).

- 4.11 Company's insurers. If the company suffers a loss and is able to claim for this loss under its insurance, the company's insurers will be able to take over (by way of subrogation) any rights which the company may have against the person(s) (who at least must be negligent) who caused the loss (ie the insurers could have a claim against any director who caused the loss to the company (subject to any express waiver of such rights)).

5 **Specific liabilities**

- 5.1 The principal means for enforcing directors' duties is the prosecution of defaulting directors under the Act. Alternative remedies for breaches of directors' statutory obligations to their companies or the infringement of statutory prohibitions imposed on them are rarely specified in the Act. On the few occasions when the Act does create a specific remedy, it most frequently takes the form of a power for the company to rescind an offending transaction; or to recover funds of the company which have been improperly expended; or to require a director who is improperly benefited to account to the company for the value of the benefit he obtained; or to recover damages or compensation from a director responsible. There are, nevertheless, certain obligations of directors which the court is expressly empowered to enforce specifically by the Act. To a large extent, these mainly relate to duties of internal management, eg the keeping of accounting records; the preparation of annual accounts; the filing of documents with the Registrar of Companies and the keeping of the statutory books of the company. Failure to perform these duties or to ensure that they are performed may result in fines both for the company and the defaulting directors. Directors may also be subject to imprisonment.

5.2 **Environmental liabilities**

Directors' duties in relation to pollution and protection of the environment have increased in the last decade or so. The position at present is that when an offence under the Control of Pollution Act 1974, which has been committed by a body corporate, is proved to have been committed with the consent or connivance of, or to be attributable to any neglect on the part of, any director, manager or other officer of the body corporate or any person who was purporting

to act in any such capacity, the director, manager or officer, as well as the body corporate, is guilty of that offence and is liable to be proceeded against and punished accordingly.

5.3 **Employment law**

From an employment law perspective, at common law, an employer is vicariously liable for the acts or omissions of directors, officers or managers (who are the employees) in respect of acts carried out in the course of their employment. While employees can also be personally liable for acts or omissions towards other employees, they are very rarely sued in their personal capacity.

5.4 **Liability for Corporation Tax**

All companies resident in the United Kingdom are chargeable to corporation tax calculated on the basis of the company's annual profits. Liability for corporation tax, therefore, lies primarily with the company. However, everything to be done by a company under the Taxes Acts must be done by the company acting through its "proper officer". For these purposes, the "proper officer" of a company is the company secretary or a person acting as the company secretary. A failure by the company secretary to discharge his duties may result in a charge of cheating the public revenue. Directors who deliberately connive at such failure may also be guilty of this offence.

5.5 **Liability for Value Added Tax**

Directors and officers of a company may be made personally liable for dishonest evasion of value added tax where it appears to Her Majesty's Revenue & Customs ("HMRC") that the conduct of such a director or officer was, in whole or in part, the principal factor giving rise to a penalty imposed on the company in respect of that offence. In those circumstances, the Commissioners may serve a notice on the company and on the director or officer in question specifying the amount of the penalty to which the company is liable, and stating that the Commissioners propose to recover the whole or a certain portion of that penalty from the director or officer. That amount is then recoverable from the director or officer as if he were personally liable.

6 **Statutory duties**

6.1 **Financial Assistance**

6.1.1 Section 667 of the Act provides a description of what is meant by the term "Financial Assistance". They include the following

- 6.1.1.1 gifts,
 - 6.1.1.2 guarantees,
 - 6.1.1.3 security or indemnity,
 - 6.1.1.4 release or waiver of an obligation,
 - 6.1.1.5 novation or assignment,
 - 6.1.1.6 any other assistance where the net assets of the company are reduced.
- 6.1.2 The Act has repealed section 151 of the Companies Act 1985, which contained a general prohibition against the giving of financial assistance by a company for the purchase of its own shares. However, this prohibition is retained for public companies although no offence will be committed by the company or its officers if the principal purpose of the assistance is not to give it for the purpose of an acquisition of shares, or where this assistance is incidental to some other larger purpose of the company and (in either case) where the assistance is given in good faith in the interests of the company. A person guilty of an offence under this section is liable to imprisonment, not exceeding two years and/or or a fine.
- 6.1.3 The Act permits a private company, not associated with a public company, to provide loans, related guarantees or security made by a company for a director of the company (or its holding company), provided member approval is first obtained. In the case of a public company, or a private company associated with a public company, member approval is required for loans, quasi-loans, credit transactions and related guarantees or security provided by the company for a director of the company (or its holding company) or a person connected with a director of the company (or its holding company). Member approval is not required for loans, quasi-loans and credit transactions below certain values.

Previously under the Companies Act 1985 breach of the equivalent provisions was a criminal offence. However, the Act has abolished the criminal penalty for breach and instead breach of this provision may result in civil penalties including accounting to the company for any consequent gain and indemnifying the company for any loss or damage resulting from the transaction or arrangement.

6.2 Fraudulent Trading

6.2.1 Section 213 of the Insolvency Act 1986 ("IA") provides:

"213(1) If in the course of the winding-up of the company it appears that any business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose the following has effect.

213(2) The Court, on the application of the Liquidator, may declare that any persons who were knowingly parties to the carrying on of the business in the manner above mentioned are to be liable to make such contributions (if any) to the company's assets as the Court thinks proper".

6.2.2 In summary, the purpose of this provision is to deal with cases of actual fraud. There has to be actual dishonesty on the part of the directors as opposed to, say, negligence or incompetence. In the case where directors have been acting fraudulently they will not be able to hide behind the corporate entity and a liquidator can apply to court for an order that the directors should be personally liable to contribute to the assets of the company.

6.3 Wrongful Trading

6.3.1 Section 214 of the IA enables the liquidator of a company to apply to court for an order that a person contribute to the company's assets where:

6.3.1.1 *the company has gone into insolvent liquidation;*

6.3.1.2 *at some time before the commencement of the winding up of the company, the person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation; and*

6.3.1.3 *that person was a director of the company at the time.*

6.3.2 Wrongful trading is very different from fraudulent trading. For a director to be found liable for wrongful trading it is not necessary to show actual dishonesty. The purpose of the provision is to ensure that directors of companies in difficulty act responsibly. In summary, it provides that where a director knows that insolvent liquidation is inevitable that

director may be held personally liable to make a contribution to the assets of the company if, notwithstanding that knowledge, the director allows the company to continue trading. In order to deal with the hopelessly optimistic director the provision is couched in terms so as to encompass not merely actual knowledge, but a case where a director ought reasonably to have concluded that insolvent liquidation was inevitable.

