

Loss Prevention Standards – Financial Lines

Management Liability - Start-ups and **Directors' Duties**

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A guide for start-ups to understand the scope of potential D&O liabilities and mitigate potential claims.



Management Liability - Start-ups and Directors' Duties



Introduction

Navigating the dynamic world of start-up companies can be exhilarating for new business owners but can come with its own set of challenges and risks. Among these, the legal duties and potential liabilities faced by Directors and Officers can often be overlooked.

Start-up founders or executives will often wear many hats and may not have prior experience in managing a company or understanding the legal responsibilities that come with their status as a company director. Rapid growth and a focus on scaling the business and innovation, rather than on governance and compliance, can lead to an oversight of important legal obligations. This can be exacerbated by resource constraints when the business is in its early stages, which could lead to diminished access to legal advice and training. Understanding the potential scope of D&O liability is crucial to safeguarding your personal assets and ensuring the long-term success of your company.

This guide aims to demystify the complexities of D&O liabilities, highlighting the key duties and risks, along with providing practical steps to mitigate them. From breaches of fiduciary duty to compliance with ever-evolving regulations, we will outline the various ways in which you could be exposed to legal claims, and give you a clearer outline of the potential pitfalls.



What are Directors Duties under the Companies Act 2006?

The Companies Act 2006 sets out the main **directors' duties**:

1. Overriding **duty to act in a way “most likely to promote the success of the company”**. When making decisions, directors must consider factors such as:
 - a. the likely consequences of any decision in the long term. An example of failing to do this would be entering into a contract on behalf of the company without properly assessing its implications, and that contract leading to financial losses or breaches.
 - b. the interests of the company's employees.
 - c. the need to foster the company's business relationships with suppliers, customers, and others.
 - d. the impact of the company's operations on the community and the environment.
 - e. the desirability of the company maintaining a reputation for high standards of business conduct.
 - f. the need to act fairly between the members of the company.

If a Director has failed to properly weigh up these factors and that decision leads to financial losses, they could be vulnerable to claims that their actions have failed to promote the success of the company, and should be personally liable for any associated losses.

2. Duty to act within powers – i.e. only in accordance with the **company's** constitution, and for the purpose for which those powers were conferred. For example, if a Director enters into an agreement beyond their authority without shareholder ratification, that action could be void and constitute a breach of duty.
3. Duty to exercise independent judgement. Directors should be careful to ensure they have not delegated decision making authority to external parties or other directors.
4. Duty to exercise reasonable care, skill and diligence. Directors need to ensure they are taking actions that a prudent person would take in similar circumstances and apply their expertise and knowledge to the role. They need to actively engage in decision making.

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5. Duty to avoid conflicts of interest. Examples of failing in this duty could be serving on the board or holding significant shares in a competitor company, personally profiting from a transaction with the company, selling property to the company in which they have a personal interest, or wanting to pursue an opportunity turned down by the company.

What other Duties does a Director have?

1. Health and Safety – In the UK, Directors have specific personal obligations relating to protecting Health and Safety. Directors should ensure they fully appreciate the scope of these obligations. A failure to adhere to them will not only potentially result in an unsafe working environment for employees and injuries, but could also result in personal fines, imprisonment or disqualification. The Health and Safety Executive have useful resources to educate business leaders on their website, which are included in Sources and Useful Links below.
2. Environmental Responsibilities – This is a constantly developing area, but directors of UK companies have specific responsibilities related to the environment (in addition to their duty under the Companies Act referred to above). These include Environmental Disclosure Obligations, Corporate Governance Disclosures, and potential personal responsibility for environmental offences caused by the company (such as a failure to comply with pollution laws or required permits).
3. Regulatory obligations – If operating in a regulated sector, Directors should be mindful of their ongoing personal obligations relevant to that industry/profession, which will often continue in tandem with their regulatory obligations owed by the company.
4. Employment Law – Directors can be held personally liable for employment claims such as inducing a **company to breach an employee’s contract, or for discrimination. They could be ordered to pay compensation to employees personally.**
5. Tax obligations – Directors could be personally liable for certain tax obligations such as PAYE, National Insurance Contributions or VAT if they are unpaid. The likelihood of personal liability is dependent on the specific rules around that tax, and may be influenced by whether the avoidance has been deliberate, fraudulent or negligent.
6. Data Protection – **Directors can be held liable for their company’s data breaches in certain circumstances** (such as where the offence has been committed with their consent, or due to their negligence, or where a company has failed to pay a fine imposed by the ICO). Directors need to ensure they are fully aware of their Data Protection obligations, and seek specialist advice where required.
7. Insolvency - Extra caution needs to be exercised by Directors in situations involving insolvency or potential insolvency, as they could have personal liability for claims related to:
 - Wrongful trading - Where Directors continue trading when they knew (or should have known) that the company could not pay its debts.
 - Fraudulent trading – Where Directors engage in fraudulent activities during insolvency.
 - Transactions at an undervalue – Where assets have been disposed of for less than their true value.
 - Trading at a preference – Where one creditor has been preferred over another.
 - Misfeasance – Where they have breached their duties.

