Directors Duties: The View from the Coal Face

Update prepared by Jamie Bookless (Counsel, Guernsey)
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// "In these challenging economic times the modern day company director faces a myriad of issues and problems which they must successfully navigate in order to discharge the duties imposed upon them by law. While there may not always be a clear or definite answer it can be invaluable to listen to and consider the views and opinions of those who have had experience of dealing with those same issues previously. "

On 27 September 2017 Mourant Ozannes and South Square chambers hosted their fifth annual joint litigation forum in London. The second panel discussion of the day (which included Mourant Ozannes' own Abel Lyall) considered some of the most pressing issues that directors currently have to deal with and how they might best deal with those. The panel discussion was hosted by Mark Arnold QC from South Square and the three topics for consideration were cyber and data security, regulatory risks and finally creditors' interests.

Cyber and Data Security

Richard Sinclair the General Manager of Talk Talk suggested that data security was an issue which affected all businesses in the modern age, with the retention of the integrity of data representing a constant challenge. He felt the reputational damage which follows an incident inevitably leaves those involved asking whether they could have done more to prevent it, particularly when there may be allegations of negligence. He noted that the question of whether to spend on general data protection presents a serious dilemma and may well depend on the financial health of the business.

Libby Elliot, a Partner at Stephenson Harwood, considered the sort of advice a director might need and as a starting point highlighted two of the codified directors' duties which she felt were of particular relevance to data security. The first of those was the duty to act in good faith and promote the success of the company for the benefit of the members as a whole. The second was the duty to act with reasonable skill, care and diligence.

Libby indicated that directors have to understand the impact of failing to put adequate protections in place. She confirmed that Richard was considering the right issues and there was always a careful balancing act to carry out. It is not enough to rely on just your own knowledge and as such it is appropriate to divide and delegate the work, as well as potentially instructing external advisers. Libby made the point that it may well be negligent not to get expert assistance with digital security. She confirmed however that there is a need to supervise and appraise work done by others and it is not just a case of standing back and letting them deal with it. The directors must ensure that what is being done is correct and they cannot abrogate that responsibility.

Mark Shaw, a partner at BDO was then asked to consider, what claims could be made against a company were it all to go wrong and it to end in administration. He indicated that in his view it is only a matter of time until a cyber-crime brings down a major business. As the Administrator of a company in these circumstances he confirmed he would want to do everything he could to swell the asset base and thus, with the assistance of his legal advisers, would look at potential claims against the directors and whether they were worth advancing.

Abel Lyall a partner at Mourant Ozannes then considered the possible types of claims which might be available against directors. Abel made the point that where something has gone wrong it should always be borne in mind that commercial errors of judgement do not inevitably mean an award of damages is due. Exercising reasonable

skill, care and diligence is an objective test and there will invariably be a high burden of proof on the Administrator to show that a reasonable director exercising skill, care and diligence would reach the same decision. Acting in the company's best interests and promoting its success is subjective, therefore it's a question of what the individual honestly believed was in the best interests of the company. The circumstances have to be examined and a variety of factors considered on a case by case basis. Abel suggested it is hard to mount a challenge in this area as you have to look at conduct which could be considered outside the norm. That said, he confirmed that it should always be considered whether the company took professional advice and whether that advice was followed.

Regulatory Risks

The second topic of discussion was regulatory risks faced by companies today. Mark Arnold QC pointed out that regulatory claims and investigations were a rising trend and therefore posed the question of what directors should be doing in respect to compliance.

Richard confirmed that regulatory matters were of the utmost importance and therefore should always be at the forefront of directors' minds. He suggested that the prioritisation of resources in relation to this will weigh heavily on the minds of the board, particularly given the risk of personal sanction. He felt that directors have to exercise their judgement to ensure they are acting in the interests of all stakeholders.

Abel highlighted that regulatory compliance always has to be balanced against the requirement to act in the company's best interests. He pointed out that in the recent judgment of the Royal Court in Guernsey in *Carlyle Capital Corporation Limited (in liq) and Ors v Conway and Ors* (Guernsey Judgment 38/2017) the judge had left open the question of choosing the duty to act in the company's best interests over its compliance requirements. He confirmed that the board always needs to understand the regulatory environment they are working in and should obtain as much information as is required in order to make an informed decision taking every relevant factor into account. While directors will be conscious of the risk of personal sanction that should not be the only basis for decisions they take.

Mark Shaw confirmed that as an insolvency practitioner there is often conflict between competing interests where a Regulator is concerned. He advised that he has to fully understand the regulatory issues at play and thereafter work out a way to navigate through them while ensuring full compliance. He confirmed it is often hard to get directors to focus on regulatory issues where their livelihoods are at stake.

Libby reiterated the need to fully understand the legal and regulatory framework within which a company operates, particularly when looking at directors' conduct in the lead up to insolvency. The question of what part the breach played has to be asked and claims against a director have to show that any loss is attributable to that regulatory breach. If a fine has been issued for example then the loss is clear however in a lot of cases it is hard to establish a quantifiable loss which flows from the breach. Libby highlighted that parties should always be mindful of limitation periods.

Abel then considered the position in Jersey and Guernsey with regard to limitation periods. While there was no local authority on this issue in either jurisdiction, there is now an English High Court decision relating to Jersey which confirms the limitation period there is 10 years (*O'Keefe and another (as liquidators of Level One Residential (Jersey) Ltd and Special Opportunity Holdings Ltd) v Caner and others* [2017] EWHC 1105 Ch). Abel confirmed that in Guernsey it was likely to be six years although there is no direct authority on the point as yet.

Creditors' Interests

The third and final topic was on the question of the point in time at which directors require to take account of the interests of creditors in the run up to an insolvency event.

Richard confirmed that this was something directors were always conscious of, not least because businesses generally want to be regarded as good trading partners. He indicated that it was difficult though to identify at precisely what point it takes effect.

Mark Shaw confirmed his view that when it arises it is very much fact specific and depends on a variety of factors such as, for example, whether the company is trading or a holding company. He felt that judges tend to err towards dates close to the insolvency.

Libby confirmed that in England it was questionable as to whether or not there was a workable test on this point. She pointed out that there have been lots of formulations in cases such as "doubtful solvency" and "on the verge of insolvency" while the "real and not remote test" from the Australian case *Kalls Enterprises Pty Ltd (in liq) & Ors v Baloglow & Anor* [2007] NSWCA 191 had been cited with approval in English cases. However, in the recent *BAT Industries v Sequana SA & Windward Prospects Ltd* [2016] EWHC 1686 (Ch) case she

highlighted that Mrs Justice Rose felt it was actually a much lower threshold and preferred a more pessimistic outlook where the insolvency was not too remote.

Abel in turn confirmed that in the *Carlyle* judgment the judge had emphasised the need to show immediacy in terms of the impending insolvency and she had as a result chosen the "brink of insolvency" test as reflecting the position in Guernsey.

Richard concluded what was an excellent discussion by confirming that, while sensible companies actively manage risk, they may in some instances be more focused on the bottom line than on creditors.

Conclusion

Where directors face problems, or require to deal with significant issues relating to their company, it is always sensible to seek professional advice in order to ensure that any decisions they might take comply with their legal duties.

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