- 6.3.3 There are saving provisions which mitigate the harshness of the rule. The principal provision is section 214(3) of the IA which provides that the court may not hold a director liable if it is satisfied that the director in question took every step with a view to minimising the potential loss to the company's creditors. The reason for this provision is that there may very well be circumstances when it is prudent for the company to continue trading notwithstanding the fact that insolvent liquidation is inevitable. In those circumstances, it is plainly right that the company should continue to trade if the effect will be to improve the position for the company's creditors. In the absence of such a provision a director would doubtless cease trading as soon as he realised that insolvent liquidation was inevitable whether or not that was the best course for the company's creditors. However, in considering this point care must be taken to ensure that the interests of some creditors are not improved at the expense of others.

6.4 **Declaration of Solvency on Voluntary Winding Up**

- 6.4.1 Where it is proposed that the company should go into a voluntary winding up, the directors (or a majority of them) may at a directors' meeting make a statutory declaration to the effect that they have made a full inquiry into the company's affairs and that they have formed the opinion that the company will be able to pay its debts in full, together with interest at the official rate, within a given period of time not exceeding 12 months from the commencement of the winding up. If a director makes a declaration of solvency without having reasonable grounds for the opinion that the company will be able to pay its debts, he is liable to imprisonment or a fine or both.
- 6.4.2 If the company is wound up within five weeks after the making of the declaration, and its debts are not paid or provided for in full within the period specified, it is to be presumed that the director did not have reasonable grounds for his opinion.

6.5 Misfeasance

- 6.5.1 In addition to creating "offences", and thereby setting standards for directors' conduct, the IA also provides a streamlined procedure for remedying breaches of statutory or common law duties.
- 6.5.2 A director of a company is guilty of misfeasance if he has misapplied or retained, or become accountable for, any money or other property of the company (section 212 of the IA). This section does not create any new offences or impose any novel duties, but provides a summary means of pursuing directors. The courts have confirmed that the misfeasance procedure is appropriate for cases of negligence as well as alleged breaches of fiduciary duty (*Re D'Jan of London Limited* [1993] BCC 646).
- 6.5.3 Any director found guilty of misfeasance may be held liable to repay or account for money or property to the company (together with any interest which the court may impose thereon) or contribute such sum to the company's assets by way of compensation as the court thinks just (section 212(3) of the IA).

6.6 Punitive damages

- 6.6.1 Directors, officers and managers may be liable under English law for punitive damages in much the same way as any other defendant in English proceedings. Under English law punitive or exemplary damages can only be awarded if they are specifically claimed; the claim falls into one of three categories and it is based on one of a limited number of causes of action. Even if those tests are satisfied, the court has the discretion to refuse an award. The three categories of claim are:
- 6.6.1.1 oppressive, arbitrary or unconstitutional action by servants of the government;
- 6.6.1.2 wrongful conduct which has been calculated by the defendant to make a profit for himself which may well exceed the compensation payable to the plaintiff; or
- 6.6.1.3 where such an award is expressly authorised by statute.

The relevant causes of action are:

- (a) malicious prosecution;

- (b) false imprisonment;
- (c) assault and battery;
- (d) defamation;
- (e) trespass to land or to goods;
- (f) private nuisance; and
- (g) tortious interference with business.

The application of the tests distinguish English law from a less restrictive approach adopted by the major Commonwealth jurisdictions. Canadian, Australian and New Zealand authorities all apply a general test of culpability, which is essentially intended to catch any example of highly reprehensible civil wrongdoing.

6.6.2 As regards insurability, in the leading case on the subject (*Lancashire County Council v Municipal Mutual Insurance* [1996] 3 All ER 545), the court held that the word "compensation" used in a director's liability insurance policy included exemplary damages and that it was not contrary to public policy for a person to be indemnified by insurance against that liability. However, it should be noted that most insurance companies specifically exclude liability for exemplary damages from the scope of their policies.

6.6.3 The Companies (Audit, Investigations and Community Enterprise) Act 2004 has largely been repealed by the Act and consequently, the Act provides that directors of companies must make certain disclosure statements in the directors' reports. This applies not only to information which the officer actually knew of but also information he would have known about if he had conducted a reasonable enquiry. However, the provision goes further and requires the director to confirm that, so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware. A director has a duty to exercise reasonable care, skill and diligence when preparing the directors' report. In determining a director's liability under the Act, the statutory test is that a director will commit an offence if he knew the statement was false or was reckless as to whether it was false and failed to take reasonable steps to prevent the report from being approved. A person guilty of an offence may be liable to imprisonment not exceeding two years or a fine or both. A guilty director may also face sanctions under

the Company Directors Disqualification Act 1986 and the Financial Services and Markets Act 2000 ("FSMA") eg the requirement pertaining to general duties of disclosure by those responsible for prospectuses pursuant to section 80 of FSMA (see further below).

