



# Guide to Directors' Duties and Liabilities



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## Foreword

Since the financial crisis, the risk oversight responsibilities of directors and supervisory board members have been increasing. Companies operate in a global world and are exposed to a large number of different risks, while board members have to adapt quicker to a continuously changing landscape. Furthermore, with more complex supply chains and with companies operating in many countries, board members have to cope with different legal frameworks and different cultures that can impact their governance.

In parallel, companies and more especially board members are subject to increased scrutiny by regulators and society at large. The role of social media is also more evident than in the past.

It is against this background that the European Confederation of Directors' Associations (ecoDa), together with AIG, has developed this Guide analysing the risks facing directors and how D&O insurance can offer legal and financial protection. The Guide covers risks to individual board members in particular, though risks to the company are also included.

The purpose of this Guide is certainly not to discourage directors from joining boards but to help them understand the true nature of their liabilities. Through different case studies, the Guide highlights specific issues in a number of countries – for example, the way directors can be prosecuted varies from one country to another.

This Guide provides important principles for individual board members and is also an invitation to directors to learn how to exercise their skills with professionalism and to be loyal to their companies. Therefore, at the very least, the Guide can serve as a tool to lower the risks the individual board members are exposed to, and at best as a tool to help avoid litigation.

I wish to pay tribute and give thanks specifically to Roger Barker (Director of Corporate Governance and Professional Standards, Institute of Directors) who chaired the joint Working Group dedicated to this task, to the experts from AIG, and to all the contributors who have spent their time and their expertise on this project.

Lars-Erik Forsgårdh,  
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## The more things change, the more they stay the same

**“It is not rules and regulations alone that make good business. It is good people – operational, advisory, executive and non executive... It takes skill, knowledge but, most of all, it takes character.”**

Sir Roger Carr, chairman of BAE Systems and Centrica and former President of the Confederation of British Industry (CBI), in an essay.



This first chapter of the guide offers some context into the environment shaping European directors' duties and liabilities. It details the corporate governance structures that exist across much of Europe and considers some of the more recent steps taken to offer a more harmonised approach. It also looks at the different legal systems and board structures across Europe and considers how this impacts the extent, content and enforcement of directors' duties and liabilities.

### EU perspective on Corporate Governance: A principles-based approach

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Inevitably across Europe there are differing approaches to corporate governance. However, directors' duties and liabilities are not dramatically different from one country to the next.

Within Europe, each country's approach to corporate governance varies according to company laws and shareholder profiles. However, most EU listed companies are subject to a “comply-or-explain” approach that includes the principles of good corporate governance without the need for prescriptive and burdensome laws and regulations.

Under this approach companies must comply with the recommendations and suggestions contained within their country's corporate governance code, or explain their non-compliance. From a risk management perspective, the promotion of good standards of corporate governance (through a comply-or-explain provision) significantly reduces an organisation's exposure to litigation as a result of the actions of its directors and officers (D&O).

There are five overarching principles contained within corporate governance codes, according to the Institute of Chartered Accountants in England and Wales<sup>1</sup>. These are:

- **Leadership:** An effective board should head each company. The Board should steer the company to meet its business purpose in both the short and long term;
- **Capability:** The Board should have an appropriate mix of skills, experience and independence to enable its members to discharge their duties and responsibilities effectively;
- **Accountability:** The Board should communicate to the company's shareholders and other stakeholders, at regular intervals, a fair, balanced and understandable assessment of how the company is achieving its business purpose and meeting its other responsibilities;
- **Sustainability:** The Board should guide the business to create value and allocate it fairly and sustainably to reinvestment and distributions to stakeholders, including shareholders, directors, employees and customers; and
- **Integrity:** The Board should lead the company to conduct its business in a fair and transparent manner that can withstand scrutiny by stakeholders.

An effective board which follows these core principles will be in a position to encourage a corporate culture that discourages unethical behaviour and excessive risk taking. Such cultures are at the heart of a strong risk management framework and will help avoid problems - issues such as bankruptcy and bribery - that could trigger legal action against directors.

If directors can maintain the right culture within their organisations, from start-up SMEs and other fast-growing private institutions through to globally-listed corporates, the rest should fall into place. With the right systems and corporate culture in place and adherence to corporate governance codes, European directors will shield themselves against legal claims.

## Strengthening shareholder rights

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### “Companies, investors and society at large will benefit from this increased transparency.”

Europe's outgoing Commissioner for Internal Market and Services Michel Barnier

In the years since the financial crisis, the European Commission has introduced a series of recommendations intended to harmonise and improve corporate governance regimes across Europe.

In April 2014, the European Commission voted to strengthen shareholder engagement by revising the existing Shareholder Rights Directive. It is expected to tackle corporate governance shortcomings relating to listed companies and their boards, shareholders, intermediaries and proxy advisors, as: “Too often, as the crisis showed, shareholders supported managers' excessive short-term risk taking and did not monitor closely the companies they invested in”.

The Commission has also proposed to strengthen the link between pay and performance for directors in order to discourage “harmful short-term tendencies”. Listed companies will be required to publish information on their remuneration policy and the pay of individual directors, which must be submitted to shareholders for approval.

## Comply-or-explain needs more explanation

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The European Commission is also tackling what it sees as “shortcomings in the way the ‘comply or explain’ principle is applied” by European listed companies. Specifically they highlight that “companies often do not provide appropriate explanations when they depart from corporate governance codes”.

Investors often argue that the explanations provided fail to adequately explain how a company’s alternative arrangements support the relevant principle. Additionally, some companies believe non-compliance affects market perception negatively and outweighs the benefits of pursuing an alternative strategy that still delivers good governance and better serves the needs of their business<sup>ii</sup>.

### “There will at times be legitimate reasons for departures from the requirements of corporate governance codes, but such departures must be considered and well explained,”

Stephen Haddrill, chief executive,  
Financial Reporting Council

The Commission is offering guidance on how listed companies should explain their departures from the relevant corporate governance codes. However, it will not be legally binding. Instead it is intended to “improve the overall quality of corporate governance statements published by companies”.

The Association of Chartered Certified Accountants welcomed the recommendations but said European realities needed to be taken into account. “It is essential for Europe to create a modern and efficient company law and governance framework,” said John Davies, head of technical, ACCA. “However, we believe that different economic environments in Europe must be acknowledged and companies have to be provided with flexibility by allowing them to manage their corporate governance according to their specificities in each Member State.”

For ecoDa, a route for improving governance effectiveness is by making better use of the principle of ‘comply-or-explain’. ecoDa is about to issue a survey report on how compliance with national governance codes is monitored throughout Europe.

## Stricter and broader definitions of directors’ duties

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The adoption of a Directive on disclosure of non-financial and diversity information by large companies and groups underlines the growing significance of directors’ duties outside of company law. Under the new rules, companies with over 500 employees must disclose information on policies, risks and results as regards environmental matters, social and employee-related aspects, respect for human rights, anti-corruption and bribery issues, and diversity on boards of directors.

This is the latest step within Europe to tighten the definition surrounding directors’ duties. In Italy, more stringent measures regarding directors’ duties and liabilities were introduced during 2003 as part of an overall reform of Italian corporate law. Of particular importance was the change from the “professional man” to the “reasonable man” standard used when assessing the performance of a director in regard to duties owed<sup>iii</sup>.

In Spain, a voluntary corporate code of governance (the Unified Good Governance Code, also known as the Conthe Code) was introduced in May 2006. It recommends a stricter definition of a director’s duties of loyalty to the company and extends that duty to shadow directors and controlling shareholders.

## European directors' legal duties

Across Europe, directors' duties are owed primarily to the company and not to the shareholders. This basic principle is universally accepted and undisputed<sup>iv</sup>. However, UK company law is more "shareholder friendly" in that shareholders, to the exclusion of employees, typically exercise sole voting rights in the general meeting in electing directors.

In addition, recent steps taken by the European Commission will further strengthen the rights of shareholders. Member States may conceptualise the company, and the role of the directors and shareholders, in two ways:

1. The shareholders may be seen as the source of corporate power and the directors as agents who receive the authority to make decisions on behalf of the company by way of delegation from the shareholders; or
2. The directors may be qualified as *sui generis* actors or fiduciaries who act for the benefit of the shareholders and the benefit of other stakeholders.

These approaches are significant because they determine the way in which shareholders have control over the company's operations. A prime example of the first strategy is English law, where the shareholders can intervene in the management of the company. Most jurisdictions in the French and German legal tradition, on the other hand, characterise the board of directors as independent corporate entities that are to some extent insulated from the shareholders.

