THE COMPANIES ACT 1985 – THE AMENDED SECTION 310
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One of the bugbears for directors, officers and auditors (hereinafter collectively "officers") and their insurers has been the uncertainty of the full effects of Section 310, Companies Act 1985. This section, it will be recalled, first saw the light of day in the Companies Act 1929 and has remained unchanged through successive consolidations of company legislation. Its effect is to make void any provision (whether in the articles, a service contract *or otherwise)* which purports to: (a) limit or extinguish an officer's liability; (b) prospectively indemnify an officer against such liability, other than that "... incurred by him in defending any proceedings (whether civil or criminal) in which judgment is given in his favour or he is acquitted"; (Section 310(3)).

Although it has long been possible for the company to arrange Directors and Officers Liability Insurance ("D&O") to provide an indemnity to the officer himself (and to the company itself as a counter-indemnity against any indemnity it can and does provide within Section 310(3)), such arrangements have been commonly regarded as potentially void on the basis that the indemnity was provided by the company "or otherwise". Whilst similar insurance effected personally by an officer can be arguably outside the contemplation of the Act (as the company is not party to it), that exemption may be lost if the company indemnifies its officer for his personal insurance premium.

The true extent of the effects of Section 310 has never been tested by the courts, nor does there seem to have been much attention paid to the possible implications for other types of company-arranged insurance which might indemnify the officer against some loss attaching to him in relation to the company but not necessarily *qua* officer. Suffice it to say that D&O has been available in the UK for many years, and has worked perfectly well without any known attempt by an underwriter to hide behind Section 310 and declare the policy void, despite the gloomy warnings of many legal advisors who have positively discouraged client companies from effecting D&O and thereby providing all concerned with valuable insured protection.

However, in a move considered by many to be long overdue, the position has now been clarified (at least in its essential particulars) by a late inclusion in the provisions of the Companies Act 1989, which received the Royal Assent on 16th November, 1989. Section 137 thereof imports a new section 310(3) (a) into the 1985 Act which states that nothing within section 310 prevents a company "from purchasing or maintaining for any such officer or auditor insurance against such liability ...". The former provisions of Section 310(3) are preserved as Section 310(3) (b).

The 1989 amendments can be regarded as at least "legitimisation" of D&O by removal of nearly all doubt as to potential for avoidance. Indeed, the Act is being regarded as the next best thing to a Parliamentary recommendation to purchase D&O and, certainly, there has been a recent upsurge in enquiries for this type of cover. However, there are still a few warnings to heed:

(a) there is a requirement to refer to D&O in the company's directors report as (per paragraph 5A of Part 1 of Schedule 7, Companies Act 1985): "Where in the financial year the company has purchased or maintained such insurance as is mentioned in Section 310(3) (a) ...., that fact shall be stated in the report." No further details are required but an admission by the company that such cover is in force might be regarded by underwriters as unfortunate, in view of the possibility of attracting litigation;

(b) the amendment does not come into effect until a date to be announced (by Statutory Instrument) and will not be retrospective. However, as it is a clarifying amendment it seems unlikely that any court, with knowledge of Parliament's published intention, would still now declare insurance of the type contemplated to be void;

(c) insurance effected by a company against its own losses will invariably contain rights of subrogation for the benefit of the underwriter. If, however, those rights are excluded as against an officer whose act is the proximate cause of the company's loss, it is arguable that the company has thereby provided its officers with an exemption from liability, which remains void within Section 310(3) (b). The answer seems to be that the full rights of subrogation should be maintained and the officers' resultant potential liability separately insured;

(d) it is important that the company and its officers are named as co-insureds, when D&O cover is provided by a single policy with two sections. This will normally be the case; if not, an officer (not being a party to the contract) may be precluded from making an effective claim – always assuming that he knows that the cover exists at all; many do not! The problem is less apparent when cover is arranged on a "two policy" basis, particularly when each officer has a personalised copy of the Directors' and Officers' policy.

The inclusion of auditors in the reference to permissible insurance is interesting. Auditors do, of course, have significant exposure to an action by a client company and attempts to limit liability within the profession generally or in relation to specific clients have found little favour. The effecting of insurance by a company against the

wrongful acts of its own auditor gives more comfort to the former than to the latter. In the wake of *Caparo Industries plc* -v- *Dickman and Others* (1989), the liability of auditors to others may have been thrown into turmoil but it has certainly not gone away – nor will it be covered by the type of insurance discussed here.

Although this is not the proper forum for a detailed discussion of the various tax implications of D&O insurance, it is appropriate to consider a few key aspects which appear to be causing misunderstanding. The premium for a D&O policy (or pair of policies) is and always has been an allowable expense of the company for corporation tax purposes as it can be demonstrated to be laid out "wholly and exclusively" for the purposes of the trade; (Section 74(a), Income and Corporation Taxes Act 1988).

That relief is quite independent of any potential personal income tax liability falling on the officer, on the basis that he enjoys a "benefit" by virtue of insurance protecting him against personal liability. The premium (or that part of it) paid by the company on behalf of the officer is likely to be assessed to income tax in the hands of the officer. He cannot expect to claim as a corresponding deductible expense such a premium (paid by the company or by him personally) if he is employed and therefore taxed under Schedule E (PAYE) unless he can show that such insurance premium was incurred "wholly, exclusively and *necessarily* in the performance of those duties" attaching to his office or employment (*ibid.*, Section 198(1)), but he will rarely succeed in doing so. On the other hand, the less common self-employed officer assessed under Schedule D (e.g. the accountant, consultant or solicitor holding a directorship in a client company whose fees are paid into the practice) can usually obtain a deduction as he merely has to satisfy the "wholly and exclusively" rule.

The Companies Acts are not taxing statutes, nor has the amendment to the 1985 provisions made "legitimised" D&O a different animal in terms of its tax treatment. It will still be necessary, in the writer's view, to apportion the premium between the company and its various officers and it is unlikely that the latter will avoid personal taxation on a share of the premium. There is in reality no difference in the tax treatment of D&O premiums compared to those incurred in the provision of, say, medical expenses insurance to a company's officers. Both certainly benefit the company, at least indirectly, by safeguarding a valuable asset but both have the immediate effect of meeting an officer's personal liability.