7 **Duties with respect to publication of a prospectus**

7.1 **The Initial Obligation**

- 7.1.1 Under section 21 of FSMA it is an offence for a person in the course of a business to communicate an invitation or inducement to engage in investment activity (ie make a financial promotion) unless (a) that person is authorised to do so under the provisions of FSMA or (b) the content of the communication has been approved by an authorised person (eg the sponsor which is authorised by virtue of its authorisation under FSMA). Breach of section 21 of FSMA has both criminal and civil consequences. It is a criminal offence to contravene section 21 punishable by imprisonment of up to two years or a fine or both. Breach of section 21 may also render any investment agreement unenforceable and entitle the other party to such agreement to recover any money paid under that agreement.
- 7.1.2 Directors should note that the scope of section 21 is very wide. Section 21 applies to all "communications" whether solicited or unsolicited. The regime applies also to communications originating both inside and outside the UK. Any communication (which includes written documents, exhibitions, radio and television broadcasts, films, videos, information posted on web-sites and certain oral statements) containing information likely to encourage dealing in shares (whether or not it is intended to have that effect) will be a financial promotion and so fall within section 21 of FSMA.
- 7.1.3 The most important statutory requirement relating to the contents of a prospectus is the general duty of disclosure set out in section 80 of FSMA. It requires that the prospectus contains, in addition to information specifically required by the Listing Rules or by the United Kingdom Listing Authority ("UKLA") as a condition of admission to listing, all such information which:
- 7.1.3.1 any person responsible for the prospectus knows or which it would be reasonable for him to obtain by making enquiries; and

7.1.3.2 investors and their professional advisers would reasonably require, and reasonably expect to find in the prospectus, for the purpose of making an informed assessment of (a) the assets and liabilities, financial position, profits and losses, and prospects of the company and (b) the rights attaching to the shares to be listed. FSMA states that in determining what information is required to satisfy this test, regard should be had to:

7.1.3.2.1 the nature of the shares and of the company;

7.1.3.2.2 the nature of the persons likely to consider acquiring the shares;

7.1.3.2.3 the fact that certain matters may reasonably be expected to be within the knowledge of professional advisers of any kind which those persons may reasonably be expected to consult; and

7.1.3.2.4 any information available to investors or their professional advisers by virtue of other requirements imposed by the UKLA, or under any other enactment.

7.1.3.3 A mere warning of potential risks will not be sufficient. Accordingly, the prospectus must give a fair impression of the risks, as well as the rewards, of an investment in the company.

7.2 The Updating Obligation

7.2.1 The directors' responsibilities will not end when the prospectus is published. The UKLA should be notified immediately if, before dealings in the shares commence, any of the directors or their advisers become aware of, amongst other matters, significant changes affecting any matter contained in the prospectus required to be included by FSMA, the Listing Rules or the UKLA.

7.2.2 Section 90 of FSMA imposes civil liability on the persons responsible for a prospectus (which includes the directors of the company). They must pay compensation to any person who acquires the shares and suffers loss in respect of them as a result of any untrue or misleading

statement in the prospectus or any supplementary prospectus, or as a result of the omission of any information required by FSMA or the Listing Rules. It does not appear to be necessary for the person claiming compensation to prove that he relied upon the misleading statement or omission. It should also be noted that liability potentially extends to any person who purchases the shares subsequently, as well as to the initial investors, and this liability may exist until such time as new information updating the prospectus is publicly available.

- 7.2.3 Under schedule 10 of FSMA (and regulation 15 of the Public Order of Securities Regulations (“POS Regs”) a person responsible for the prospectus will not be liable if, when the prospectus was submitted to the UKLA, he reasonably believed, having made such enquiries (if any) as were reasonable, that the statement was true and not misleading or that the matter the omission of which caused the loss was properly omitted, and that, inter alia, he continued in that belief until the time when the shares were acquired.
- 7.2.4 Additional exemptions from liability are available, including:
- 7.2.4.1 reasonably believing an expert to be competent to make or authorise a statement in the prospectus when the expert has consented to its inclusion;
 - 7.2.4.2 publication of a correction prior to the acquisition of the shares; or taking reasonable steps to secure such publication and reasonably believing it had taken place;
 - 7.2.4.3 reliance on an official statement or public official document accurately and fairly reproduced;
 - 7.2.4.4 demonstrating that the investor knew that the information in question was false or misleading, or that this was an omission or a change or a new matter; and
 - 7.2.4.5 reasonably believing that a change in circumstances or a new matter was not such as to require a supplementary prospectus.
- 7.2.5 FSMA does not, however, affect any civil or criminal liability which a person may incur under the general law.

8 Market Abuse, Part VIII FSMA

- 8.1 FSMA introduced a new market abuse regime under which those who commit market abuse can be punished by an unlimited financial penalty, public censure, ordered to make restitution or restrained by injunction. Under the new regime the Financial Services Authority (“FSA”) has power to act directly against anyone committing market abuse (and not just persons it regulates).
- 8.2 Market abuse is committed by a person or persons engaging in market abuse or by taking or refraining from any action which requires or encourages another person to engage in behaviour which would amount to market abuse. Behaviour includes both action and inaction and in order to amount to market abuse behaviour must:
- 8.2.1 occur in relation to qualifying investments including shares traded on a prescribed market (eg the London Stock Exchange);
 - 8.2.2 satisfy one of the following conditions:
 - 8.2.2.1 *misuse of information*: based on information which is not generally available to those using the market but which, if it were available to a regular user of the market, would be regarded by him as relevant when entering into transactions in certain investments traded on certain markets;
 - 8.2.2.2 *misleading practices*: be likely to give a regular user of the market a false or misleading impression as to the supply of, or demand for, or as to the price or value of relevant investments;
 - 8.2.2.3 *manipulation*: the activity will be likely regarded by a user of the market as behaviour which would, or is likely to, distort the market in certain investments of the kind in question; and
 - 8.2.2.4 be likely to fail the regular user test ie be regarded by a regular user of that market as a failure on the part of the person concerned to observe the standard of behaviour reasonably expected of a person in his position in relation to the market.
 - 8.2.3 Under FSMA, a code has been issued to assist market users in determining whether or not behaviour amounts to market abuse. The code does not describe every form of behaviour which might amount to

market abuse and the provisions of the code are mainly evidential. However, it does describe conduct which does **not** amount to market abuse and these "safe harbours" are conclusive. It is no defence that a person did not intend to commit market abuse; the emphasis is on the effects of and not the intention behind the behaviour. It should be noted that the market abuse regime applies in addition to, and not in substitution for, existing criminal offences and regulatory provisions relating to insider dealing and market manipulation.

9 The Listing Rules²

9.1 General reporting requirements

A company must notify a *regulated information service* approved by the FSA of any major new developments in the company's sphere of activity which are not public knowledge which may, by virtue of the effect of those developments on its assets and liabilities or financial position or on the general course of its business, lead to substantial movements in the price of its listed securities (Listing Rule 9.6 and Disclosure Rules and Transparency Rules, Rule 2,2).

