Published on *The National Law Review* https://natlawreview.com

Does Failure to Prevent Sexual Harassment Lead to Directors Exposing Themselves? (UK)

Article By:

David Whincup

In the normal course, the question of whether there is any interplay between the new duty to take proactive steps to prevent sexual harassment on the one hand and section 172 Companies Act 2006 on the other would be a bit of a downer at your Christmas dinner. However, if you are a director then you may wish to lift your head from the turkey and pay attention, as the question is potentially a cracker.

The proactive duty we know all about, at least pending the promised further guidance on it. If the employer does not take those steps and there is an incident of harassment (whether or not any causal connection to your failure can be established) then the compensation awarded may be increased. The Equality and Human Rights Commission will have a separate right to challenge the employer on the steps it has or has not taken. This strictly applies even where there has been no incident or allegation of harassment, though sensibly EHRC is unlikely to spend much of its time shaking down companies for not taking reasonable steps to prevent harassment which hasn't happened.

But what is section 172 all about, and given that it has been around for years, why is it suddenly relevant now? It concerns the duties of a company director, and requires him to "*act in the way he considers in good faith would be most likely to promote the success of the company for the benefit of its members as a whole and in doing so, have regard (amongst other matters) to . . .*" a range of considerations expressly including "*the interests of the company's employees*". A failure to comply with that duty is deemed equivalent to a breach of fiduciary duty, and so not glad tidings for the director in any way.

As a relative latecomer to our dinner, section 414CZA (yes, really) demonstrates primarily that the Companies Act is running out of space for new law. Aside from that, it requires that relevant companies should include in their strategic reports a statement "*which describes how the directors have had regard to the matters set out in section 172 . . . when performing their duty*". In other words, the company will need to set out in writing for public consumption each year how its directors have had regard to the interests of the company's employees. If that report doesn't speak to the measures taken to prevent sexual harassment, the reader's assumption must be that there haven't been any. Hitherto that would only reflect a decision not to do something you could ideally do but don't have to, not great but hardly fatal, but now that omission from the report will indicate a failure to

do something you are legally obliged to do, which puts a rather different spin on things.

That takes us back to our opening question – if the directors have not taken sufficient proactive steps to prevent sexual harassment in line with the new obligations, can they say that they have complied with that obligation under section 172? And if they can't, does the deemed breach of fiduciary duties which arises as a result leave them exposed to the same sort of shareholder action as any other breach, including removal from office and/or a claim for damages against them personally? Are they now, like their turkey, stuffed?

In principle, yes — as director you could be personally exposed if your business does not comply with that proactive duty. In practice, not that we would ever encourage non-compliance, the would-be claimant shareholders face an almost insurmountable uphill struggle to impose personal liability. **In particular:-**

1. The duty to "*have regard to the interests of the company's employees*" in section 172 is subsidiary to consideration of the best interests of the business as a whole. There is nothing in that section which requires the absolute protection of employee interests. That duty would not be breached merely because some employees lose their jobs, for example, or are quite deliberately unlawfully or unfairly dismissed where the corporate priority is speed over cost – so it is not automatically a failure under section 172 to take action against one or more employees which infringes their legal rights or protections. NB also that the protection of employee interests is not limited to the prevention of sexual harassment – the provision of the minimum wage, proper holidays, equal pay, containable hours, a safe working environment, training, measures against bullying, *etc*., will also be found in that same stocking. As director, you could quite legitimately determine, say, that if the balance of your staff training budget has to go on something, it should be the safe handling of the deeply hazardous materials in your workplace rather than possibly but not necessarily avoiding the occasional smutty joke in your canteen.
2. The duty is quite expressly subject to the many competing priorities and pressures on directors – time, resources, corporate imperatives, PR, the relative gravity of risks, available expertise, short-term pain for longer-term gain, etc., let alone all the other "must have regard to" factors in section 172 (customer relations, impact on community and environment, business conduct, fairness between shareholders). Therefore we are very far from the position that a failure to take any particular measure to prevent sexual harassment necessarily puts a director in breach of section 172.
3. Relatedly, the obligation on the director is to act in good faith, to do his best to do the Right Thing, but in no sense necessarily to succeed. It will not be a breach of section 172 for directors to make decisions which actively harm the best interests of the company and its members and employees so long as that wasn't a reasonably obvious consequence at the time. Courts and Tribunals will be very reluctant to second-guess the judgment of a director at a time when they weren't there and can't know what was pulling his time and attention in different directions at that point. In any case, you do not prove lack of good faith just by establishing negligence, ignorance or incompetence with the benefit of hindsight.
4. While concerted action by shareholders can remove directors at almost any time with or without the help of section 172, a claim for damages requires them to have suffered some quantifiable loss. It must be extremely unlikely that the directors' failure to take proactive steps to prevent sexual harassment would cause any material or identifiable loss of value for shareholders. No individual harassment claim is likely to move the needle, even in the very unlikely circumstances where it could be shown as a fact that the claim would not have arisen had those proactive steps been taken. Action or enquiry by EHRC might lead to some

unattractive press coverage for a few days and possibly supplier/advertiser/employee boycotts in protest. However, even if that dinged the share price briefly, today's news wraps tomorrow's chips and so establishing long-term loss would be a Herculean task.

5. There is obviously no certainty that the taking of the anti-harassment measures required by the new rules will have any impact at all on whether harassment actually takes place or not. However, that is probably not your best defence as director – the necessary expectation of the lawmakers is that it will, and it can only reflect badly on your business to assert that your employees are such a collection of recidivist troglodytes that they would be impervious to such messages, hence no loss caused by your failure, so yah boo sucks to you, shareholders. Especially if it's true, obviously.

Therefore the principal issue here is not the enforcement of section 172 to make claims against individual directors – the burden of proof of their failure to have regard to employee interests is almost always going to be too high. Instead it is a question of what you will be able to say in your s414CZA report that you have done to protect the interests of employees. It is all very well noting that your reporting obligation in that respect would be satisfied by a glib statement that you had done little or nothing to that end (which is strictly true), but in an era of increased shareholder activism, harassment in the news and (in particular) the introduction of the mandatory pro-active obligation to take such steps, that just won't cut it with your stakeholders any longer.

The obvious hope behind the combination of the new duty and the Companies Act reporting obligation, as with the Modern Slavery Act and the gender pay gap rules, is that it will spark a sort of moral arms-race where each employer vies to say that it has done more to combat harassment than the next. You can get into that if you wish, but alternatively you can keep in mind that that new duty probably will not require much more on the anti-harassment front than most sensible companies already do. If you can refer to some recent high-quality training, engagement of senior management, enforcement where appropriate and the letting of some fresh light into the drawer in HR where Policies Go To Die, you will be well on the way to compliance all round. And then you can decide without legal distraction whether to end your dinner with dessert or save the calories and just go straight to the traditional searing indigestion.

National Law Review, Volumess XIII, Number 342