CICERO™

LEAGUE OF INTERNATIONAL LAWYERS

Corporate and Commercial Newsletter:

Director Duties

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HOLMAN WEBB – Australia

STRUCTURE OF COMPANIES UNDER AUSTRALIAN LAW

There are several types of companies in Australia; the most prevalent being public companies and private (proprietary) companies. Public companies are further divided into those that are listed and unlisted. There is a class of Not-For-Profit t companies which are treated as public companies limited by guarantee. No Liability companies are available for high-risk mining activities or oil exploration. Despite the various structures available, directors in each type of company carry the same fundamental obligations of good faith, trust and loyalty.

For public companies, there must be at least three directors (not counting alternate directors), and at least two of these directors must reside in Australia. In comparison, private (or proprietary) companies which are generally closely held, may have a single director, provided this director resides in Australia. There is no prescribed minimum number of shareholders, and there is no residence/domicile requirement for shareholder. A proprietary company may have no more than 50 members.

The minimum age for directorship is 18.

REGULATION

In Australia, companies are subject to oversight by numerous regulatory regimes, the most significant being:

a) the Australian Securities and Investments Commission, which oversees compliance with the Corporations Act 2001 and is responsible for financial market integrity, business conduct and disclosure, and consumer protection in the financial system;

b) the Australian Prudential Regulation Authority, which is responsible for prudential supervision of financial institutions and for promoting financial system stability in Australia;

c) the Australian Competition and Consumer Commission whose role is to enforce the Competition and Consumer Act 2010 and a range of additional legislation, promoting competition, fair trading and regulating national infrastructure; and,

d) the Australian Taxation Office.

Registered Charities are also subject to regulation by the Australian Charities and Not for Profits Commission.

POWERS

Companies have all the powers of a natural person as well as the special powers of a body corporate. A company has unlimited legal capacity to perform acts such as contracting with third parties and dealing with property. Companies are not obliged to have a detailed constitution, and may adopt what are known as the “Replaceable Rules”. Despite this, it is common for a company to have a constitution, and where this is the case, the Constitution may contain express restrictions on, or prohibitions of, the company's exercise of any of its powers. Therefore, even though the exercise of powers by a company is not necessarily restricted by the law, the obligation on directors to comply with the company’s constitution, and to act in the best interests of the company as a whole is not diminished.

RESPONSIBILITIES OF DIRECTORS

Australian corporate governance makes a distinction between the management role of the board of directors, and the function of executives who have day-to-day operational management of the company. The role of the board is more strategic, concerned with formulating policy. The board and the executive should understand the distinction. The Australian Stock Exchange Corporate Governance Committee’s governance principles and recommendations emphasise this important point.

Directors may exercise all the powers of the company except any powers that are required to be exercised in a general meeting. For example, unless the company’s constitution says otherwise, directors may, amongst other things, issue shares, borrow money and issue debentures on behalf of the company. Directors may also delegate any of their powers to committees, an individual director, an employee or any other person. Delegations must be properly recorded. Delegation to a committee does not diminish the responsibility of the board as a whole with regards to the delegated issue. In undertaking all company activities, it is the responsibility of the directors to ensure the company is complying with all general and specific laws that relate to its operation.

Outside of the Corporations Act 2001, directors must comply with the relevant legislation across a broad range of company activities in areas such as workplace health and safety, employment, the environment and competition and consumer laws.

DIRECTORS DUTIES

In exercising their powers, there are several important duties to which directors must adhere.

These duties, which arise out of the Corporations Act 2001, the common law (judge-made law), and a company’s own constitution, are predominantly designed to promote good governance and to ensure that directors consistently act in the best interests of their company.

For registered charities, the statutory duties of directors are contained in the Australian Charities and Not for Profits Regulations. These are similar, but not identical to the statutory duties contained in the Corporations Act. For this note, we concentrate on duties imposed by the common law and the Corporations Act 2001.