9.2 Transactions

9.2.1 If the company applies for listing of additional shares following its listing, it must publish listing particulars, save in certain circumstances, for example the issue of shares which would increase the shares of a class already listed by less than ten per cent (10%) (for this purpose a series of issues in connection with a single transaction, or a series of transactions that is regarded by the UKLA as a single transaction, will be deemed to be a single issue); and transactions are classified by assessing their size relative to that of the listed company proposing to make it by way of "percentage ratios". The degree of notification required will vary according to the percentage ratio of the transaction.

9.2.2 If an acquisition of a public company is involved, the City Code on Takeovers and Mergers and the Rules Governing Substantial Acquisitions of Shares will be relevant. These set out the general principles and detailed rules relating to the conduct and timing of UK public company takeovers, aimed at ensuring the fair and equal treatment of all shareholders in relation to takeovers.

² The Listing Rules apply to all publicly listed companies in the UK and are administered by the FSA.

9.2.3 Where a company proposes to enter into a transaction with certain related parties, such as a director, substantial shareholder (that is, a shareholder holding ten per cent (10%) or more of the voting power of the company), or their "associates", the transaction must, whatever its size, be first approved by the shareholders in general meeting. The UKLA will normally require a circular to be sent to shareholders and require the relevant related party to abstain from voting. Further details are set out in Chapter 11 of the Listing Rules.

9.3 **Breach of the Listing Rules**

If the UKLA considers that a company is in breach of the Listing Rules, it may under Listing Rule 5 suspend or cancel the listing of any class of the company's securities.

9.4 **Continuing obligations**

9.4.1 Companies (and their directors) listed on the Official List of the UKLA, which is regulated and maintained by the FSA, must adhere to certain obligations in the Combined Code on Corporate Governance published in June 2008 by the Financial Reporting Council ("Combined Code")³. The Combined Code is appended to the Listing Rules and sets out standards of good practice in relation to issues such as board composition and development, remuneration, accountability, audit and relations with shareholders. All listed companies incorporated in the UK are required to report on how they have applied the Combined Code in their annual report and accounts. Listed overseas companies are required to disclose the significant ways in which their corporate governance practices differ from those set out in the Combined Code.

9.4.2 The Combined Code contains principles of good governance. The principles are divided into two sections, section 1 - Companies (divided into four parts: A - Directors; B - Remuneration, C - Accountability and Audit and D - Relations with Shareholders) and section 2 - Institutional Shareholders. There follows a Code of Best Practice under which detailed provisions are set out in relation to each principle, except where a principle is considered to be self explanatory.

³ A version of the Combined Code incorporating recommendations from the Higgs Report (discussed below at paragraph 9.7) was published in July 2003, the 1993 version replaced the 1998 version. The 1993 version applies to reporting years ending before 31 October 2007. Following a review of the 2003 version in 2005, a small number of changes were incorporated into the 2006 version of the Combined Code which applies to reporting years beginning on or after 1 November 2006. The most recent version was published in June 2008 and applies to accounting periods beginning on or after 29 June 2008.

9.4.3 The requirements in the Combined Code are supplemented by those contained in: the Model Code on Directors' Dealings (as set out in Annex I to Chapter 9 of the Listing Rules); the Directors' Remuneration Report Regulations 2002; the City Code on Takeovers and Mergers; and FSMA. Observance of these obligations is regarded as critical by the UKLA in order to maintain an orderly market and to ensure that all users of the market have simultaneous access to the same information.

9.5 **Internal Control: Guidance for Directors on the Combined Code**

9.5.1 In September 1999 the Institute for Chartered Accountants in England and Wales published guidance entitled *Internal Control: Guidance for directors on the Combined Code or the "Turnbull Report"*. The guidance focused on the financial risk management in companies and it clarified the steps which companies can take to comply with internal control requirements of the Combined Code. The internal control requirements set out in the guidance were latterly incorporated into the Combined Code and are as follows:

9.5.1.1 directors are required to maintain a sound system of internal control to safeguard shareholders' investments and the company's assets (section 1, Principle C2); and

9.5.1.2 directors must, at least annually, conduct a review of the effectiveness of the group's system of internal controls and report to shareholders that they have done so (Provision C2.1).

9.6 **The Model Code on Directors' Dealings (Model Code)**

9.6.1 The freedom of directors and certain employees of listed companies to deal in their company's securities is restricted in a number of ways - by statute, by common law and by the requirement of the Listing Rules that listed companies adopt and apply a code of dealing which is at least as strict as the Model Code, in Annex 1 Chapter 9 of the Listing Rules (referred to above at paragraph 9.4.23).

9.6.2 The vast majority of listed companies follow the Model Code to the letter, although certain multi-national corporations will have a consistent code between jurisdictions and so may adopt their own bespoke Code.

9.6.3 The Model Code imposes restrictions beyond those that are imposed by law. Its purpose is to ensure that *people discharging managerial*

responsibilities (eg a director) and *employee insiders* (defined in the Model Code as any employee of the company or parent company or of any member of the group) do not abuse, and do not place themselves under suspicion of abusing price-sensitive information that they may have or be thought to have, especially in periods leading up to an announcement of results. A company may impose more rigorous restrictions on directors than those set out in the Model Code.

9.6.4 The Model Code provides that a director must not deal with any securities of the company without first notifying the chairman (or a director designated by the board for this purpose) and receiving clearance to deal from him. An employee insider must not deal with any securities of the company without first notifying the company secretary or designated director and receiving clearance to deal from him. Clearance to deal in any securities of the listed company should not be granted during certain specified "*prohibited periods*" (eg as mentioned above periods leading up to an announcement of results).

9.6.5 The Directors should also consider the impact of the insider dealing legislation contained in Part V of the Criminal Justice Act 1993 ("CJA"). The CJA makes insider dealing a criminal offence. The CJA applies to individuals and not companies. It applies to debt securities as well as equity (and so debentures, loan stock, loan notes and preference shares are all covered and not just ordinary shares) as well as convertibles such as options and warrants. The CJA applies to all dealings on-market, but also will attach to off-market dealings if such dealings are through a professional intermediary, such as a stockbroker or bank. Breach of the CJA is a criminal offence and an offender may be liable to imprisonment for up to seven years and/or an unlimited fine.