### Classification of national company laws on the basis of managerial insulation

**Under English law, the shareholders can intervene in the management of the company. But most jurisdictions in the French and German legal tradition characterise the board of directors as independent corporate entities that are to some extent insulated from the shareholders.**



The authors from The London School of Economics and Political Science identified three distinct groups of company laws:

- Group I contains the company laws that offer the highest degree of managerial insulation to company directors;
- Group II This group contains the "intermediate cases"; and
- Group III contains the jurisdictions whose company laws offer shareholders the highest degree of power over management.

Group I
  Group II
  Group III

In spite of these differences, the effect of the legal strategies employed by the Member States are often remarkably similar. The directors' duties of virtually all countries derive from case law, even if the company law is largely codified. While there is a distinction between common law and civil law countries, this distinction has lost much of its meaning in the context of directors duties<sup>v</sup>.

All legal systems draw on principles of general contract law, civil law or fiduciary principles to supplement the company law-specific rules where necessary. And increasingly, directors must also consider their duties in relation to legislation pertaining to the environmental, health & safety, competition, data protection and anti-bribery and corruption for instance.

Directors' duties in Europe are also evolving as a result of cross border issues. Corporate mobility is on the rise, however there is a perception a director of a company that operates abroad is only subject to his or her statutory duties under the company law of the home country.

Liability does not end there. In an global world, companies based in one jurisdiction are more and more conducting business activities, sourcing components from and/or setting up subsidiary companies in other jurisdictions. This is particularly pertinent for companies with involvement in the US or Australia, both highly litigious D&O markets. As a result, directors must increasingly make the distinction between their potential liabilities in one jurisdiction versus another.

## Different board structures across Europe

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Notable variation exists in the basic board structure across Europe as well as in relation to other aspects of company board makeup, such as election/nomination rights and the participation of employees.

Board structures are usually classified into one-tier and two-tier structures, which have evolved from the corporate law of England and Germany respectively.

Under the one-tier model, a company is governed by a unified board which performs both management and supervisory functions (therefore there is no separate supervisory board). Such boards comprise a mixture of executive directors and non-executive directors (NEDs). The NED serves as a bridge between shareholders and management and is expected to challenge the executive team about how they are running the organisation.

In a two-tier board there is an executive or management board (all executive directors) and a separate supervisory board for all non-executive directors. The management board is responsible for the day-to-day running of the business and is led by the chief executive. The supervisory board is responsible for the strategic oversight of the organisation and is led by the chairman.

At present, seven Member States (Austria, the Czech Republic, Estonia, Germany, Latvia, Poland, and Slovakia) require a two-tier board, while eight Member States (Belgium, Cyprus, Greece, Ireland, Malta, Spain, Sweden, and the United Kingdom) provide for a one-tier board structure. By contrast, 13 EU Member States offer a choice of board structure, while under the law in Italy and Portugal, companies are offered three options.

The Nordic countries have a hybrid system. Although company law prescribes a structure that is one-tier in nature, the executive team (including the CEO) under the Nordic Model are in effect, not typically elected by the shareholders, but rather by the shareholder-elected board, which in turn monitors the executive team.

### Conclusion

While the approach to corporate governance is diverse from one Member State to another, in the main the duties and liabilities of European directors have a large degree of commonality. Moves by the European Commission to strengthen the rights of shareholders and tighten the definition around directors' duties will have most impact on listed companies.



However, it is not just the directors of large multinationals who are the recipients of more stringent rules and greater scrutiny. Small and medium sized enterprises account for around 99% of all European businesses, and as a result, a large majority of European directors carry out their duties on behalf of private unlisted enterprises. Yet less than a quarter of SMEs in the UK take out D&O insurance, according to one statistic<sup>vi</sup>.

Despite their economic importance and large numbers, the governance of unlisted companies is an often neglected area of corporate governance recommendations, according to the Institute of Directors<sup>vii</sup>. A key step in the development of unlisted companies is the decision to invite external directors onto the board. For its part, ecoDa offers [detailed guidance](#) on corporate governance for unlisted companies.

It is important to recognise that the emphasis of good governance can look different depending on a company's size and situation, although their legal duties will not differ. In owner-managed smaller companies, for instance, it is important to recognise that the company is not an extension of the personal property of the owner.

## Case Studies

### SME directors exposed

A case before the Supreme Court of England and Wales in 2013 – *Prest v Petrodel Resources Limited and others* [2013] – highlighted the exposure of SME directors. The Supreme Court had to decide if a number of properties owned by companies of which Mr Prest was the controlling director and shareholder, should be transferred to Mrs Prest as part of a divorce settlement.

It was accepted that Mr Prest had used the companies' assets as his own without restriction, but because he (not the companies) had originally provided funds to acquire the properties, the companies actually held the properties on a "bare trust" for him. As Mr Prest beneficially owned the properties, an order could therefore be made for the transfer of the seven properties to Mrs Prest.

### One-tier or two?

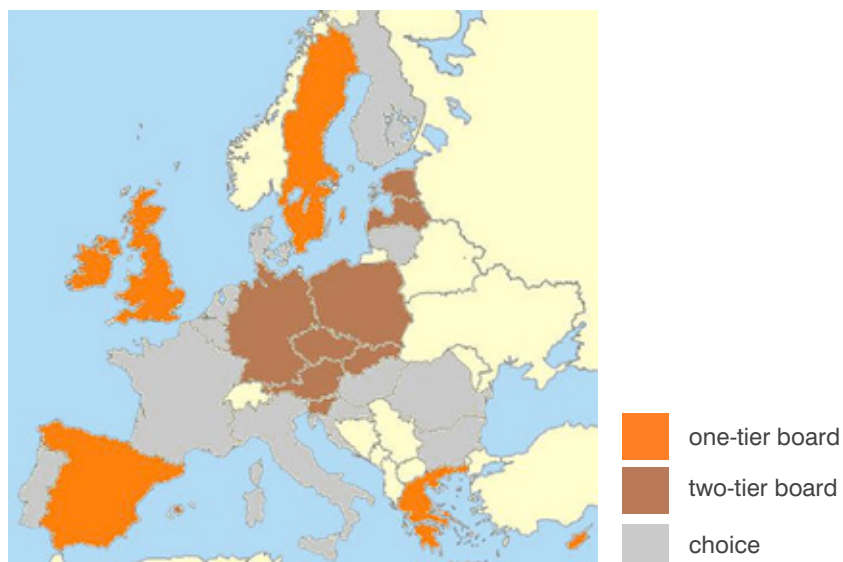
Sir Richard Greenbury, chairman and chief executive of UK retailer Marks and Spencer between 1988 and 1999 was once a staunch advocate for one-tier boards. In the Greenbury Report in 1995, Sir Richard recommended a single unitary board with non-executive directors on site to supervise and challenge the executive. He argued this was the best defence against executive excess.

Greenbury appeared to alter his view after spending 11 years on the supervisory board at Dutch technology giant Philips. In an interview with *The Times* in March 2009, he submitted there was a "good chance" a two-tier board would have prevented the collapse of RBS by challenging and curbing the actions of Sir Fred Goodwin.

One-tier board system	Two-tier board system
<p><b>Advantages</b></p> <p>Spirit of partnership and mutual respect between directors, which allows greater interaction amongst board members.</p> <p>Non-executive directors have more contact with the company and are more closely involved in the decision-making process.</p> <p>Non-executive directors have direct access to information. Decision-making process is faster.</p> <p>A lighter administrative burden as only a single management body needs to hold meetings and only a single set of minutes need be drawn up.</p>	<p><b>Advantages</b></p> <p>Clear distinction between supervisory and management functions within the company.</p> <p>Clear distinction between the liability of members of the supervisory and management bodies.</p> <p>Supervisory board members are more independent. Clear separation of the roles of chairperson and CEO.</p>
<p><b>Disadvantages</b></p> <p>A single body is entrusted with both managing and supervising the company's operations.</p> <p>It is more difficult to guarantee the independence of board members, and there is a greater risk of non-executive directors aligning too closely with executive directors.</p> <p>Greater liability for non-executive directors.</p>	<p><b>Disadvantages</b></p> <p>It is more difficult for directors to build relationships of trust, thereby potentially undermining communication between the two boards.</p> <p>Supervisory board members only receive limited information (from the management board) and at a later stage (decreased involvement). There is a heightened risk of the supervisory board not discovering shortcomings (or discovering them too late) and not fully understanding and ratifying strategic initiatives.</p> <p>The decision-making process is delayed due to less frequent supervisory board meetings.</p>