Australian law imposes fiduciary duties on directors. The Australian High Court has, essentially, described the fiduciary duties of a director as:

a) the duty to act in good faith;

b) the duty to exercise powers for proper purpose;

c) the duty to avoid conflicts of interest;

d) the duty to retain discretion.

In general, the Corporations Act 2001 reflects the common law position:

a) section 180 requires that directors exercise power with the degree of care and diligence that a reasonable person would exercise if they were in the same or similar position. This implies that directors must refrain from having a material personal interest in any judgment, remain informed and ensure they act in the best interest of the company;

b) section 181 requires that directors exercise duties in good faith and for a proper purpose;

c) section 182 requires that directors refrain from using their position as a director to gain an advantage for themselves or someone else, or to cause detriment to the corporation.

Directors may also rely on section 180(2), commonly referred to as the "business judgement rule". This rule outlines the presumption that when making a business decision directors:

a) have exercised care and diligence;

b) have made the judgement in good faith and for proper purpose;

c) have no material personal interest in the judgment; and

d) rationally believe that the judgement is in the best interests of the corporation.

Another less used but still potent defence for a director is in sections 1317 and 1318 of the Corporations Act 2001, which, in circumstances where the director has acted honestly, gives them the ability to obtain a declaration that despite a breach of their obligations as director they "ought reasonably to be excused".

INSOLVENT TRADING

One fundamental duty, not yet mentioned, is the duty directors have to prevent insolvent trading. In this regard, a director must ensure they adhere to several key principles:

a) Directors must keep informed about the financial affairs of their company. This means that directors must ensure their company complies with its financial record keeping obligations so that they can form a reasonable view about the company's financial viability and the impact of further debts.

b) Directors should take positive steps to confirm a company's financial position and realistically assess all options available in times of financial distress.

c) Directors must obtain appropriate advice from a suitably qualified, competent and reliable people about the company's financial position and how it can be addressed.

d) Directors must consider all advice and act appropriately and in a timely manner.

Where directors follow these key principles, they are more likely to be able to demonstrate that they have reasonably complied with their duties. Directors of companies in financial distress will be able to rely on these new "safe harbour" protections if they start developing one or more courses of action that are "reasonably likely" to lead to a better outcome for the company than the immediate appointment of an administrator or liquidator.

LIABILITY

There are potentially severe consequences for any breach of directors duties. Criminal sanctions can apply when certain key duties are breached, such as the duty to act in good faith. Such activity is punishable by a fine of up to $200,000 and/or up to five years imprisonment.

Breaches may also result in potential civil sanctions and the payment of substantial fines of up to $200,000. Directors may also be disqualified from their position if either the Australian Securities and Investments Commission or the courts believe that the director has failed to comply with their duties.

There are also circumstances where directors may be found personally liable for breaches of the law by the company itself. For example, directors may be liable if the company does not pay its tax liabilities or causes significant environmental damage. This is because the director may be deemed to have aided, abetted, counselled or procured the act or omission of the company, or had knowledge of the act or omission.

Directors can also be personally liable to compensate a company for any loss or damage it suffers as a result of a breach of their directors duty. For example, directors may be liable for debts incurred by the company if the director allows the company to trade when it has become insolvent.

SECTION 1322

Despite the above, directors should be comforted to know that the Court does hold broad powers under section 1322 of the Corporations Act 2001 to validate procedural and administrative errors as well as irregularities and mistakes of a general nature. A court will only exercise this power where it is satisfied that the action was procedural in nature, the director acted honestly, it is just and equitable that the order be made and no substantial injustice will result from the order.

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ARDENT ADVOCATEN – Belgium

1. Introduction

In this article, a brief and basic overview will be given of director's liability in public and private limited companies under Belgian law. The general rules concerning director's liability in Belgium are almost 150 years old. Apart from some rather small changes, Belgian company law has been relatively unchanged these last decades. Only very recent, a large reform of the Belgian Company Code has been announced, which will be implemented in the fall of 2018 at the earliest.

