



HOW ORITAIN HELPS REDUCE DIRECTORS LIABILITY



Directors risk and personal liability

In today's business landscape, being a company director or officer has never been riskier. Consumers and investors now demand higher standards from both companies and their officeholders. With fiduciary duties extending to many areas of business, directors now have to navigate their companies through a minefield of compliance considerations from bribery and corruption, through to cyber and privacy breaches, and - the newest buzzword in the boardroom - 'Environmental, Social and Governance' (ESG).

But, it's not only the scope of the director's governance role that is increasing. We are seeing a growing trend of directors and officeholders being held personally liable for the company's actions they oversee. It's no wonder then that in many jurisdictions around the world there are concerns about director shortages.

The probability of a successful prosecution is high and the consequences can be grave. Without the appropriate level of directors or officers insurance, bankruptcy is a real risk - let alone the emotional and reputational strain it puts on the individual. As so stated by DLA Piper in their 2015 Avoiding Personal Liability Guide:¹



“In addition to the rising tide of litigation, recent legislative reforms and regulatory enforcement actions emphasise increased directorial oversight, involvement and accountability, increasing the exposure for a company's directors and officers. Now, more than ever, it is important for directors and officers of companies to understand their duties and obligations, the legal safeguards available to them and, perhaps more important, the limits of those safeguards.”

But why are we seeing this trend towards increased personal liability? What should directors and officers of today be concerned about? And how can they best protect themselves, the interests of the companies that they govern, and their relevant stakeholders?



The trend towards personal liability



The growing pursuit against directors and officers was, by and large, a result of the global financial crisis². Jurisdictions around the world have tightened up regulation to protect consumers, investors and society as a whole. All whilst aiming to strengthen market integrity.

The International Bar Association also proposes that increased regulation and liability could be an attempt to discourage bullish executives. In the majority of cases where a company is liable for wrongdoing, there is often a large fine. And, more often than not, the company's share price takes a hit – causing the shareholders to suffer, not the executives that may have contributed to the issue in the first place.

The article goes on to suggest that “the prospect of personal action against directors may help curb executives undertaking, or encouraging subordinates to undertake, activities that can give rise to corporate offences”. And perhaps there is some merit in this theory with the US Department of Justice agreeing in publishing its Yates Memorandum.

In 2016, the United Kingdom introduced an individual accountability scheme called the UK Senior Managers and Certification Scheme (SMCR)³. Its intent was to encourage personal responsibility at all levels of business. Whilst its remit covers the financial sector, it has set a precedent in other industries too.

Individuals (especially directors and officers) can no longer hide behind the ‘corporate veil’ – they must take responsibility of the decisions they make whilst in charge of their respective businesses.

But it's not only about protecting the consumer or the integrity of the market. If governments and businesses don't take the lead and accept responsibility for helping to drive change within society, we are on a collision course with a very different and volatile future. One that will be subject to increased resource scarcity, a climate that will bring even harsher weather extremes and a society that will have to provide a lot more with a lot less. So it is up to businesses, and by default its directors and officers, to support the societies they operate in or risk being held personally accountable.

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Personal prosecution



The warnings aren't all smoke and mirrors either and directors need to take note. **Personal prosecution is already happening today in courts throughout the world⁴** – including cases relating to modern slavery in the UK⁵, food safety in the United States⁶, environmental contamination in Canada⁷, health and safety in Australia⁸ and employment law breaches in New Zealand⁹. In the State of Delaware – often viewed as one of the leading jurisdictions of corporate litigation¹⁰ – the case of *In re Caremark Int'l, Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996) set a defining doctrine. It obligated directors to install and oversee effective risk management and compliance controls.

This doctrine has been debated in several instances – particularly in the cases of *Marchand*¹¹ and *Clovis*¹². Both cases have helped lay the foundations to claim against directors for oversight failures related to ESG risks. They also turned on “mission-critical” regulatory compliance risks tied to core business pursuits¹³. The scope and the extent to which directors and officers can be held liable will continue to extend beyond their fiduciary duties. As well as the increase in penalties, corporate executives are being challenged and could even be held liable for cases such as funding climate denialism and opposing policies to fight climate change.

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Protection from prosecution



So, what does a director or officer in 2020 need to do to serve the company's best interests whilst mitigating their own personal risk?