Source: ecoDa

## Board structures in Europe



Country	one-tier or two-tier board structure (public companies)
Austria	mandatory two-tier board structure
Belgium	one-tier board or mixed structure <sup>1</sup>
Bulgaria	choice between one-tier and two-tier board structure
Croatia	choice between one-tier and two-tier board structure
Cyprus	one-tier board structure <sup>2</sup>
Czech Republic	mandatory two-tier board structure
Denmark	choice between “Nordic model” <sup>3</sup> and German-type two-tier board structure
Estonia	mandatory two-tier board structure
Finland	choice between “Nordic model” and German-type two-tier board structure
France	choice between one-tier and two-tier board structure in addition, in the one-tier structure the company may choose between the PDG model and the separation of chairman and CEO responsibilities <sup>4</sup>
Germany	mandatory two-tier board structure
Greece	one-tier board structure
Hungary	choice between one-tier and two-tier board structure
Ireland	one-tier board structure <sup>5</sup>
Italy	choice between three different board structures <sup>6</sup>
Latvia	mandatory two-tier board structure
Lithuania	choice: supervisory board and/or board of directors are optional under Lithuanian law
Luxembourg	choice between one-tier and two-tier board structure
Malta	one-tier board structure
Netherlands	choice between one-tier and two-tier board structure <sup>7</sup>
Poland	mandatory two-tier board structure
Portugal	choice between three different board structures <sup>8</sup>
Romania	choice between one-tier and two-tier board structure
Slovakia	mandatory two-tier board structure
Slovenia	choice between one-tier and two-tier board structure
Spain	one-tier board structure
Sweden	“Nordic model” <sup>9</sup>
United Kingdom	one-tier board structure <sup>10</sup>

(Source: LSE and European Commission)

- 1 Under Belgian law, the board of directors may transfer some of its power to a “direction committee”, which consists of both directors and non-directors.
- 2 Cypriot company law is based on the UK Companies Act 1948. As under the law of the United Kingdom, the argument can be made that a degree of choice exists in relation to board structures. See also n. 25 below.
- 3 See the description of the “Nordic Model” below.
- 4 The PDG or “président-directeur general”-model combines the offices of the CEO and the chairman of the board.
- 5 Irish company law is similar to the law of the United Kingdom; hence, a degree of choice may exist in relation to board structures. As a matter of fact, Irish companies do, however, invariably adopt a one-tier board structure; see also n. 25 below.
- 6 Italian company law allows companies to choose between the “traditional” model with a board of directors and a board of statutory auditors, as well as a typical two-tier and a typical one-tier system. The prevalent choice, i.e. the traditional system, can probably best be described as a special form of a one-tier board structure. See the Italian report, Annex, Section 1.3, for details on the three board structures.
- 7 While companies may generally adopt either structure, after exceeding certain size-related thresholds, companies are obliged to adopt a two-tier board.
- 8 Portuguese company law allows companies to choose between the a structure with a board of directors and an audit board, as well as a typical two-tier and a typical one-tier system. The prevalent choice is best described as a special form of a one-tier board structure, in our view. See the Portuguese report, Annex, Section 1.3, for details regarding the available board structures.
- 9 See the description of the “Nordic Model” below.
- 10 UK company law does not contain mandatory rules as to a company’s board structure, arguably allowing shareholders to adopt a structure that resembles a typical two-tier board; see PL Davies and S Worthington, Gower and Davies’ Principles of Modern Company Law (9th ed., London: Sweet & Maxwell 2012) 14-65; PL Davies “Board Structure in the UK and Germany: Convergence or Continuing Divergence?” (2001) 2 International and Comparative Corporate Law Journal 435

# Directors' liabilities: The current and future threat landscape

From regulatory investigations to lawsuits and insolvency, there are many potential sources of directors' and officers' (D&O) claims. However, it is also true that for the majority of European directors they will be able to carry out their duties and watch their companies thrive and grow under this guardianship without ever facing a claim. It is therefore important to keep a perspective on the level of the exposure for European directors.



Nevertheless, the threat environment is changing with a trend towards greater regulatory scrutiny since the financial crisis. Many countries have seen increased enforcement activity from their supervisors, while in the UK and US new bribery laws have extended the extraterritorial reach of the regulator. For European companies with any involvement in the US market, the liabilities are also magnified as a result of the US legal system.

The following section summarises the main risk categories with an aim to inform directors about the threat environment and how it is evolving. As always, the best defence directors can give themselves is to carry out their duties to the best of their ability while keeping informed about the risks they face.

## Less forgiving regulators: Growing regulatory and political scrutiny

Regulatory action remains one of the biggest sources of litigation against corporate directors and officers. In Europe the impact of the financial crisis is still being felt with pressure on regulators to be vigilant after their perceived failings during the banking crisis. Investigations alleging regulatory violations are on the rise as newly-empowered supervisors seek to flex their muscles.

While much of this more robust enforcement has been felt in the financial sector, other sectors are seeing an increase as well, including energy, high tech, telecommunications, pharmaceuticals, manufacturing, real estate development and construction. For all these sectors the legal costs associated with regulatory investigations is steadily rising.

In addition to banking and insurance regulations arising from the credit crisis, directors are also attracting the gaze of regulators in various other areas - including anti-corruption and bribery, health and safety, pollution and the environment, data protection and competition and cartel activity.

Not only are European companies and their senior decision-makers facing a series of new laws - such as the EU Environmental Liability Directive and UK Bribery Act - in many cases there is also the threat of fines and penalties in addition to drawn out investigations. Regulatory claims are particularly lengthy, taking an average of five to seven years to resolve.

Along with heightened regulatory scrutiny across Europe, another trend is the greater cross-border cooperation amongst supervisors. For many companies and their directors, their most significant regulatory risk may lie outside of their home country. Along with growing extraterritorial powers, regulatory investigations increasingly involve cross-border collaboration and cooperation of supervisors from different countries. Enforcement activity under the US Foreign Corrupt Practices Act (FCPA) is one example.

While there is pressure on many of Europe's regulatory bodies to produce results, the recent recession has resulted in many supervisors' budgets being cut back. The pressure to do more with less has resulted in a greater emphasis on outsourcing of investigation and the encouragement to undergo self reporting.

And businesses are responding, leaning on the side of caution in an attempt to demonstrate to the regulator they are taking action to remedy any perceived misconduct. The hope is a proactive response will invite leniency on the part of the regulator.

While Europe so far lacks the whistle blowing incentives available in the US, the UK Serious Fraud Office (SFO) is exploring implementing a US-style bounty system and these are certainly trends directors should be watching closely. And while it is early days, it is worth noting that the bulk of whistleblower tips under the Dodd-Frank Act have come from outside the US.

### Case study:

#### Deferred prosecution agreements

Effective 24 February 2014, prosecutors in the UK are able to use deferred prosecution agreements (DPAs). Under DPAs, criminal charges are dropped after a period of time if a company complies with the terms of the agreement. Such terms typically include the agreement to fulfil certain requirements, ie fines, corporate reforms and cooperation with the investigation.

While DPAs can help companies avoid lengthy legal proceedings, there is some concern their introduction could result in a heightened exposure for corporate directors and officers. While DPAs do not involve individual directors, there is inevitably a risk that directors involved at the heart of these crises could be exposed to future litigation.

Should there be a rise in self reporting, it may put individual directors at a greater risk of prosecution. While it may be in the interest of the corporate to volunteer disclosure, for an individual director who has had some involvement in the activities, voluntary disclosure could lead to his/her own personal investigation and directors disqualification proceedings if misconduct uncovered looks sufficiently serious.

### Case study:

#### Germany and Sweden: Antitrust fines hit record high



Fines and penalties for violating antitrust laws have shot up in recent years in line with a tougher stance as authorities around the world seek to enforce competition laws. This has implications for directors and officers as a result of the fallout from this regulatory enthusiasm for detecting cartels and punishing them.

Competition agencies levied fines totalling \$5.3bn (€5bn) in 2014, a 31% increase on 2013's record-breaking total. France and Germany imposed their highest fines for companies found guilty of price fixing, with French authorities levying a \$1.2bn penalty on a single cartel, and Germany fining three cartels nearly \$1bn in total.

Individual accountability is becoming more of a feature as senior executives risk sanctions for their own conduct as well as ignoring violations of their subordinates (as is alleged to have happened at Barclays during the Libor rigging scandal). Another example is the securities class action brought in the US against Sweden based auto parts firm Autoliv and some of its directors and officers in April 2013 after the firm pleaded guilty to price-fixing. In June 2014 the company agreed to pay \$65m (€61m) to settle the suits.

## Case study:

### New bribery laws and the long arm of the regulator

Around the world efforts to curb corruption have been ramped up by governments and regulators. Some observers believe a growing number of governments, motivated by the potential financial recovery at a time when they are struggling financially, have introduced bribery laws with an extraterritorial reach<sup>viii</sup>. European directors are increasingly exposed as a result of these anti-corruption measures.

The UK Bribery Act and US Foreign Corrupt Practices Act (FCPA) are among the global treaties and statutes set up to tackle bribery on a global scale. There are differences between the two. The Bribery Act created criminal offences and is thus distinguishable from the FCPA, which enables the SEC to pursue civil proceedings in certain circumstances.