Although the rules concerning the director's liability remain, in comparison to the rest of the Belgian Company Code, largely unchanged, one significant change will be introduced soon: the concept of 'wrongful trading' (which was already integrated in the Belgian Economic Code and caselaw) will now be introduced in the Belgian Company Code. Continuing a company's activities without reasonable prospect of continuity may then lead to director's liability, be it limited to a certain amount.

2. General director's liability under Belgian law

In normal circumstances, shareholders cannot be held liable for the debts of their limited-liability company. Each company is a separate legal entity, and the shareholders' liability is in principle limited to their contribution to the company's share capital.

However, in certain circumstances, a director will be individually and in some cases even jointly and severally liable. In general, under Belgian law, directors may be held liable (i) for acts in breach of the statutory dispositions on mandate, (ii) for breach of the Belgian Company Code or of the Company's Articles, (iii) for tortious acts or, in rather rare occasions, (iv) for serious and indisputable misconduct leading to bankruptcy.

3. Specific director's liability under Belgian law

The Belgian Company Code contains a number of specific liability grounds on which directors can be held accountable. These can roughly be summarized as follows :

a. Liability for certain capital operations

The Belgian Company Code contains several specific director's liabilities concerning certain capital operations. Amongst others, directors can be held liable for the overvaluation of a quasi-contribution or contribution in kind, for the full part of the capital increase for which no valid contribution has been made.

b. Specific liabilities in case of bankruptcy

When in the course of a bankruptcy, it is established that a serious and indisputable fault was committed by the (former) directors, managers or other persons who have actual management authority in respect of the company's affairs, they can be can be personally and severally or jointly and severally liable for all or part of the debts of the company to the amount of the over-indebtedness.

Any form of serious tax fraud, organized or otherwise, will be considered to be serious and indisputable error. Proof however will have to be provided of this indisputable fault, the damage caused and the causal relation between fault and damage.

There is an exception to this aforementioned general principle of liability in case of bankruptcy regarding debts to the National Social Security Office, and with regard to debts concerning payroll taxes and VAT. There will be a presumption of a serious and indisputable fault - which means the burden of proof will lie on the directors - (i) when no payroll taxes have been paid for at least 2 quarterly periods during a one year period, or in case of monthly payment, for at least 3 months during a one year period, or (ii) when VAT hasn't been paid for 2 periods or 3 months during a one year period also depending on quarterly or monthly payments, or (iii) when in the five years prior to the declaration of bankruptcy these directors have been involved in at least 2 bankruptcies, liquidations or similar procedures with debts to a collection institution of social security contributions.

c. Liability concerning conflicts of interest

In case certain decisions or transactions as described in the Belgian Company Code were made or took place which provided an unlawful financial advantage to certain directors or the entire directors' board to the detriment of the company, the directors will be liable for the damage suffered by the company or third parties as a result thereof.

d. Liability concerning formal requirements

Directors are also liable (i) for obligations entered into by their company when the documents issued by the company do not meet the statutory requirements and (ii) for the non or late submission of the annual accounts.

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MICHAEL DAMIANOS & CO LLC – Cyprus

DIRECTORS' DUTIES UNDER CYPRUS LAW

Cyprus law follows the principles of common law in relation to the duties imposed on directors of a company. In addition to common law principles, the Companies Law, Cap. 113 (the "Law") imposes certain specific duties on directors, along with other relevant legislation, such as the Assessment and Collection of Taxes Law of 1978.

A. <u>Categories of directors' duties</u>

Directors' duties are categorized as follows:

1. <u>Fiduciary duties</u>

Directors owe fiduciary duties to the company, similar to those owed by an agent to his principal.

Directors of a Cypriot company have a duty to exercise the powers conferred upon them in good faith in what they consider are the best interests of the company, which, in general, are the long-term interests of a company's shareholders, both present and future.

A fiduciary duty, therefore, imposes on a director a largely negative obligation to do nothing which conflicts with the company's interest and aims to ensure that a director acts within the powers conferred on him by the relevant legislation and by the company's memorandum and articles of association. In practice a company's memorandum and articles of association prescribe the realm of directors' powers. A director who acts ultra vires the company's bylaws is accordingly responsible for his conduct to the company and to third parties.

