https://www.rpclegal.com/thinking/insurance-and-reinsurance/ml-covered-september-2024/

ML Covered - September 2024

11 September 2024

Welcome to the second edition of ML Covered, our new monthly round-up of key events that are relevant for those dealing with Management Liability Policies covering D&O, EPL and PTL-type risks.

Latest insolvencies figures & quantifying "trading misfeasance" claims

The Insolvency Service's most recent **report** reveals that company insolvencies remain high, with there being 16% more insolvencies than in July 2023 – albeit, they are down 7% from June 2024. The position is also similar for individual insolvencies, which are recorded to be up 24% compared to June 2023.

Of particular note is the increase in the number of compulsory liquidations. The data shows that in July 2024, there were 320 compulsory liquidations, with that figure being the highest it has been since before the pandemic.

A compulsory liquidation is often an indication that there has been a "stressed" insolvency and where a business finds itself within this territory, there is often a greater risk to directors. The point at which a business is destined for insolvency is often not clear cut, but the period prior to when a business is placed into compulsory liquidation can give rise to situations where a business should, for example, have ceased trading to protect the interests of creditors, as opposed to trying to keep the business afloat through continued trading (which can, for example, lead to allegations of wrongful trading). To understand more about directors' duties prior to and during the insolvency process, we suggest reading **our blog** which considers the Supreme Court decision in *BTI 2014 LLC v Sequana SA*.

This month we have also seen the Court consider for the first time how to quantify a claim for "trading misfeasance" which can occur when D&Os continue to run a company when their company is insolvent or bordering on insolvency. In *Wright v Chappell*, two former directors of BHS were held liable for over £100m as the Court applied causation on a joint and several basis against the directors. It is also worth noting that the Judge in a prior ruling in this case was not prepared to take into consideration the D&Os' limited level of D&O cover to reduce the amount that was awarded against them.

The recent decision in the longstanding BHS litigation is an arguably extreme example with the Court holding there had been a "disastrous stewardship" of the company. However, the Court's approach of applying causation on a joint and several basis for "trading misfeasance" claims highlights the need for D&Os to pay close attention to decisions being made when a company is in financial difficulties.

For further detail on *Wright v Chappell*, please read our blog **here.**

Director disqualifications – what may lead to them and current trends

Being a director of a company comes with legal responsibilities and if directors fail to fulfil those responsibilities, they may face the prospect of being disqualified under the Company Directors Disqualification Act 1986 (the **Act**).

Grounds for disqualification

The Act sets out broadly three different categories of conduct which, if a director falls foul of, may, or in some instances must, result in the Court making an order to disqualify them from being involved in the management of companies. Those categories are:

1. General misconduct in connection with companies

   Broadly, general misconduct would include a conviction in relation to the promotion, formation, management, or liquidation of a company, or with the receivership or management of a company's property. It would also include persistent breaches of company legislation, as well as various fraudulent offences.

2. Disqualification for unfitness

A director's conduct may be deemed unfit for a variety of different reasons including:

- Continuing to trade when a company is unable to pay debts or when it is insolvent
- Failing to keep proper accounting records
- Failing to pay tax liabilities
- Failing to file statutory accounts and returns at Companies House
- Fraudulent activity

The recent case of *Secretary of State for Business and Trade v Low* [2024] demonstrates the type of behaviour which may see a director disqualified for unfitness. In this case, the director turned a blind eye to whether missing trader intra-community (**MTIC**) fraud was taking place in the company's wholesale trading. The Court found that as a director, he was responsible for all of the company's business and finances, and his willingness to be a "front" enabled the company to participate in transactions connected with MTIC fraud and make wrongful claims for VAT. On that basis, the Court concluded that the director's conduct fell below the standards of probity and competence appropriate for persons fit to be directors of companies.

3. Other cases for disqualification

   The Act also sets out other instances whereby if a director is found to have acted in a way contrary to the requirements of the Act, they risk disqualification. These include participating in wrongful trading, occupying a position as a director whilst bankrupt and failing to pay under a county court administration order.

Where the Court concludes that disqualification of a director is appropriate, this can be for a period of up to 15 years, whilst the Court may also in more serious cases impose a prison sentence.

Current trends

Recent data released by the Insolvency Service shows there has been an increase in director disqualifications over the last 6 months. For the first 6 months of the 2023/24 period, there were 577 disqualifications and for the last 6 months there were 645. The data also shows that over the past 6 months, there have been an increasing number of directors being disqualified due to reasons relating to COVID-19 financial support scheme abuse allegations.

As we move further away from the pandemic, more COVID-19 fraud investigations may be reaching a conclusion. This, along with Labour's manifesto pledge to appoint a "Covid Corruption Commissioner", whose focus will include recoupment of fraudulent loans, may lead to a further increase in the number of directors being investigated for reasons associated with COVID-19 financial support which may result in further notifications to Insurers

Labour's New Deal: What does this mean for UK employers?

As we previously made you aware in our **July 2024 Edition** of ML Covered, the King's Speech confirmed that Labour proposes to make extensive reforms to UK employment law, including a new Employment Rights Bill. As part of **Labour's Plan to Make Work Pay: Delivering a New Deal for Working People** (**Labour's New Deal**), published in May this year, Labour proposes to "adapt and build" on the current legislation, which will provide strengthened protections and greater flexibility for UK employees. In this edition of ML Covered we highlight a few of the most significant proposed changes.