Also, while the FCPA covers bribery of foreign public officials by companies and individuals, the Bribery Act also covers any other form of bribery that leads to any business advantage. Specifically, there is strict liability under the Bribery Act which means individuals can be held liable for failing to prevent bribery, meaning that action against individual directors and officers may be taken.

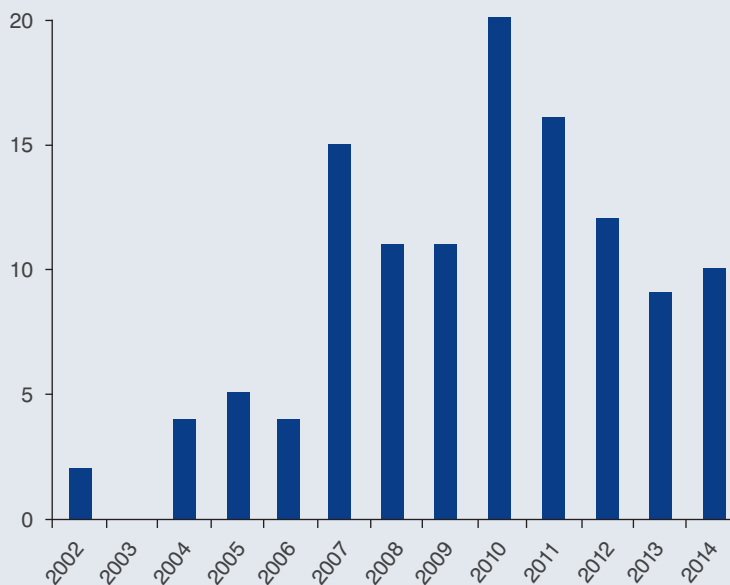
In the US, FCPA enforcement activity by the Securities and Exchange Commission (SEC) and US Department of Justice (DoJ) dramatically increased over the past 12 years<sup>ix</sup>, reaching its peak in 2010. Enforcement activity dipped slightly in 2013 but increased again in 2014 with the government bringing ten enforcement actions against corporations and fourteen individuals.

In 2008, German engineering and electronics giant Siemens AG agreed to a record \$800m settlement with the DOJ and SEC. The settlement of a wide-ranging FCPA investigation involved at least 4,200 allegedly corrupt payments totalling approximately \$1.4bn over six years to foreign officials in numerous countries.

Other European companies with the top 10 highest ever FCPA penalties include BAE (UK: \$400m), Total SA (France: \$398m), Snamprogetti Netherlands BV / ENI SpA (Holland/Italy: \$365m), Technip SA (France: \$338m), Daimler AG (Germany: \$185m), and Weatherford International (Switzerland: \$152.6m)<sup>x</sup>.

#### Total Aggregate Corporate Cases 2002-2014:

#### FCPA enforcement has increased dramatically over the past 12 years



## Going global: Risks faced by multinational companies

As outlined in the previous section, the long arm of the regulator (such as the SEC in the US and SFO in the UK) has implications for multinational companies. Directors' liabilities may extend well beyond the borders of the country in which they are located, particularly where a company has US interests.

This means they must keep pace with constantly evolving and increasingly complex local laws. Directors of companies operating internationally should also check whether their D&O policy is globally compliant. There is more information on this in the next chapter.

For foreign-controlled companies, it is the US that is the principal non-EU destination in terms of turnover for both the United Kingdom and Germany, according to the European Commission. And it is the US authorities, in particular the SEC, that has shown itself to be more willing to act extraterritorially in recent years in line with a tougher stance overall.

### “There are no institutions that are too big to indict”

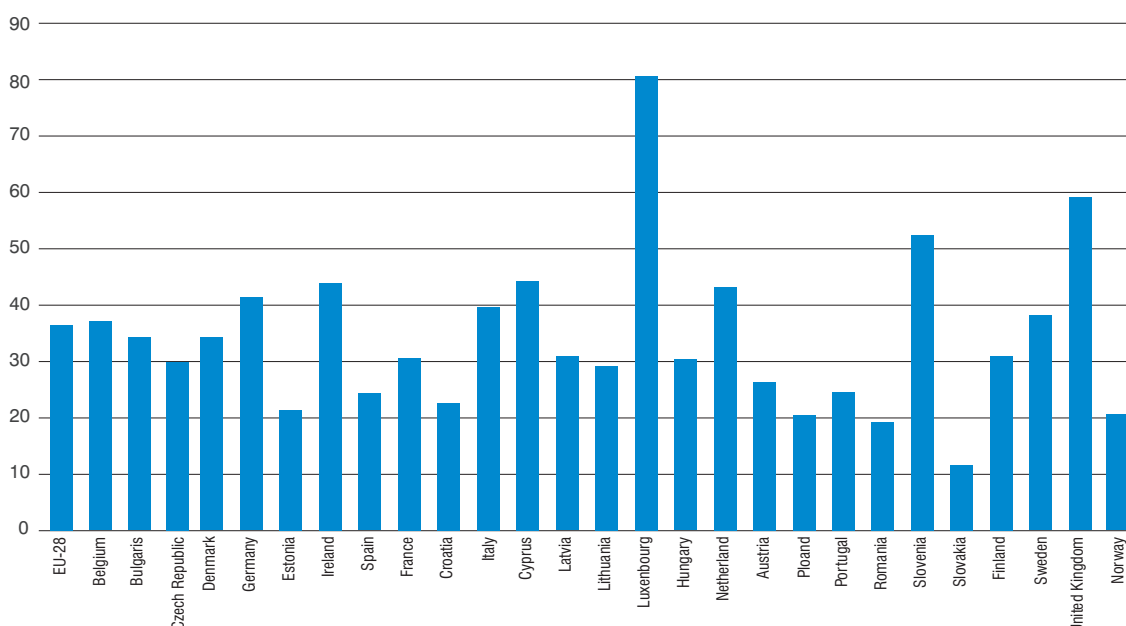
US attorney general Eric Holder in 2014.

The greater level of collaboration between the regulatory authorities in different jurisdictions has exacerbated the issue. By sharing information the actions of companies and their directors are exposed to overseas regulators when historically they may not have fallen within their gaze.

Cooperation with foreign authorities was again a theme in the 2014 Foreign Corrupt Practices Act enforcement actions, as several examples demonstrate. In HP Russia, US authorities became involved after German investigators discovered the alleged bribery scheme in 2012. Likewise, Alcoa and Alstom included a multijurisdictional component as the SFO cooperated extensively with the DOJ and SEC during the course of the investigations.

In spite of the growing cross-border scrutiny, an important crossroads was reached in 2010 that affected securities cases with foreign elements. The US Supreme Court's decision in the *Morrison v. National Australia Bank* case that made it clear that US securities laws do not allow so-called F-cubed cases (lawsuits by foreign plaintiffs, against foreign defendants concerning securities traded on a foreign exchange) in US courts. The ruling had a dramatic effect on securities cases with foreign elements.

However, a month after *Morrison*, US Congress responded when it passed the Dodd-Frank Wall Street Reform and Consumer Protection Act. It expanded the “extraterritorial jurisdiction of the antifraud provisions of the federal securities laws” but only in actions brought by the SEC or DOJ.



GRAPH:  
Share of foreign-controlled  
companies controlled  
by a non-EU country, in  
percentages (source:  
Eurostat information)

## Case studies:

### France: New law calls for supply chain vigilance



Ever since the Rana Plaza collapse in Bangladesh in April 2013, which killed 1,129 people there has been heightened scrutiny of the working conditions in factories that supply global brands. As EU Member States seek to enshrine the UN's Guiding Principles on Business and Human Rights, Europeans should keep a close eye on how this affects their responsibilities going forward.

To date there has been mixed progress, but in France a draft bill - Devoir de Vigilance - is calling for a duty of care of parent companies in preventing environment and human rights abuses in France and abroad. If adopted, the rules will introduce an obligation for business enterprises (and their board of directors) to prevent certain risks, including human rights violations, which could result from their business operations as well as those of their subsidiaries, sub-contractors and suppliers.

### France and Germany: Falling foul of sanctions



In July 2014 French bank BNP Paribas pleaded guilty in the US to two criminal charges and agreed to pay almost \$8.9bn (€8.44bn) to resolve accusations that it had violated US sanctions against Sudan, Cuba and Iran. BNP staff were accused of concealing over \$190bn (€178bn) in US dollar transactions between 2002 and 2012 for clients subject to US sanctions.

The steep fine - more than the bank's 2013 profits of \$6.5bn (€6.12bn) - is in line with an altogether tougher approach being taken by the US authorities. "Until shareholders demand from their boards [of directors] that those boards choose leaders that create a healthy culture of compliance, the money will keep walking out the door," said US deputy attorney general James Cole.