A director should also avoid any conflicts between his personal interests and those of the company.

2. <u>Duty of care and skill</u>

As far as the duty of care and skill is concerned, we note that such imposes a positive duty on a director, when acting in the company's interests to exercise whatever skill he possesses and reasonable care.

3. <u>Statutory duties</u>

Apart from the directors' common law duties, the Law and other relevant legislation also impose certain specific duties on companies' directors.

The key statutory duties of directors, under various legislations, are the following:

a. Duty to disclose their personal interest in a contract or proposed contract with the company;

b. Duty to keep proper books of accounts;

c. Duty to submit the Income Tax Returns and proceed with the assessment and submission of taxes imposed on the company;

d. Duty to arrange for the preparation of the company's financial statements in accordance with the International Accounting Standards; and

e. Duty to prepare and file the company's annual return to the Cyprus Companies Registry.

B. <u>Directors' duties if the company is insolvent</u>

As mentioned above, a director is under a duty to act in the best interests of the company, i.e. its shareholders, whilst the company is solvent. However, once the director forms the view that there is insolvency, or the company is close to insolvency, there is a shift in the directors' duties in that the director will need to act primarily (but not solely) in the best interests of the creditors of the company, as a whole and not to an individual creditor or section of creditors.

The most common acts for which a director may be held personally liable or which may otherwise have adverse consequences for him following any insolvency of the company are the following:

1. <u>Misfeasance and breach of duty</u>

Where a director is found to have misapplied or retained, or become accountable for, any money or assets of the company, or where a director has breached a fiduciary duty owed to the company, the court may order such director to repay or restore the money or property with interest, or contribute such sum to the company's assets by way of compensation, as the court thinks is fair.

For example, transactions entered into at undervalue or payments made to a creditor of a company in preference to another may give rise to a claim against a director based on misfeasance or breach of duty.

2. <u>Fraudulent trading</u>

If, in the course of a winding up of a company, the company's business has been carried out with an intent to defraud the company's creditors or other persons for any fraudulent purpose, the court may declare that any persons (including the directors) who were knowingly involved in the carrying out of the company's business, are held personally liable for all or any debts or obligations of the company as the court may order.

C. <u>Liability</u>

Breach of a common law duty, i.e. breach of a fiduciary duty and of the duty of skill and care, will render a director personally liable to the company in damages. It should be noted that the liability is to the company, not to individual shareholders. It is, therefore, for the company (or its liquidator if the company is insolvent) to take the necessary action. However, an exception to this is the possibility for a minority shareholder to bring a derivative action against a director who is in breach of his duties in certain circumstances.

Breach of a statutory duty may result in criminal, civil or administrative liability or all the above, depending on the breach.

In order to avoid directors hiding with impunity behind the veil of their companies' limited liability it has been the practice to include in various statutes provisions by which directors and other officers of a limited liability company are subject to criminal liability. For example, Cyprus VAT legislation provides that if a criminal offense is committed by a legal person, the liability for such an offense (both criminal and civil) lies with the legal person's directors.

Apart from the imposition of civil/criminal liability, a director may also be disqualified from being a company director on the basis of the same conduct. Where a person is convicted of any offense in connection with the promotion, formation or management of a company, or, in the course of winding up, appears to have been guilty of fraudulent trading or any other type of fraud in relation to the company or other breach of duty to the company, the court may make an order that such person shall not, without the leave of the court, be a director of or in any way, directly or indirectly, be concerned or take part in the management of a company for a period not exceeding five years.

D. Relief from liability

The Law provides that it is not possible to grant a general exemption in advance to directors in respect of liability to the company. Any provision in any contract or in the articles of association of a company, which attempts to exempt a director or indemnify a director who has been in breach of his common law duties of has been negligent or omitted to act as per the relevant legislation, is void.

This section does not prevent the company's shareholders from ratifying the directors' actions, where this is provided by the relevant legislation. Where a director is sued for breach of any of his duties, he can apply for relief from the court, that he has acted honestly and reasonably.

