# Liability of Directors

Chris Riley, Company law Module Convenor

Hello I'm Chris Riley and I'm the Module Convenor for Company law. This blog is going to look at how far directors are entitled to rely on others to manage the company. It looks at recent developments in two key areas of Company law: the duty of directors to monitor those to whom they have delegated tasks, and the enforcement of that duty through a so called derivative claim.

A number of recent cases have examined whether directors can be held liable where they have delegated a task to someone else and that person fails to perform that task properly. Directors have always been free to delegate to others. But increasingly, directors are expected to monitor their delegates' performance and ensure they are carrying out the activities assigned to them in an appropriate way.

UK cases such as *Re Barings* [2001] BCC 273 and *Lexi Holdings v Luqman* [2009] BCC 716 emphasised that even non-executive directors must still oversee the performance of their executive colleagues, and the much discussed Australian case of *ASIC v Healey* [2011] FCA 717 made similar observations. The 2017 UK case of *Raithatha v Baig* [2017] EWHC 2059 (Ch) confirmed that where directors do delegate to others, they cannot simply assume that the delegate will carry out that job properly. Directors must still check and inform themselves sufficiently whether the delegate has done what was required. In this case, the company had failed to register for, or to collect in, a sales tax. The directors believed that the company's accountants were dealing with the issue of registration, and they thought the accountants must have concluded that the company did not need to register for, or collect the tax, or otherwise the accountants would have told the directors. But the court emphasised it was the responsibility of the directors themselves to check those matters with their accountants. If they failed to do so, liability would still attach to the directors and for breach of the duty of care, skill and diligence, under section 174 Companies Act 2006. The case also shows that a director who is found to be in breach of section 174 is unlikely to escape liability by trying to rely on section 1157 CA 2006. That is the provision which permits the court to grant relief to a director, who has been found to be in breach of duty, but who has acted honestly and reasonably and ought fairly to be excused.

That deals with the question of breach of duty, but what of enforcement? Even if the law is now more insistent that directors must actively monitor the company's management, how likely is a breach of duty to be enforced? The rule in *Foss v Harbottle* tells us that it should ordinarily be the company that brings enforcement proceedings. But, so long as the company is solvent, it is for the board to decide whether the company will sue, and boards rarely decide to do so.

One way to get around the board's refusal is for a shareholder to bring a derivative claim. Part 11 of the Companies Act 2006 put such claims on a statutory footing. The

Government's hope was that derivative claims would increase in number. To that end, Part 11 now permits a derivative claim to be brought for *any* breach of duty, rather than only for 'fraud', as was the case under the old law. This change ensures that simple negligence (which historically did not count as fraud) can now be the subject of a derivative claim. But has this change increased the number of successful claims? It seems not. A look at the case law on derivative claims brought under Act shows that such claims continue to be very rare, and claims for negligence almost non-existent. A search on Westlaw shows, as of March 2018, just 27 cases brought under the new Act. That's still less than 3 cases per year. Only 2 of those cases included a real claim for negligence against the directors. And neither of those two cases did that allegation involve a director who had failed to monitor the managers of the company. Furthermore, in neither of those negligence cases did the courts give permission to allow the claim to continue to a trial against the directors. Indeed, permission to continue the derivative claim was given in only 11 cases overall. So more often than not, then, permission is being refused by the courts. It has always been recognised that shareholders do not have much incentive to bring derivative claims. After all any money recovered by a successful claim goes to the company, and not the shareholder who brought the claim. The low chance of getting permission to continue the claim to a trial adds a further disincentive to a shareholder to take on such proceedings. And, finally, whilst the court can make a so called *Wallersteiner* order which requires the company to indemnify the claimant against any legal costs that might be incurred, in recent cases, such as *Bhullar v Bhullar* [2015] EWHC 1943 (Ch), the courts seem to have become more reluctant to make those indemnity orders, leaving the shareholder who brings the claim exposed to the risk of having to pay the costs of the action.

So to summarise, the expectations on directors to oversee the management of the company are certainly increasing, but enforcing those expectations seems to be as difficult as ever.