At the time of writing, Germany's Commerzbank had agreed to pay US authorities over \$1.4bn (€1.3bn) to settle allegations it violated US sanctions in dealings with Iran and Sudan between 2002 and 2011. French lender Credit Agricole is also expected to reach an agreement with US officials over its alleged sanctions violations and has set aside provisions of \$1.8bn (€1.6bn) to cover all potential litigation costs.

In 2012, HSBC confirmed it was to pay US authorities \$1.9bn (€1.78bn) to settle a money-laundering probe. The US Justice Department stated the bank had intentionally allowed prohibited transactions with Iran, Libya, Sudan and Myanmar that date between 2001 and 2006. Meanwhile British bank Standard Chartered was levied with a \$327m (€305m) fine for violating US sanctions against Iran.



## Listed companies: Europe inches closer to collective redress

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There is an impression that European culture is growing more litigious<sup>xi</sup>. Certainly the economic environment of the last six to seven years has made it more likely that directors and officers of publicly-listed companies will be the target of lawsuits brought by groups of disgruntled shareholders.

In the UK, current class-action style lawsuits against Lloyds Banking Group and Royal Bank of Scotland have been launched by shareholder action groups. Law firm Stewarts Law (which is behind the RBS litigation) is currently rallying shareholder support to bring a similar action against beleaguered supermarket firm Tesco (see case study box).

The Companies Act 2006 extended the circumstances under which a claim against directors could be brought. In addition, the basis on which shareholder action groups may bring claims were further strengthened in 2010 under Section 90 of the Financial Service and Markets Act 2000 regarding liability for issuers of public statements to the market.

Additionally, the move across Europe for broader collective action has been watched closely since the outcome of *Morrison v. National Australia Bank*, which made it difficult to apply US securities fraud laws to foreign claims. There has not been the expected surge in European shareholder litigation since *Morrison*, however a growing number of EU jurisdictions are providing collective redress mechanisms.

The Netherlands has emerged as a possible centre for European collective action after the success of the *Converium* case in January 2012. Here the Court of Appeal secured jurisdiction even though the claims were not brought under Dutch law, the alleged wrongdoing took place outside the Netherlands and none of the potentially liable parties and only a limited number of potential claimants were based in the Netherlands.

The ruling allowed the settlement to be declared binding on an “opt out” basis, the same process that is used in the US. Because the Netherlands is the only European country with such a collective settlement procedure it has become an attractive venue for settling international mass claims, irrespective of whether any litigation has taken place in the Netherlands.

In France the “Hamon Law” introduced the concept of class action in 2014, although the focus is limited to consumer organisations and the system has yet to be tested. In the UK, there is anticipation that the Legal Aid, Sentencing and Punishment of Offenders Act (LASPO) 2012, permitting damages-based agreements in most civil cases, could result in a greater prevalence of collective action because of the increased financial incentives. In a system similar to the US, lawyers may receive up to 50% of damages awarded under the new laws.

In some European countries, derivative or securities actions - where shareholders sue directors or officers on behalf of the company - are the most common form of shareholder litigation. Mergers and acquisitions (M&A) and initial public offerings (IPOs), where there are increased reporting requirements, are common causes. Lawsuits typically challenge the price, process, deal protection provisions and disclosures.

## Case studies:

### Shareholder activism: The day a tweet cost Quindell €1.4bn



Shareholder activism is becoming more prevalent. Increasingly there are examples of activist groups pursuing companies to spin off underperforming units, return excess capital to shareholders and/or urging companies to revitalise management.

When little-known US researcher Gotham City tweeted a link to a research report on British AIM-listed outsourcer Quindell in April 2014 the company's shares plunged. In the space of a single day nearly €1.4bn had been wiped off its valuation. The report, a scathing attack on Quindell's acquisitions, profits and cash flow, was accused of being "highly defamatory" and "deliberately misrepresentative" but the damage had been done.

In December 2014 a class action lawsuit was instigated against the firm and ex-directors, including founder and former chairman Rob Terry. Liverpool-based legal firm Your Legal Friend, has so far attracted over 250 small investors and will argue that Quindell's public statements were misleading, leading directly to a loss of shareholder value.

### Shareholder activism: Vivendi battles activist shareholder



Another example that illustrates the growing influence of shareholder action involves Vivendi, which reached a deal with P Schoenfeld Asset Management (PSAM), a US hedge fund founded by Peter Schoenfeld in April 2015. The French media giant had been facing a rebellion from the activist shareholder, which had demanded additional payouts. After initially threatening legal action against the US hedge fund, Vivendi compromised and announced it would return €6.75bn to shareholders in regular and special dividends, above the €5.7bn it had previously earmarked, but below the €9bn PSAM had demanded.

Currently, the incident has no implications for the company's directors. Arnaud de Puyfontaine, Vivendi's chief executive, said in a statement that the increased payouts demonstrated, "our willingness to reach consensus with some of our minority shareholders, even if it may result in reduced flexibility for Vivendi".

### UK: Is Tesco the next class action-style suit?



A lawsuit brought by some of Tesco's biggest shareholders after the UK supermarket giant revealed a massive hole in its accounts last year, could be a sign of more class action-type securities claims to come. The company is also being investigated by the SFO for its accounting irregularities.

One shareholder action is being brought by Stewarts Law, a law firm which is also representing 300 institutional investors in a multi-billion pound rights-issue action against bank RBS. The claim against Tesco shareholders will argue they are entitled to seek compensation for losses caused by alleged breaches of this section of the Financial Services and Markets Act 2000 and in particular, its overstatements of its profits.

The Tesco lawsuit is due to be financed by third-party litigation funder Bentham Ventures, assuming it is successful in recruiting the required number of shareholders. Litigation funders, who finance such lawsuits and then take a proportion of any damages if the case is successful, are becoming increasingly active in the UK.

Meanwhile, US law firm Scott & Scott has dropped a securities class action against the supermarket in Manhattan federal district court in order to bring litigation against the company in England. The case "exemplifies how the Supreme Court's Morrison ruling, in conjunction with the UK's Financial Services and Markets Act of 2000, has changed securities litigation against global companies," according to Reuters legal blogger Alison Frankel.

## Economic risk and insolvency

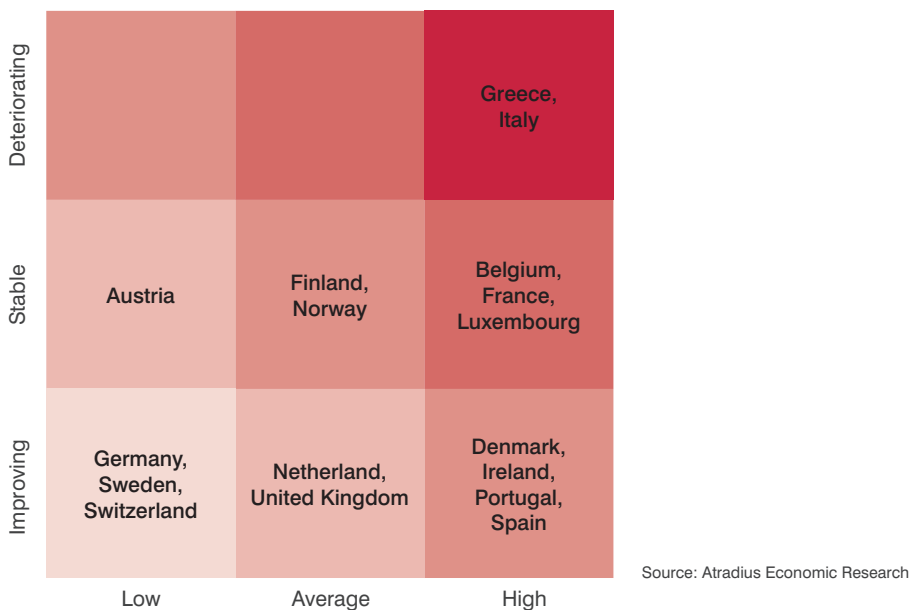
With almost 600 companies entering liquidation in Europe each day, it is perhaps unsurprising that insolvencies are a leading cause of D&O claims in Europe. Bankruptcy trustees in most countries have a duty to investigate the root cause of a insolvency and consider whether the directors and officers were to blame. They are also becoming increasingly aggressive in their pursuit of claims alleging personal liability.

Insolvency laws can particularly increase the exposure for directors in countries where there are personal liabilities for trading whilst technically insolvent (see case study box). This typically occurs where company bosses believe they are able to turn their fortunes around given another couple of months of trading. However, as a result, they potentially put their creditors in a worse off position.

Although the overall economic situation in Europe is improving, most countries are still in a high insolvency environment as a result of the economic crisis and the following years of weak economic growth<sup>xii</sup>. All Eurozone periphery countries face a relatively high number of insolvencies and there is continuing uncertainty over the Greek debt crisis.

