Personal liability pitfalls for directors

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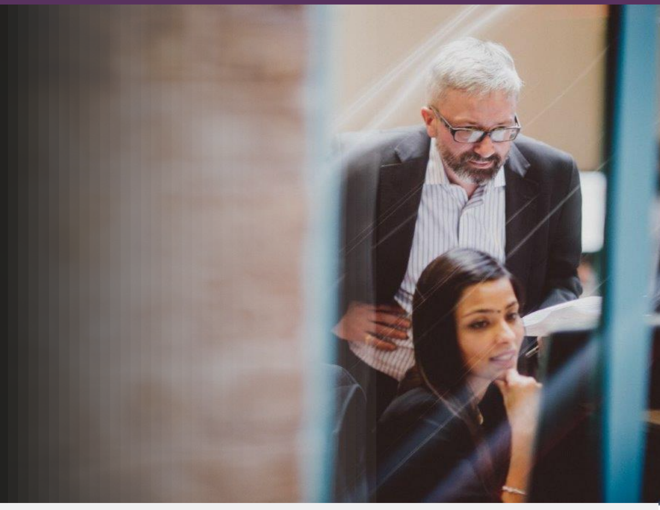

A recent Supreme Court judgment in Lifestyle Equities CV and another v Ahmed and another serves as a critical reminder that company directors are not insulated from personal liability for torts (wrongs) committed by their companies.

Directors can be held personally accountable, even when acting in their official capacity, a fact that underlines the serious risks involved in their role. While some points raised by the court were obiter (non-binding), the case sheds light on several key legal pitfalls that directors must be mindful of to avoid personal exposure.

What is tort law?

Tort law governs civil lawsuits that arise outside of contractual disputes. Its primary purpose is to address harm caused by wrongful actions, offering relief to the injured party, usually in the form of monetary compensation. For directors, tort law represents a potential personal liability that can have serious financial and reputational consequences.

Key pitfalls and risks for directors

The ruling highlighted several crucial points that directors need to consider:

1. Personal liability when acting for a company

Directors may mistakenly believe that their position within a company shields them from personal liability. However, the Supreme Court rejected the idea that acting in good faith to promote the success of the company (as required by section 172(1) of the Companies Act 2006) is necessarily sufficient to protect them from liability for torts.

Lord Leggatt, delivering the judgment, made it clear that "*the fact a company is regarded as a separate person does not… justify treating a director whose act is attributed to the company as free from personal liability for that act*." In other words, directors cannot hide behind the corporate veil; they can be held personally responsible for wrongful acts committed by the company under their direction.

2. Directors as accessories to corporate wrongs

Another pitfall involves being held liable as an accessory to a tort committed by the company. The court ruled that directors can be personally liable if they have specific knowledge of the wrongful act, even if they are not directly responsible for it. In cases of strict liability torts (where knowledge of wrongdoing is not required for the primary tortfeasor), a director could still be held accountable if it can be shown that they were aware of the tort being committed. Acting without knowledge or in good faith may provide some protection, but directors cannot rely on this alone.

3. Directors' salaries could be at risk

In addressing how profits should be accounted for where the company has been guilty of a tort, the court provided some clarification, but also a potential area of vulnerability for directors: the court determined that while only the profits of the primary tortfeasor (the person committing the tort) should be accounted for, a director's salary could be considered profit if it can be shown that the salary is directly tied to the tort.

Although this is difficult to prove, the ruling sends a strong message: under the right circumstances, directors could be forced to account for part of their salary if it results from wrongful acts. This risk underscores the need for directors to exercise caution in their decision-making to avoid personal financial exposure.

Lessons for directors

Directors should not assume that they are protected simply because they act in good faith or within their corporate duties. The Supreme Court has made it clear that directors can be held personally liable for torts committed by the companies they represent. Failure to act prudently or ignorance of wrongful acts could leave them exposed to significant legal and financial consequences.

To minimise these risks, directors should:

- **Immediately cease any conduct that could constitute a tort** as soon as they become aware of it.
- **Seek legal advice** whenever there is uncertainty about whether their actions may lead to liability.
- **Closely monitor company activities**, ensuring that any questionable actions are addressed swiftly and effectively to prevent liability.

The importance of legal guidance

This judgment highlights the complex responsibilities directors face in their role. It is essential for directors to be proactive in seeking expert legal advice to fully understand their liabilities and to avoid personal exposure to tort claims. Having a clear understanding of the law will help directors navigate their duties more confidently and mitigate risks.

If you are a director and would like advice about your personal liability, contact our corporate and commercial team at RIAA Barker Gillette for expert legal guidance tailored to safeguard you and your business from potential tort-related risks.

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Note: This article is not legal advice; it provides information of general interest about current legal issues.