A director or officer is at greater risk of personal liability if they breach any one of their fiduciary duties¹⁴. In much of the Western world at least, these duties are relatively similar. For example, directors must exercise a duty of care, act in good faith and in the best interests of the company. Typically, these duties are confined to the internal operations of a business. Now, **these duties extend to external factors as well, such as a business' impact on the environment, how it treats its people, and how contributes to wider societal issues such as rising inequality, climate change and modern slavery.** In a recent article published by Corpgov they argued that:



“For resource companies, human rights & community relations and ecological impacts are the heart of legal compliance and viable resource extraction. For technology and communications companies, privacy and data security are central to both regulatory compliance and brand value. For consumer goods, supply chain management plays a similar role, particularly given the lasting harm that civil society campaigns can inflict on shareholder value. And, with the tightening web of mandatory due diligence and disclosure regulation across jurisdictions, we are likely to see modern slavery and climate risk management become mission critical to a broad array of industries.”

No business or industry – wherever they operate in the world – is immune to the growing risks of personal liability. Hiding behind the company **(‘the corporate veil’) or plausible deniability is no longer a relevant defence.** They are no longer accepted by the courts – and certainly not in today's current climate.

If the judgements in *Marchand*¹⁵ and *Clovis*¹⁶ are anything to go by, any action (or inaction) from a company that falls short of their ‘mission-critical’, fiduciary duties or ESG stance shouldn't cause surprise when the lawyers come knocking. As suggested by DLA Piper “A board that fails to implement any reporting or information system or fails to correct a system it ‘knows’ is not working, may face liability for bad faith. Similarly, having implemented such a system, directors can face liability if they consciously fail to monitor or oversee the system, thereby disabling themselves from being informed and being deemed to be ‘asleep at the switch’.”¹⁷

FOOTNOTES

- 1 DLA Piper, *Avoiding Personal Liability: A guide for Directors and Officers* (2015)
- 2 <https://www.lexisnexis.com/legalnewsroom/corporate/b/blog/posts/a-guide-to-directors-duties-and-liabilities-in-europe>
- 3 <https://www.fca.org.uk/firms/senior-managers-certification-regime>
- 4 <https://www.lexisnexis.com/legalnewsroom/corporate/b/blog/posts/a-guide-to-directors-duties-and-liabilities-in-europe> and <https://www.nortonrosefulbright.com/en-us/knowledge/publications/bodae4a0/cyber-risk-and-directors-liabilities-an-international-perspective>
- 5 <https://www.allenoverly.com/en-gb/global/news-and-insights/publications/modern-slavery-directors-can-be-personally-liable-for-employee-exploitation>
- 6 *Marchand v. Barnhill*, No. 533, 2018 (Del. June 19, 2019).
- 7 <https://www.lexisnexis.com/LegalNewsRoom/corporate/b/blog/posts/directors-and-officers-held-personally-liable-for-bankrupt-company-39-s-environmental-liabilities>
- 8 <https://lynchmeyer.com.au/legal-updates/directors-found-personally-liable-for-breaches-of-whs-may-face-hefty-penalties-and-jail-time/>
- 9 <https://www.employment.govt.nz/about/news-and-updates/director-and-managers-personally-liable-for-employment-law-breaches/>
- 10 <https://corplaw.delaware.gov/delawares-benefits-international-business/>
- 11 *Marchand v. Barnhill*, 212 A.2d 805 (Del. 2019)
- 12 *In re Clovis*, 2019 WL4850188 (Del. Ch. 2019)
- 13 <https://corp.gov.com/esg-and-mission-critical-issues-for-director-officer-liability/>
- 14 In New Zealand: <https://www.parryfield.com/directors-duties-liabilities-new-zealand-company/>; in Australia: <https://home.kpmg/au/en/home/insights/2018/07/directors-duties-04-july-2018.html>; in the US: <http://www.mondaq.com/unitedstates/x/668770/Directors+Officers/Fiduciary+Duties+Of+Directors>; in the UK: <http://www.mondaq.com/uk/x/63438/Directors+Officers/Directors+Duties+Liabilities+Under+The+Companies+Act+2006>
- 15 *Marchand v. Barnhill*, 212 A.2d 805 (Del. 2019)
- 16 *In re Clovis*, 2019 WL4850188 (Del. Ch. 2019)
- 17 DLA Piper, *Avoiding Personal Liability: A guide for Directors and Officers* (2015)



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