In 2015, Eurozone insolvencies remain 70% higher than in 2007. Spain has lost 500,000 companies since the height of the financial crisis in 2009<sup>xiii</sup>. However, given the typical lag between insolvencies occurring and legal cases being brought, the fallout from this period could continue for some time.

### Insolvency matrix 2014 Western Europe

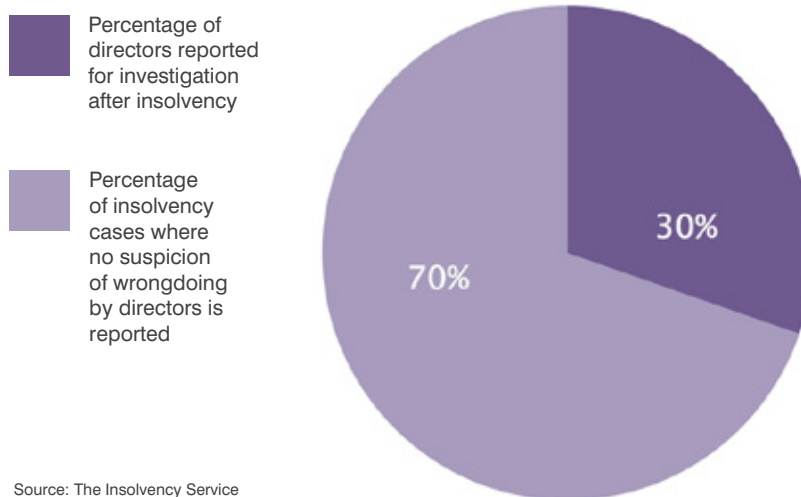


Many insolvencies emanate from so-called zombie companies, firms that may be trading profitably but are struggling to pay off enormous debts, leaving insolvency as the only option. In the UK alone there were over 227,000 zombie companies in 2013, an increase of 108% since the beginning of the financial crisis.

However, the insolvency environment is improving in line with the general improvement in economic conditions compared to 2013. It is hoped the European Central Bank's quantitative easing plan, introduced in January 2015, will further revitalise the eurozone economy and counter deflation.

Across Europe, directors have similar sets of duties when it comes to dealing with insolvency. However, there is more potential in some countries - including France and the UK - for directors to be personally liable for losses suffered by creditors as a result of continuing to trade while technically insolvent.

### UK directors suspected of wrongdoing in 30% of all business insolvencies



This concept of wrongful trading and civil liability can leave directors exposed to disqualification and litigation. In wrongful trading actions the liquidator will try to establish a date at which the company can be shown to be balance sheet insolvent. It will then show why it was unreasonable for directors to continue to trade after this.

Many legal systems (including English law) recognise the blue sky defence. This broadly provides that, if the directors, in good faith, believed the company was about to turn the corner and improve, they would not normally be held liable for continuing to trade. Liability only attaches when the company has no realistic prospect of avoiding insolvent liquidation.

In the UK, the Department for Business Innovation & Skills (BIS) produced recommendations in 2013 intended to improve the transparency of UK company ownership. These were backed by the government in April 2014. Within the changes is a proposal to place even greater personal liability on directors for misconduct<sup>xiv</sup>.

In France, a country with strict bankruptcy laws, it is even more common for directors to be held personally liable for wrongful trading (in around 10% to 12% of cases<sup>xv</sup>). In 2013, business insolvencies in France remained at their 2009 peak level of 62,700.

The most common procedure in France is judiciary bankruptcy, controlled by the court, who may allow the company to continue to trade, sell the business as a going concern, dismantle it or liquidate the assets. French insolvency law is weighted towards the employee and tax creditors who rank ahead of other creditors, so returns to ordinary creditors can be poor.

## Case study:

### Germany: When a company sues its directors



In Germany, lawsuits brought against directors by their own companies are more common than shareholder litigation. This is a result of Germany's two-tier board system whereby the Supervisory Board can instigate legal action against the Management Board. It is also possible for the management board to introduce legal action against the supervisory board, although this does not tend to happen in practice.

Companies suing their own directors and officers represent over two-thirds of all D&O claims in Germany, according to Advisen. One example involves the Kirch media empire. In 2002 media mogul Leo Kirch, who passed away in 2011, accused the then Deutsche Bank chairman Rolf Breuer of contributing to the bankruptcy of his company by saying in a television interview that banks would not lend Kirch's company any more money.

The statement caused a public discussion about the liquidity of Kirch Group and sparked a prolonged legal battle with the bank. Deutsche Bank eventually settled with Kirch's heirs in February 2014, agreeing to pay €775m (Kirch had originally sought to recoup up to €3bn). Now the bank is seeking compensation from Breuer and other former top managers, including former co-CEO Juergen Fitschen, for the out-of-court settlement, arguing they gave misleading evidence in connection with the Kirch collapse<sup>xvi</sup>.

In another example, a claim which was ongoing at the time of writing, the former director of a private SME firm was involved in unauthorised derivative activities which allegedly caused a loss of €8.8m. In addition, the director ordered renovation of buildings without (it is argued) considering more favourable conditions of offers from competitors. These contracts were not authorised by the supervisory board and led to an additional loss of €1m, it is alleged.

## Criminal liability: In clear breach of directors' duties

Of all the potential liabilities faced by European directors, the one most likely to cause pause for thought are criminal penalties. However, it is important to note that the risk of jail time for directors carrying out their duties with honesty and integrity is a remote one, albeit disastrous when it occurs.

Criminal prosecutions mostly occur where there has been a clear and knowing breach of directors' trust and duties, such as the misuse of company assets. This is a particular issue for small and medium-sized companies (SMEs), that may lack the control structures of larger organisations.

In France the majority of criminal cases reported deal with smaller limited liability companies. However, this doesn't necessarily mean the directors of smaller companies are more often subject to liability, just that there are so many more of them, given that statistically SMEs are the backbone of the economy. The vast majority of cases go ahead in France, whereas in the UK, where litigation is more expensive, most are encouraged to settle out of court.

When directors treat their company assets as their own they risk imprisonment as well as large fines or penalties. As was the case with Thomas Middelhoff and Conrad Black, such misdemeanours are often more likely to be discovered and directors charged when a company faces or enters insolvency.

There had been some discussion in the UK as to whether the LASPO [Legal Aid, Sentencing and Punishment of Offenders] Act would lead to a reduction in litigation against rogue directors, particularly for smaller cases that would struggle to attract third-party finance. April 2013, when the Act came in, was due to mark the end of an exemption for insolvency cases to be brought under no-win no-fee structures. However, the government recently issued a reprieve which allows insolvency practitioners to continue with the current funding arrangement for the foreseeable future.

In the past it tended to follow that criminal convictions of directors and officers occurred where there were clear cases of fraudulent activity and financial crime, such as during the accounting scandals associated with Enron, Worldcom and Dutch supermarket giant Royal Ahold. But increasingly, criminal proceedings relate to behaviour in connection with legitimate corporate operations and potentially the actions of subordinates in cases that are not always so black and white.

Regulators are increasingly likely to use criminal proceedings to punish offending executive behaviour and set an example in their enforcement of laws ranging from health and safety to anti-bribery and corruption<sup>xvii</sup>. Within Europe, countries such as Germany and the UK are more inclined than others to threaten criminal liability in an effort to motivate director behaviour.

### Case studies:

#### Germany: Jailed for misusing company funds



In 2014, Thomas Middelhoff, former chief executive of collapsed German retail and travel group Arcandor - which held a majority stake in Thomas Cook - was convicted of misusing company funds. Specifically, Middelhoff was accused of charging the company for over 400 private jet flights to London and New York and helicopter commutes from his home in Bielefeld to the company's offices in Essen between 2005 and 2009.

Middelhoff was sentenced to three years in prison in Germany for breach of trust over expenses that amounted to €800,000. He denied allegations of misusing company money but the judge said he had given the court some "fanciful explanations" for the expenses.

Middelhoff's tenure at Arcandor ended in 2009 when the company filed for insolvency. Its stake in Thomas Cook was sold by the company's creditors later that year. The judge said the trial would probably not have happened without the "bean-counting" of the insolvency administrators.

## Case studies:

### Italy: Political scandal



In an ongoing political scandal, 35 individuals in the Italian city of Venice - including the former Mayor of Venice Giorgio Orsoni - were arrested and over 100 were under investigation on corruption charges at the time of writing. It is alleged that those arrested embezzled around €20m in public funds earmarked for flood defences. A lengthy legal battle is anticipated<sup>xviii</sup>.

### UK: Criminal offence for reckless misconduct of senior bankers



In December 2013 the Financial Services (Banking Reform) Act became law, introducing a criminal sanction for reckless misconduct that leads to bank failure. The reforms implement key recommendations of the Parliamentary Commission on Banking Standards (PCBS) in its report Changing banking for good<sup>xix</sup>.