9.7 **The Higgs Review**

9.7.1 On 20 January 2003, The Higgs Review of the Role and Effectiveness of Non-Executive Directors was published. It was aimed at improving corporate governance amongst listed companies and was intended to promote greater transparency and accountability. Some key recommendations were as follows:

9.7.1.1 At least half the members of the board, excluding the chairman, should be independent non-executive directors.

9.7.1.2 Guidance is offered in the report on how non-executive directors can maximise their effectiveness.

- 9.7.1.3 Non-executive directors should meet at least once a year without the chairman or executive directors present.
- 9.7.1.4 Potential new non-executive directors should carry out due diligence on the board to satisfy themselves they have the requisite skills to make a positive contribution to the board.
- 9.7.1.5 All directors should take decisions objectively in the interests of the company.
- 9.7.1.6 Companies should provide appropriate D&O insurance.

10 Statements

- 10.1 **Negligent mis-statement** - There may be civil liability in tort (under the rule in *Hedley Byrne v Heller* [1963] 2 All ER 575) for misstatements in a prospectus. The responsibility statement required by the Listing Rules is thought to place a duty of care on the directors (and anyone else accepting responsibility in these terms) as against persons who acquire shares on the basis of the contents of the prospectus. Breach of this duty can give rise to a claim in negligence against the persons responsible for the prospectus for any resulting loss. The loss recoverable is that which could have been reasonably foreseeable.
- 10.2 **Fraudulent misrepresentation** - Civil liability in tort can arise in respect of a fraudulent misstatement of fact (although not a promise, forecast or expression of opinion). "*Fraudulent*" in this context is interpreted widely to mean made either with knowledge of the falsity or made recklessly (ie not caring whether the statement is true or false or not believing it to be true). It is not necessary to show either an intent to defraud or that the fraudulent statement was the sole cause which induced the shareholder to purchase the shares. The loss recoverable is the actual loss suffered by the claimant.
- 10.3 **Misrepresentation Act 1967** - Section 2(1) of the Misrepresentation Act 1967 ("MA") gives a statutory right to damages in respect of negligent misstatements. Under section 2(1) of the MA, damages may be recovered for any pre-contractual misrepresentation if liability would have arisen had the representation been fraudulently made, unless the person making the representation proved he had reasonable grounds to believe and did believe up to the time the contract itself was made that the facts represented were true. Section 2(2) of the MA permits the court to award damages in lieu of rescission where a misrepresentation has been made. Liability under both subsections 2(1) and 2(2) falls only on the party to the contract and will accordingly be relevant only to those who are selling shares (and will thus be contracting directly with investors).

- 10.4 **Section 501 of the Act** - A director will be guilty of an offence if he knowingly or recklessly makes to an auditor of the company a statement (oral or written) that (a) conveys or purports to convey any information or explanations which the auditor requires, or is entitled to require and (b) is misleading, false or deceptive in a material particular. A director found guilty of such an offence may be liable for imprisonment not exceeding two years and/or a fine (on conviction on indictment) or liable for imprisonment not exceeding 12 months and/or a fine not exceeding the statutory maximum (on summary conviction).
- 10.5 **Liability in contract** - The prospectus will form the basis of a contract between the company and the successful applicants. If there are inaccurate or misleading statements in the prospectus, the purchasers may be able to rescind the contract and/or sue for damages.
- 10.6 The company and its directors will often enter into an offer agreement with the sponsor in connection with a flotation. In that agreement, the sponsor will typically ask the directors to give warranties or indemnities to protect the sponsor if subscribers or purchasers of the shares bring an action against it. The sponsor can bring an action against the directors or the company for loss suffered by it as a result of such claims except where the loss arose because of the sponsor's negligence or wilful default. Such liability could be substantial, particularly if the sponsor has itself purchased shares (for example, pursuant to an underwriting agreement).
- 11 **Criminal liability**
- 11.1 **Section 397 of FSMA**
- 11.1.1 Under section 397 of FSMA, any person (including a director) who knowingly or recklessly makes a false, misleading or deceptive statement or who dishonestly conceals a material fact is guilty of a criminal offence if his purpose in doing so is to encourage others to deal in securities in a company or if he is reckless as to whether his actions will have that result. It should be noted that section 397 can apply not only to the contents of a prospectus, other documents and oral statements (particularly forecasts), but also to omissions from such documents or oral statements.
- 11.1.2 A person will be reckless if he deliberately shuts his eyes to the fact that his statement is misleading or if he does not even consider its accuracy - it does not require any dishonest intent.

- 11.1.3 Under section 397(3), any person (including a director) who creates a false or misleading impression as to the market in, or price or value of, any shares in order to encourage others to deal or not deal in them is guilty of a criminal offence. There is no need for the prosecution to prove dishonesty on his part or an intention to create a false impression. All the prosecution need establish is an intent or purpose to create an impression which, in the event, turns out to be false or misleading. Defences are set out in section 397, but are only available to a director if he can prove that he reasonably believed that his act or course of conduct would not create a false or misleading impression.
- 11.1.4 Each of subsections 397(1), (2) and (3) can apply to misstatements in, or omissions from, a prospectus. A person guilty of an offence under those sections is liable to imprisonment for up to seven years or to a fine or both.

11.2 **Section 398 of FSMA**

- 11.2.1 Under section 398 of FSMA a person will be guilty of an offence if, in accordance with any requirements imposed by or under FSMA, he knowingly or recklessly gives the FSA information which is false or misleading in a material particular. This section only applies where there is no other provision under FSMA which creates an offence in connection with the giving of information. The definition of reckless set out in paragraph 11.1.2 above will apply equally to this section.
- 11.2.2 A person guilty of an offence under this section will be liable to a fine not exceeding the statutory maximum (on summary conviction) or an unlimited fine (on conviction by indictment).

11.3 **Section 19 of the Theft Act 1968**

A director or other officer or person purporting to act as an officer of the company commits an offence if, with intent to deceive its members or creditors about its affairs, he publishes or concurs in publishing a written statement which, to his knowledge, is or may be misleading, false or deceptive in a material particular.