Flexible Working

In April this year, new legislative changes were implemented by the **Employment Rights (Flexible Working) Act 2023** (**the Act**). The Act allows employees more flexibility over when and where they work. The key updates implemented by the Act are summarised in the table below:

	Previous position	**Position from 6 April 2024**
Qualification for right	26 weeks' continuous service.	No period of qualifying service required. An employee can request from the first day of their employment.
Frequency	One request per year allowed.	Two requests per year allowed.
Content of request	Employees must explainthe effects of their flexible working request on their employer.	No requirement to explainthe effect of the flexible working request on their employer.
Rejecting a request	No requirement to consult.	Employers must consult with an employee first, which will involve aformal meeting with the employee to discuss the request and explore available options.

Time to respond to requests	Three months.	Two months.

Whilst the Act has been a welcome change for employees, by allowing greater scope to request flexible working, Labour's latest proposals are likely to see even greater possibilities when it comes to flexible working for employees.

Employees can currently *request* flexible working from day one; however, Labour's proposed legislation could see flexible working become an immediate day one right if arrangements are "reasonably feasible". This would strengthen flexible working arrangements and could potentially replace the eight business reasons which an employer can currently use to reject a flexible working request, with more employee-friendly terms. Employers would be expected to accommodate flexible working patterns "as far as is reasonable”.

It is essential for employers to have a flexible working policy in place which explains how to make a request and what needs to be included in a request and they should ensure correct procedures are followed in relation to flexible working requests. Failure to do so may result in employees bringing Employment Tribunal claims, resulting in financial penalties for the employer and its insurer and reputational issues for the employer. With more employees entitled to request flexible working and a shift to a much higher burden on employers needing to accommodate these, an increase in these types of claims is sure to follow.

Unfair Dismissal

As well as increased flexibility when it comes to when and where employees can work, another one of the most impactful changes proposed in Labour’s New Deal is making protection against unfair dismissal a day one right. Under current law, employees are typically entitled to unfair dismissal protection only after two years of continuous service, with a few exceptions. Labour’s plan does acknowledge the role of probation periods in evaluating new hires, but it remains unclear as to how these will be regulated. For instance, will there be a cap on the length of probation periods to prevent employers from bypassing these new protections? In any event, making unfair dismissal protections a day one right highlights a huge shift towards more employee-friendly legislation, and could see the volume of Employment Tribunal claims for unfair dismissal skyrocket. Moreover, employers will have to be more cautious about the way they dismiss employees to mitigate against unfair dismissal claims being pursued.

Employment Status

Employment status is also a hot topic amongst Labour's proposals. In the UK, currently there are three categories of employment status: "employee", "worker" and "self-employed", each with differing obligations and rights. The Employment Rights Bill proposes to combine employee and worker into one category and then have those who are genuinely self-employed in a separate category. This means those currently considered to have worker status are likely to receive the same rights as those with employee status, including unfair dismissal rights from day one, as mentioned above. This is an important proposal to be aware of as it will mean any distinction between an employee versus a worker falls away and with that a higher number of a Policyholder's workforce are likely to qualify as an "employee". Again, increased rights and protections for employees may lead to an increase in the number of Employment Tribunal claims, and employers who currently engage workers will need to ensure they are prepared to reevaluate their current practices and procedures.

Government Details Scope for 'Phase One' of Pensions Review

On 16 August 2024, the Government published the terms of reference for the Pensions Review (launched on 20 July 2024), which set out the scope of 'Phase One'. The Pensions Review is intended to "*boost investment, increase pension pots and tackle waste in the pensions system*".

Phase One will focus on developing policy in four areas:

1. Driving scale and consolidation of defined contribution workplace schemes;
2. Tackling fragmentation and inefficiency in the Local Government Pensions Scheme (**LGPS**) through consolidation and improved governance;
3. The structure of the pensions ecosystem and achieving a greater focus on value to deliver better outcomes for future pensioners, rather than cost; and
4. Encouraging further pension investment into UK assets to boost growth across the country.

As it stands, there is little detail as to who will be responsible for ensuring value/returns for members. Is there going to be more of a focus on pension trustees and/or on the investment adviser/fiduciary management market? What if the government sets targets for investment in say UK investments that do not then perform – where does the buck fall? The risk to PTL is if the buck stops with trustees in terms of which funds they pick. We await further detail of the Pensions Review for answers to these questions and many more.

The Government has confirmed that the second phase will start later this year with a focus on considering what further steps are necessary to "*improve pension outcomes and increase investment in UK markets, including assessing retirement adequacy*".

To read RPC's blog on Phase One, please click **here**.

TPR's new funding code to apply from 22 September

The Pensions Regulator's (**TPR**) final draft defined benefit (**DB**) funding code was laid in parliament on 29 July 2024. This replaces the existing DB funding code (introduced in 2014) and sets out the regulator's view of best practice for trustees required to comply with the legislative requirements set out in The Occupational Pension Schemes (Funding and Investment Strategy and Amendment) Regulations 2024 (the **Regulations**). The funding code will take effect from 22 September 2024 and apply to DB schemes whose actuarial valuations have an effective date on or after that date.

Broadly, the Regulations require trustees to:

- Determine a funding and investment strategy, setting out how they intend the scheme to provide benefits over the long term; and
- Record the funding and investment strategy in a statement of strategy.

TPR has said that the new funding code is designed to encourage good long-term planning and risk management behaviours, and provide guidance to trustees as to how they can implement funding strategies with support from the sponsoring employers to ultimately enable maturing schemes to move to a point of "low dependency" on the employer.

As the funding code represents TPR's view on best practice, we expect it to be used to determine whether trustees have complied with their legal obligations under the Regulations, including by TPR when considering how to use its powers for non-compliance. The adoption of the new funding code is a potential risk for PTL insurers dependent on TPR's regulatory response – with a risk that TPR will up the ante on schemes (and with that their trustees and employers) if the period to full funding/deficit reduction is considered "too long" in TPR's eyes.

To read more, please click **here**.