In addition to personal liability for compensation, a Director could also face disqualification from acting as a Director for up to 15 years.

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If facing an insolvency or potential insolvency, directors should ensure they safeguard the company's assets, treat all creditors equally and seek specialist insolvency advice where appropriate to ensure they are properly protected while they seek professional advice.

8. Fiduciary duties – A fiduciary duty arises by virtue of a relationship where there is a legal or ethical obligation to maintain trust (such as a legal guardian caring for a child or a solicitor-client relationship). Directors owe fiduciary duties to the company itself, not just its shareholders. Many of the fiduciary duties owed by Directors overlap to some extent with their obligations under the Companies Act 2006, but a fiduciary duty also involves heightened expectations of trust and loyalty, and require Directors to act with utmost good faith. If a Director is successfully sued for breach of fiduciary duty, they could be personally liable for paying damages, restoring company property, or account of profits.

How can I protect myself and ensure I am meeting these duties?

- Understand your duties – Familiarise yourself with the duties outlined in this guide, and undertake further research or obtain specialist advice if there are areas you are unsure of.
- Comply with your Companies House filing requirements - This is simple, but very important.
- Have properly documented corporate governance procedures – Which you always follow. Similarly, ensure your articles of association have been professionally written and that you understand and comply with them.
- Maintain accurate records – Keep detailed records of decisions, actions and board meetings. Dated and detailed notes and minutes can protect you in the event of any disputes.
- Clarify and document all ownership and shareholding agreements - This will help prevent misunderstandings with investors that could lead to claims in future.
- Document all ownership of assets accurately – in company accounts, title documents and board minutes.
- Make proactive decisions – And document your decision-making processes.
- Prioritise compliance– Stay compliant with regulations and place an emphasis on proper governance practices.
- Seek legal advice – If you are uncertain about legal implications of your decisions, consult legal professionals. Obtaining timely legal advice can prevent problems further down the road.
- Monitor financial health – **Regularly assess your company's financial position**, even if it is not your primary area of expertise. Address cash flow shortages promptly.
- Avoid Insolvent Trading – **Ensure your company's financial health and cash flow is regularly discussed at board meetings**. Document these meetings with minutes to help demonstrate you made informed decisions based on the available information. Act reasonably and responsibly and avoid taking actions that could harm creditors or place personal interests over theirs. Always seek expert advice if you are unsure.
- Maintain transparency – Disclose any conflicts of interest and related party transactions, and make sure the information you are providing to stakeholders is accurate.
- Promote Health and Safety – Regularly review health and safety policies, risk assessments and procedures. Keep up to date with relevant legislation and industry best practices (and check out the below link to Aviva Specialist Partners, who could provide further support). Set a strong safety culture, and maintain clear records.
- Stay informed – About changes to company law, employee rights and industry best practices.

Specialist Partner Solutions

Aviva Risk Management Solutions can offer access to a wide range of risk management products and services at preferential rates via our network of Specialist Partners.

For more information please visit:

[Aviva Risk Management Solutions – Specialist Partners](#)

Sources and Useful Links

- [Companies Act 2006 \(legislation.gov.uk\)](#)
- www.hse.gov.uk/leadership/index.htm
- [For organisations | ICO](#)
- [Insolvency Act 1986 \(legislation.gov.uk\)](#)
- [Being a company director - GOV.UK \(www.gov.uk\)](http://www.gov.uk)

Additional Information

To find out more, please visit [Aviva Risk Management Solutions](#) or speak to one of our advisors.

Email us at riskadvice@aviva.com or call 0345 366 6666.*

*The cost of calls to 03 prefixed numbers are charged at national call rates (charges may vary dependent on your network provider) and are usually included in inclusive minute plans from landlines and mobiles. For our joint protection telephone calls may be recorded and/or monitored.

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