11.4 **Section 400 of FSMA**

This section sets out the provisions for the criminal liability of, amongst others, persons running bodies corporate. Where an offence committed under FSMA by the company is shown to have been committed with the consent or connivance of an officer (including director), or to be attributable to any neglect on his part, the

officer as well as the company is guilty of the offence and liable to be proceeded against. It should be noted that as a matter of law, all the directors of the company regardless of whether they are executive or non-executive, are collectively and individually responsible for the accuracy of the contents of the prospectus.

11.5 The Enterprise Act 2002

11.5.1 The Enterprise Act 2002 ("EA") was introduced pursuant to one of the Government's 2001 electoral pledges and reforms two areas of the law - competition and insolvency. In the area of the former, the EA introduces a new cartel offence and provides for the disqualification of directors for infringements (up to 15 years) and prosecution. The EA provides that:

"An individual is guilty of an offence if he dishonestly agrees with one or more other persons to make or implement, or to cause to be made or implemented arrangements of the following kind relating to at least two undertakings (A and B).

The arrangements must be ones which, if operating as the parties to the agreement intend, would:

- (a) directly or indirectly fix a price for the supply by A in the United Kingdom (otherwise than to B) of a product or service;*
- (b) limit or prevent supply by A in the United Kingdom of a product or service;*
- (c) limit or prevent production by A in the United Kingdom of a product;*
- (d) divide between A and B the supply in the United Kingdom of a product or service to a customer or customers;*
- (e) divide between A and B customers for the supply in the United Kingdom of a product or service; or*
- (f) be bid-rigging arrangements."*

The following should be noted:

- (i) as proposed, the cartel offence is committed whether or not the cartel is implemented;*

- (ii) the fines are unlimited and the relevant officer can be imprisoned for up to five years on indictment;
- (iii) the existing civil sanctions under the Competition Act 1998 remain;
- (iv) the Office of Fair Trading (“OFT”) has the ability to investigate claims of cartels; and
- (v) there is a proposed "leniency" process which permits the OFT to issue a written notice to an individual advising that he/she will not be prosecuted for a particular matter provided certain conditions are observed, including:
 - A an admission of guilt;
 - B the applicant must not be a lead cartel member;
 - C the applicant must cease all involvement in the cartel (except as directed by the OFT to avoid raising the suspicion of the parties);
 - D co-operate fully with the investigation; and
 - E full disclosure.

12 Corporate manslaughter

12.1 The established law as to manslaughter is:

12.1.1 the defendant must have owed a duty of care to the deceased;

12.1.2 there had been a breach of this duty; and

12.1.3 the breach was so grossly negligent that the defendant can be held to have had such a disregard for the life of the deceased that it should be viewed as criminal and deserving of punishment (*R v Adamako* [1995] 1 AC 171).

12.2 As for corporate manslaughter, the most recent development was in *R v Kite and OLL Ltd*, 8 December 1994 (unreported), where both the company and its managing director were found guilty of manslaughter. The prosecution arose from a tragic canoeing accident in Dorset in 1993 which resulted in the deaths of four teenagers. OLL Ltd became the first company to be convicted of corporate manslaughter. The company was fined £60,000 which was said by the court to

represent its entire assets. The prosecution alleged that Mr Kite (who was the sole director of OLL Ltd) had primary responsibility for devising, instituting, enforcing and maintaining the safety policy. However, it should be borne in mind the OLL Ltd was a small company and it was clear that Mr Kite was the controlling mind. Mr Kite was originally sentenced to three years, subsequently reduced to two years on appeal.

As a result of a number of failed prosecutions, the Corporate Manslaughter and Homicide Act 2007 ("2007 Act") has now been enacted. The 2007 Act provides as follows:

- (a) the organisation must owe a relevant duty of care to the victim that is connected with certain activities carried out by the organisation;
- (b) the organisation must be in breach of that duty of care as a result of the activities performed by senior managers;
- (c) the senior management failure must have caused the victim's death (it need only be a cause, although a break in the chain of causation can negate culpability); and
- (d) the breach of the duty must have been gross ie the conduct falls far below what reasonably might be expected (similar to the threshold for the offence of gross negligence manslaughter).

Where there is a guilty finding, the company can be subject to an unlimited fine; remedial orders or publicity orders. However, it should be noted that the common law in connection with individual directors remains as stated above.

13 Pollution

13.1 The Environmental Protection Act 1990 regulates the disposal of controlled waste. Controlled waste includes, but is not limited to:

- (a) Waste from factories
- (b) Waste from premises used wholly or mainly for the purposes of a trade or business or the purposes of sport, recreation or entertainment;
- (c) Waste from premises used for transportation of goods by air, sea or road;
- (d) Other specific wastes prescribed by the Secretary of State.

13.2 Section 157 of the Act means that directors can be held personally liable if it can be shown that a breach was committed with a director's consent or encouragement or that the breach was attributable to any neglect on the part of the director. On conviction a director faces a fine or in the most serious cases imprisonment.

14 Health & safety

14.1 With over 120,000 injuries at work in 2010 directors should be aware of their duties under the Health and Safety at Work Act 1974. The Act requires companies:

- (a) To have an up to date written health and safety policy
- (b) Ensure that all employees are aware of this policy
- (c) To assess all risks
- (d) Keep records of all significant risks discovered.

14.2 If a health and safety offence is committed with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other similar officer of the organisation, then that person (as well as the organisation) can be prosecuted under section 37 of the Health and Safety at Work Act 1974.

14.3 Those convicted of offences under the Act face the threat of fines or imprisonment. The courts also has the discretion under section 2(1) of the Company Directors Disqualification Act 1986 to disqualify directors who are convicted of health and safety offences.

15 The Data Protection Act 1998

15.1 With growing concerns over privacy directors need to be aware of their legal duties. The Data Protection Act 1998 regulates the protection of personal data which is held either electronically or in a 'relevant filing system'. Section 1(1) of the Data Protection Act 1998 defines a relevant filing system as any set of information relating to individuals to the extent that, although the information is not processed by means of equipment operating automatically in response to instructions given for that purpose, the set is structured either by reference to the individual or to criteria relating to individuals, in such a way that specific information relating to a particular individual is readily accessible". The Court of Appeal held in *Durant v Financial Services Authority* ([2003] EWCA Civ 1746) that the definition is narrow and that manual filing systems will only fall within the

definition if they are similar to computerised systems in that they allow ready access to personal data.