The tougher rules will come into force on 7 March 2016 when the Senior Managers and Certification Regime replaces the existing senior persons' regime. It applies to senior staff in both UK firms and UK branches of foreign firms.

Under the new criminal offence for reckless misconduct, directors and officers in UK banks, building societies and regulated investment firms could receive custodial sentences of up to seven years for the most serious cases. In such cases there will be a reversal of the burden of proof such that Senior Persons must show that they took all reasonable steps to prevent or mitigate the effects of a specified failing.

The new rules will apply to non-executive directors with specific responsibilities for aspects of the firm's "safety and soundness" as well as those responsible for the day-to-day running of the firm. Specifically, it applies to the chairs of the main committees and the chairman. Banks have until 8 February 2016 to notify the regulators of the names of the senior staff they intend to appoint as senior managers under the new regime.

"The cocktail of measures increasing individual accountability may make the banking sector a less attractive place to work," PwC warned upon the release of the PCBS report<sup>xx</sup>.

## Criminal penalties are first on the list of factors motivating directors to comply with competition rules

Ranking by Businesses	Ranking by Lawyers
1. Criminal Penalties	1. Criminal Penalties
2. Disqualification of Directors	2. Fines
3. Adverse publicity	3. Disqualification of Directors
4. Fines	4. Adverse publicity
5. Private damages actions	5. Private damages actions

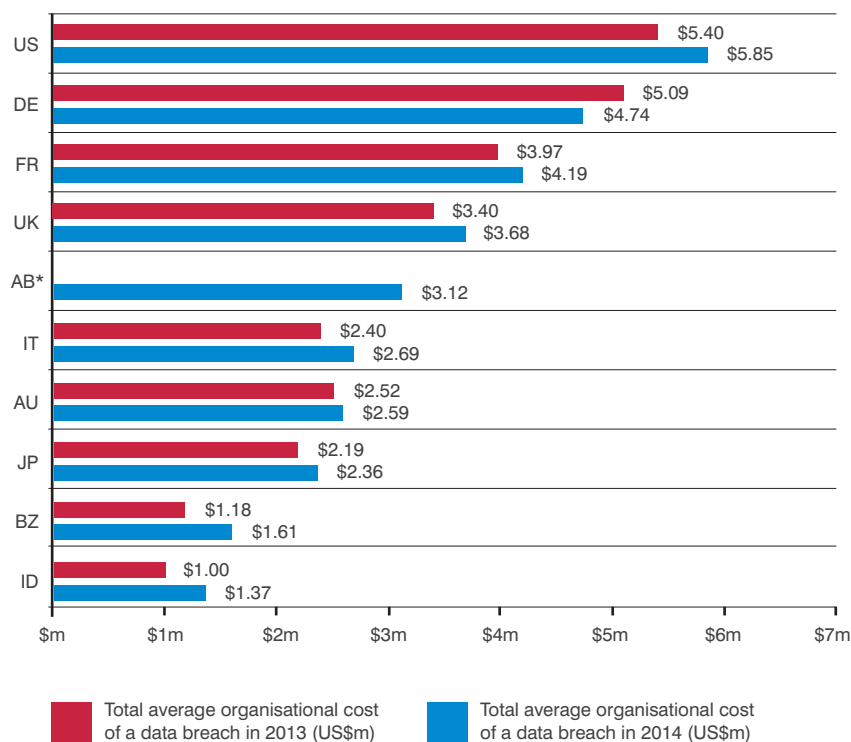
source: UK Office of Fair Trading

## Changing headwinds as Europe tightens data protection laws

Ashley Madison, Anthem, Target, JP Morgan Chase, eBay and Home Depot are just some of the corporate heavyweights that have been subject to large-scale data breaches in recent months. With a rapidly evolving cyber threat landscape, directors in Europe are becoming more mindful of their responsibilities to protect sensitive data.

Germany is second only to the US with the most costly data breaches, according to research from Ponemon, with the average cost of a breach at \$4.74m (€4.47m) in 2014. This is followed by France, with an average data breach cost of \$4.19m (€3.96m) in 2014 and the UK with an average of \$3.68m (€3.47m).

### The average total organisational cost of data breach over two years



Source: Ponemon Institute

\* Historical information is not available for the Arabian Cluster"

Currently the US has the strictest data protection regime, but Europe is not far behind. New data protection rules are set to be introduced by the European Commission that will require firms to notify regulators and other stakeholders of a breach, within 24 hours where possible. There will be penalties of up to 2% of annual turnover.

The Netherlands is already a step closer than its European contemporaries. In May 2015, the Dutch Senate passed a bill that obliges data controllers to notify the Dutch Data Protection Authority (DPA) of data security breaches and provides increased sanctions for violations of the Dutch Data Protection Act. The new law is expected to come into force at the beginning of 2016.

The proposed General Data Protection Regulation interacts with other EU data privacy reforms, including the e-Privacy Directive and Cybersecurity Directive. The law will come into force in 2017 at the earliest but many Member States are encouraging businesses to prepare for the changes now.



Small firms may lack the IT security resources of some of their larger contemporaries, but the regulations stating the need to protect sensitive data do not vary by sector or size of company. Recent examples indicate cyber liability is not just an issue for large global corporates.

Even micro entities can fall foul of the ever tightening rules. In the UK, a sole trader was fined €6,995 in a move intended to “act as a warning” by the Information Commissioner’s Office in 2013 for failing to encrypt customer data. A hard drive containing the data on around 250 individuals was stolen when the owner of Jala Transport’s car was opened in a traffic jam. It included the names, dates of birth and addresses among other details.

Several recent cases in the US have demonstrated how cyber liability has the potential to cross over into D&O. In addition to the cost of business interruption, restoring systems, notifying customers, responding to regulators and paying significant fines and penalties, several companies in the US are facing derivative lawsuits brought by their shareholders.

Wyndham, Target, Home Depot and most recently, Sony Pictures - among others - have been sued by shareholders and, in the case of Sony, former employees, in connection with data breaches. The litigation against Target and Wyndham also targeted the companies’ directors and officers. In October 2014, the derivative lawsuit against Wyndham officials was dismissed, following a costly and prolonged legal battle.

These are not the first cases pertaining to a potential new liability exposure for directors and officers. In 2010, a shareholder suit was filed against EJX Companies, the owner of TJ Maxx. Similar actions were taken in 2009 and 2008 by the shareholders of Heartland Payment Systems and Choicepoint respectively, both following security breaches.

Whether similar litigation against directors could occur in Europe remains to be seen. Certainly, European boards appear to be better prepared, according to one piece of research. It found nearly 72% of European companies are likely to have chief information security officers, compared to 58% of North American companies. And nearly 60% of the European companies surveyed had risk/security committees on their board, compared to just 28% of North American firms<sup>xxd</sup>.

### Case study:

#### US: Target in the firing line



At the end of February 2015, US retail giant Target revealed its credit card breach in 2013 which affected some 70 million customers had cost the company over \$250m. Partly offsetting these costs were insurance receivables amounting to \$46m in 2014 and \$44m in 2013.

The company faces further defence costs after four derivative lawsuits were filed against 13 of Target’s directors and officers. The shareholders challenged not only their conduct before the data breach, but also following its discovery.

Specifically, plaintiffs allege the company’s directors breached their fiduciary duties to shareholders by “failing to implement a system of internal controls to protect customers’ personal and financial information” and “causing or allowing [Target] to conceal the full scope of the data breach”.

## Board Committee Structures

Boards have these committees?	North America	Europe	Asia		Energy / Utilities	Financial	IT / Telecom	Industrials
Have Risk/Security Committee	28%	59%	95%		36%	86%	46%	63%
Have IT/Technology Committee	16%	21%	38%		14%	39%	0%	13%

Source: Carnegie Mellon CyLab

## Key changes under the European Data Protection Regulation

A **single set of rules** on data protection, valid across the EU.

Companies and organisations must notify the national supervisory authority of serious **data breaches** as soon as possible (if feasible within 24 hours).

Organisations will only have to deal with a **single national data protection authority** in the EU country where they have their main establishment.

People will have easier **access to their own data** and be able to **transfer personal data** from one service provider to another more easily (right to data portability). This will improve competition among services.

A '**right to be forgotten**' will help people better manage data protection risks online: people will be able to delete their data if there are no legitimate grounds for retaining it.

EU rules must apply if personal data is **handled abroad** by companies that are active in the EU market and offer their services to EU citizens.

**Independent national data** protection authorities will be strengthened so they can better enforce the EU rules at home. They will be empowered to fine companies that violate EU data protection rules. This can lead to penalties of up to €1m or up to 2% of the global annual turnover of a company.

A new **Directive** will apply general data protection principles and rules for **police and judicial cooperation** in criminal matters. The rules will apply to both domestic and cross-border transfers of data.