- 15.2 The Data Protection Act makes it an offence to knowingly or recklessly obtain, disclose or procure the disclosure of information without the permission of the Data Controller.
- 15.3 A director will be personally liable for any breaches of the Data Protection Act which he consented to, encouraged or which can be attributed to his neglect. The Information Commissioner can impose fines up to a maximum of £500,000. It is likely, that following a EU consultation paper on data privacy breaches that liabilities with regard to data breaches are set to expand significantly.

16 **The Bribery Act 2010**

16.1 The Bribery Act 2010 came into force on 1 July 2011. The Act introduces a strict liability offence for companies which fail to prevent their employees either giving or receiving bribes. Employers must ensure there are “adequate procedures” in place to prevent bribery in order to avoid criminal liability. The Act does not solely apply to UK companies as overseas companies will be caught by the Act if they carry on their business in the UK. Whilst the Act creates new statutory offences, companies should be mindful of the fact that similar statutory and common law offences already exist.

16.2 The Act creates four principal offences.

16.2.1 **Two general offences**

The two general offences relate to the paying and receiving of bribes. In relation to paying bribes, it will be an offence to offer or give a financial or other advantage with the intention of inducing that person to perform a “relevant function or activity” “improperly” or to reward that person for doing so. With regards to receiving bribes, it will be an offence to receive a financial or other advantage intending that a “relevant function or activity” should be performed “improperly” as a result.

A “relevant function or activity” includes any function that is of a public nature and any activity that is connected with a business. The individual who performs that activity must be expected to perform it in good faith or impartially or be in a position of trust.

An “improper performance” will be judged by whether it breaches the expectation of what a reasonable person in the UK would expect, in relation to the performance of the type of function or activity concerned. However, neither the function nor activity needs to have a connection to the UK.

16.2.2 **Bribery of foreign public officials**

It is an offence if an individual offers or gives a financial or other advantage to a foreign public official with the intention of influencing the foreign public official and obtaining or retaining business, where the foreign public official was neither permitted nor required by written law to be so influenced.

16.2.3 **Failure of commercial organisations to prevent bribery**

This is a new offence under the Act. This offence can only be committed by commercial organisations. This offence is committed where a person associated with a relevant commercial organisation (which includes not only employees, but agents, and external third parties) bribes another person (i.e. commits one of the above offences) intending to obtain or retain a business advantage; and the organisation cannot show that it had adequate procedures in place to prevent bribes being paid.

A company may be guilty of this offence even if no one within the company knew of the bribe.

16.2.4 **Extra-territoriality**

All of the new offences will have extra-territorial application. Offences may be prosecuted if:

- they are committed by a British national or corporate or by a person who is ordinarily resident in the UK regardless of whether the act or omission which forms part of the offence took place outside the UK; and/or
- if any act or omission which forms part of the offence occurs within the UK.

The corporate criminal offence will apply to commercial organisations which have a business presence in the UK (regardless of where the bribe is paid or whether the procedures are controlled from the UK).

With regards to individuals, it will be a criminal offence to give, promise, or offer a bribe and to request, agree to receive or accept a bribe. The penalty for failing to comply with this is an unlimited fine and/or up to ten years imprisonment.

16.2.5 With regards to companies, if a corporate offence is committed, employers face the penalty of an unlimited fine. The amount of any such fine is dependent upon the scale of the initial offence. In addition, companies could also be banned from bidding for EU public contracts.

16.2.6 However there is a defence available if “adequate procedures” were in place. What constitutes an adequate procedure has not been clarified. However, the UK Government has produced draft guidance and suggested the following six principles will be sufficient.

- (a) Risk assessment
- (b) Top-level commitment from the Board down
- (c) Appropriate due diligence to ascertain which areas need to be looked at
- (d) Clear, practical and accessible policies and procedures
- (e) Effective implementation
- (f) Monitoring and review

16.2.7 A company may be at an increased risk of prosecution under the Act if it is incorporated in the UK or carries on part of its business in the UK and

- it uses an intermediary e.g. agent, distributor, consultant, facilitator, market researchers, lobbyist, lawyer, or
- it does business in high risk countries or regions e.g. China, South-East Asia, India, Russia, Africa, Middle East, South and Central America, Central, Eastern and Southern Europe, or

- it does business with the Government, including central, regional and local government and state owned or state controlled companies and institutions, or
- the business has other interactions with the Government e.g. import/export, obtaining licences, building or operating facilities, obtaining visas, navigating regulations concerning business operations, legal disputes, tax affairs, political donations and lobbying.

16.2.8 It is imperative that companies review their current anti-bribery compliance program before the Act comes into force e.g. by rectifying any gaps in their current procedures. It is advisable that all companies ensure that they exercise a greater deal of control over their employees to prevent them from engaging in bribery.

16.2.9 Accounting systems should be reviewed to ensure that they are effective in maintaining accurate records. A register of gifts and hospitality should be created to record and monitor who is receiving what and from whom.

16.2.10 From an HR perspective the following should be considered:

- Do contracts of employment contain any express provisions relating to corrupt practices e.g. expressly outlawing such practices, requiring employees to comply with relevant guidelines and imposing duties upon employees to raise any concerns they have?
- Are there policies in place dealing with bribery? If so, are these policies adequate e.g. are they clear, practicable and easily accessible?
- How do any policies deal with issues such as hospitality, procurement of services, facilitation payments and donations to charity or political parties?
- Are there systems in place to identify high-risk situations?
- Are there systems in place to train employees to identify and avoid situations where there is a risk of bribery?

17 Statutory Limitation Periods

- 17.1 **Contractual disputes** - The statutory time limit for a breach of contract as set out in the Limitation Act 1980 is six years (or 12 in the case of a contract under seal). Time begins to run from the date of the breach.
- 17.2 **Claims in tort** – The statutory time limit for an action arising out of the commission of a tort is six years from the date on which the cause of action accrued (special time limits may apply where the facts relevant to the cause of action are not known at the date of accrual – generally this will be three years from when the person in which the cause of action vested had the relevant knowledge required for bringing such an action).
- 17.3 **Discrimination actions** - Under the Equal Pay Act 1970, the Sex Discrimination Act 1975, the Race Relations Act 1976 and the Disability Discrimination Act 1995, there is a time limit for statutory discrimination claims of three months. For these purposes, time begins to run when the act complained of occurs.
- 17.4 A court or tribunal may nevertheless consider any such complaint, claim or application which is out of time if, in all the circumstances of the case, it considers that it is just and equitable to do so. The question whether it is "equitable" to consider complaints out of time is one of fact and degree for a tribunal to consider in each case.
- 17.5 **Sexual Harassment Actions** - The majority of claims in this area are brought under the Sex Discrimination Act 1975. Hence, the time limit is again three months.
- 17.6 **Wrongful termination actions** - A statutory claim for unfair dismissal under the Employment Rights Act 1996 (as amended by the Employment Rights (Dispute Resolution) Act 1998), must be brought within three months of the date of dismissal or within such further period as the employment tribunal considers reasonable in a case where it is satisfied that it was not reasonably practicable for the complaint to be presented before the end of that period. Where a dismissal is with notice, an employment tribunal must consider such a complaint if it is presented after the notice is given but before the date of termination.
- 17.7 Claims under common law for wrongful dismissal are effectively claims for breach of contract. Therefore the time limits under 13.1 above would apply.
- 17.8 The Limitation Act 1980 does not apply to proceedings instituted by the Director of Revenue and Custom Prosecutions for the recovery of any sum due in respect of a tax or duty. The Taxes Acts themselves set out the limitation periods that

apply in respect of actions taken to recover outstanding taxes, penalties and interest. In general, a six year limitation period applies to such actions. However, where a taxpayer (individual or corporate) is guilty of fraud or negligence, actions may be commenced outside this six year limitation period. In addition, for certain types of offences the time period is extended to 10 years, for example, making of false statements to obtain allowances.

18 Enforcement of Foreign Judgments Against Directors and Officers in English Law

- 18.1 Foreign judgments may be enforced in the English courts in accordance with statute law or the application of certain conventions. This, however, depends on the country where the judgment was obtained.
- 18.2 **Scottish and Irish judgments.** There are reciprocal arrangements between the various parts of the United Kingdom for the enforcement of judgments. The main piece of legislation providing for these arrangements is the Civil Jurisdiction and Judgments Act 1982, which gives the Brussels and Lugano Conventions the force of law in the United Kingdom.
- 18.3 **European judgments.** Up until March 2003, the enforcement of judgments obtained in the courts of EU Member States was governed by the Brussels Convention of 1968, and the enforcement of judgments obtained in EFTA countries (countries of the European Free Trade Association) by the Lugano Convention. Although the Lugano Convention remains in force, the Brussels Convention has been amended by the EC Regulation on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters (EC Regulation Number 44/2001) ("Regulation"). All EU member states, with the exception of Denmark, have agreed to be governed by the Regulation. The 1968 Convention, therefore, continues to apply between Denmark and other EU member states.
- 18.4 The terms of the Regulation provide for a streamlined procedure for enforcement. The principles, however, remain largely the same as those of the Brussels Convention. In general they provide that an enforcing court in the United Kingdom will enforce a foreign judgment from another member state if it is satisfied that that court was the court of correct jurisdiction.
- 18.5 **Other judgments.** Apart from the European regimes, the UK is party to two systems of reciprocal enforcement set up by international treaty. They were implemented in the United Kingdom by two statutes: the Administration of Justice Act 1920 and the Foreign Judgments (Reciprocal Enforcement) Act 1933.

- 18.6 **Administration of Justice Act 1920.** The 1920 Act applies mainly to Commonwealth states, and others who signed up to the same reciprocal enforcement regime between 1920 and 1933. No new states have been added to the list since 1933, although some have dropped out. Changes to the list of participating states are made by statutory instrument.
- 18.7 **Foreign Judgments (Reciprocal Enforcement) Act 1933.** Since 1922, all non-European states entering reciprocal enforcement arrangements with the United Kingdom have joined this regime. Jersey, Guernsey and the Isle of Man all fall within it, as did many EC states before moving to the Brussels and Lugano conventions.
- 18.8 **US judgments.** None of the states of the USA falls within one of these reciprocal regimes; accordingly, to enforce in the United Kingdom a judgment from one of these states:
- 18.8.1 If the judgment is a money judgment, the party seeking enforcement must bring a fresh action in the English courts based on the judgment debt. It is possible that the court will issue summary judgment, unless the judgment debtor raises an arguable objection to enforcement.
- 18.8.2 If the judgment is a non-money judgment, like an injunction, it is probably not enforceable at all in the United Kingdom.
- 18.9 **Indemnity and Insurance**
- 18.9.1 Similar to section 310 of the Companies Act 1985, section 234 of the Act provides that a company may indemnify its directors or officers' for any liability incurred by him in defending any civil or criminal proceedings in which judgment is given in his favour or he is acquitted. Alternatively, under section 233 of the Act, the company may purchase and maintain insurance to cover directors' and officers' personal liabilities for negligence, breach of duty or breach of trust of which they may be guilty of in relation to the company.
- 18.9.2 Where an employer arranges and pays for insurance to cover potential liabilities arising to directors or officers (D&O insurance), tax is payable in respect of the benefit of the insurance cover by the director or officer as an emolument arising from the employment. The measure of the charge is the "proper proportion" of the premium, that is, that proportion of the overall premium which is attributable to the cover provided for that director or officer. Relief is available in the form of a deduction against the emoluments of a director or officer who pays for or makes

contributions towards his own insurance. In contrast, no relief is available in respect of premium paid for mixed policies, ie policies which provide D&O as well as other cover. This is to ensure that the operation of the relief is kept relatively simple.

18.10 **Where can UK companies obtain D&O insurance?**

UK companies can obtain D&O policies from any insurance company operating in the market, so long as they are regulated by the FSA.

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