Source: European Commission

## Keeping out of the firing line



European directors and officers are faced with an ever-evolving threat environment as a result of a world that is becoming more global, with changing regulations and broader scrutiny from supervisors, shareholders and the wider public. However, directors need not be passive sitting targets. They should understand their role within the company and take an active approach to fulfil these responsibilities, as set out in job descriptions or terms of reference.

Directors should insist on receiving regular financial and risk reports to keep up-to-date with the company's situation and projections. They should ensure their position is noted in the minutes of each meeting, together with their reasons. This can be particularly important if the company's financial situation is poor or the company is going through a highly scrutinised process, such as an M&A or public listing.

Directors may even opt to keep a private record of events and decisions, and their part in them. Such documents can be instructive as a future defence. Directors' liabilities are long-tail in nature and this means that a claim can be made against them and their actions many years after decisions have been made.

Carrying out their directors' duties effectively remains the best defence in many cases. The business judgement rule, applicable in most jurisdictions, is the presumption that a business decision made by a director was reasonable. Liability will not be established where the claimant suing the director cannot demonstrate that, in making the business decision, the director failed to act on an informed basis.

This assumes the director arrived at the decision after deliberating on the matter, exercising independent judgement and examining all the reasonable facts available at the time. The fact that pre-financial crisis management decisions could only be deemed reckless or ill judged with the benefit of hindsight could be one reason why the crisis did not spark the level of litigation against directors that some anticipated.

However, the assumption that a director cannot be held liable if they acted in good faith based on information available at the time is beginning to change. Increasingly in some areas of the law (examples including UK health and safety and anti-bribery laws) directors will be held liable if they have failed in their legal obligations, even if they can demonstrate they had good intentions.

This puts the emphasis on directors to put in place a corporate culture that will encourage good behaviour and a strong moral compass. And to carry out risk assessments and put in place frameworks that mitigate against unethical behaviour and excessive risk taking among other things.

As a result, a European directors' main form of mitigation in the future is not going to be, 'I didn't intend for this to happen'. Instead it moves the defence into the realms of, 'I put in a good system and reasonable processes to guard against this'.

### Case studies:

#### Reversing the burden of proof

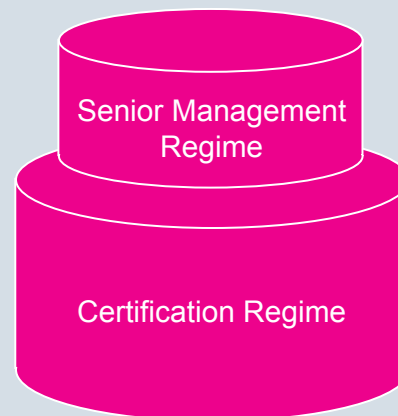
Such an approach can be found in the UK's new senior persons' regime, a role that is based on the presumption of senior responsibility, placing the evidential burden on senior managers to demonstrate they took "reasonable steps" to prevent, stop or remedy regulatory breaches. Removing any doubt over liability, each senior person also has a "Statement of Responsibilities".

Directors subject to the new senior persons regime will be unable to hide behind collective decision-making as a result of these statements of responsibilities. In addition, they will face much tougher penalties, including a new criminal offence.

#### Birth of the Senior Persons Regime

For banks, building societies and Prudential Regulation Authority-designated investment firms

- Individuals to have a "statement of responsibilities"
- Firms to have clear map of responsibilities
- New set of conduct rules
- Reverse burden of proof
- Criminal offence (for actions resulting in failure of an institution)



Source: Bovill

#### Attributes of a "good" director

Source: Kaplan Financial

There are many characteristics and skills required to be an effective directors of a company. But some of the key ones include:

**Characteristics:** Motivated, proactive, experienced (been there, done that)

**Skills required:** Listening, questioning, negotiating, leadership (especially for the chairman and CEO), knowledge in specialist area (executive directors) and general business knowledge (important for executive directors and non-executive directors)

## The role of directors' and officers' (D&O) insurance

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With legal costs on the rise across Europe and regulators' strategy to hold directors personally liable, directors should feel empowered to ask their organisations whether or not they are covered by D&O insurance. There are anecdotal signs directors are becoming more robust in how they approach their duties and liabilities and the questions they ask about their individual coverage.

As a condition of becoming a director in the UK for instance, it is becoming more common for individuals to request a contractual indemnity from the company, something that was not traditionally done in the past. In more litigious environments, such as the US and Australia, it is rare for individuals to agree to sit on a board without D&O insurance. Directors are aware there is more legal and regulatory scrutiny into what they are doing and in response, are becoming more confident in asking questions about D&O cover.

D&O insurance covers the cost of defending directors and officers against lawsuits brought against them, as well as any compensation costs that arise from an unsuccessful defence. However, it is important to stress that insurance does not cover criminal or regulatory fines in most instances. While there is solidarity between directors, in cases of criminal liability the insurance policy will cover directors who have not participated in a misdeed.

If directors and officers do not have insurance, they face a greater risk of not being able to defend themselves against:

- disqualification from holding the position of director;
- civil proceedings which can lead to significant legal costs and awards for damages; and
- criminal prosecution which can lead to fines and possible imprisonment<sup>xxiv</sup>.

D&O policies cover both the personal liability of company directors and officers (Side A cover) and also the insured company where it has paid the claim of a third party on behalf of its managers (Side B or Company Reimbursement Cover). Such insurance can be taken out by companies of any size and from any industry sector.

For directors operating in a multinational environment it is important to have a D&O programme that is compliant in all countries. A country where a subsidiary is located may not recognise insurance that is provided by a "non-admitted" insurer. Such "gaps" in cover then need to be filled by taking out policies with local "admitted" insurers where this is possible.

If a local policy is necessary for compliance, an insurance company may not be able to indemnify a director or officer, leaving him or her without coverage. The company itself can be exposed to income tax if it elects to transfer money or intellectual capital back into a country to offset an insurance loss. Fines and penalties can arise from non payment of premium taxes.

D&O insurance has come a long way since it was first devised in the aftermath of the Great Depression and today the product is broad in the risks it caters to. As part of the tripartite relationship between brokers, insurers and insurance buyers, companies should be able to design a D&O package that best fits their needs and risk profile.

Some of the more recent innovations include any-one-claim reinstatement provisions, that provides aggregate cover should a firm encounter more than one claim against its directors and officers in a calendar year. Standalone quasi-D&O policies can also be taken out to specifically cater to IPOs and bond offerings<sup>xxv</sup>.

Responding to the increased regulatory scrutiny and move towards self-reporting, a number of insurers also now offer pre-claim provisions. Under such provisions, the policy will be triggered to cover the costs of responding to informal regulators' requests before or in lieu of a claim made in relation to alleged wrongful acts.

In terms of current limit of indemnity, public companies purchase higher limits than non-public. Companies with securities traded on US exchanges purchase materially higher D&O limits than those not in the US.

### Case study:

#### German Vorst AG: Sharing the burden



In response to the financial crisis, the German government introduced an executive compensation act in 2009 (German: Gesetz zur Angemessenheit der Vorstandsvergütung, abbr: VorstAG). The VorstAG modifies the German Stock Corporation Act (AktG) and the German Commercial Code (HGB) and became effective as of 5 August 2009. The German Corporate Governance Code was also modified at the same time.

Among the changes is the requirement for directors to retain some of their liability risk. If a company takes out D&O insurance, the policy must include a deductible for the executive member.

The mandatory minimum for such a deduction is 10% of the damage incurred and is capped at 150% of the executive's fixed annual remuneration at the time the breach of duty occurs. In contrast, D&O insurance for supervisory board members need not include a minimum percentage deductible<sup>xxvi</sup>.

## Effective claims handling

While having D&O insurance cannot insulate a director from legal action, it can help to cover the cost of civil, criminal or regulatory proceedings brought against them for alleged wrongful or criminal acts and ensure the right legal representation is available as soon as it is needed. Wrongful acts include:

- Breach of trust;
- Breach of duty;
- Neglect;
- Error;
- Misleading statements; and
- Wrongful trading.

The average D&O claim can take between five and seven years to resolve, a lengthy period during which a director is unable to go about his or her business, faces a loss of reputation and a stressful period in his or her life. This is particularly true of regulatory actions and investigations, which can take many years to resolve and can subject directors and officers to multiple probing interviews under caution.

By virtue of their success in business, directors are often strong-minded individuals who may find it difficult to relinquish control to their legal advisors, especially when faced with unpleasant allegations. But a directors' behaviour and actions are likely to be scrutinised when a claim is made against them.

The utmost care must be taken not to harm a defence. The best advice, when the worst happens, is to get legal experts involved early and to listen and respond to what they say. Directors need stamina and strength to go the distance. Meanwhile, an experienced claims team will keep the communication channels open, assist with settlement opportunities and help directors prepare for a complex and potentially protracted legal process.

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