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HOFFMANNOVA KORANDA – Czech Republic

General Summary of Certain Director's Liabilities in Czech Republic

1. <u>General Duties</u>

Board Members (the Executives in a limited liability companies and the board members in the joint stock companies) are generally obliged to act with due care of a prudent businessman and consider the interests of the Company as well as remain loyal to the Company.

If a situation arises which goes beyond the professional competence and skills of a Board Member, the Board Member shall be able to identify such a situation and seek professional advice (for instance from a professional accountant, lawyer or tax advisor). However, this does not relieve the Board Member from the responsibility towards the Company for the final decision.

Directors should convene the General Meeting as soon as the Managing Director realizes the possibility of pending insolvency, i.e. as soon it is justified to assume that the Company will be unable to duly and timely satisfy its financial obligations or that the Company will become over-indebted.

In case of Joint-Stock Company the General Meeting should be convened without undue delay when Board Members ascertain that the total loss of the Company as shown in the financial statements reached such a level that, if covered from the Company's available resources, the outstanding accumulated loss would or, in view of the circumstances, could be expected to amount to half of the registered capital, or when the Board has established that the Company is insolvent, in which case it shall recommend to the General Meeting winding up the Company or adopting another measure.

The directors shall file an insolvency petition on behalf of the Company without undue delay when they find out or, had they exercised due care, should have found out that the Company is insolvent. Should they not adhere to this statutory duty, each of them may be held personally liable.

Moreover, directors may not resign from their positions at a time inappropriate for the Company. Whether an insolvency scenario is an inappropriate time shall be assessed on a case-to- case basis.

Directors shall always put the interests of the Company first, even if that may be in contradiction to their own interests or the interests of the shareholders. However, this does not apply in case of bankruptcy of the Company, because during insolvency proceedings, the interests of creditors shall always be prioritized.

2. Liability of the Directors

Generally, directors bear no liability for the obligations of the Company. However, in certain cases there can be personal liability for directors.

Following a petition made by the insolvency administrator or a creditor of the Company, the Court may decide that a director or even a former director is liable for the debts of the insolvent company, provided that the director knew or should have known that the Company is on the verge of insolvency and did not take appropriate steps in order to prevent it. This does not apply to directors appointed to their positions for the purpose of averting the insolvency ("crisis managers") who performed their responsibilities with due care.

Should a director cause damage to the Company and fail to compensate the Company for the damage when obliged to do so, the director should be secondarily liable for any debts of the Company up to the amount of the damage caused to the Company.

3. Potential Claims against Directors

The Company may claim compensation for any damage caused to it by its director due to breach of their duty of due care. Should the Company fail to raise such an action, it may be raised by the supervisory board or by a shareholder.

Another action may be raised by a Company's creditor if the damage occurred in relation to the director's failure to file an insolvency petition.

Further, in creditor-initiated insolvency proceedings, directors may be ordered by the insolvency administrator to return the consideration they received from the Company under their managerial contracts as well as any other consideration received from the Company in the two years before insolvency was declared by a final decision of the Court or to pay compensation into the Company's insolvency estate provided that they knew that the Company may be insolvent and failed to take sufficient measures in order to prevent insolvency.

Finally, a director may be held liable for the debts of the insolvent company provided that the director knew or should have known that the Company is on the verge of insolvency and did not take appropriate steps in order to prevent it.

4. Criminal Liability

Directors can be liable for under the Czech Criminal Code especially for Fraud, Tax evasion, Hindering a creditor, Preference actions, Inducing insolvency, Misrepresentation of Economic Results and Assets.

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KELLER – Denmark

MANAGEMENT DUTIES IN LIMITED LIABILITY COMPANIES UNDER DANISH LAW

Corporate management under Danish law can be structured as either a one-tier or two-tier system. It is mandatory for public limited companies to have a supervisory board consisting of at least 3 members (elected by the shareholders and in certain cases partly by the company's employees), and one or more executive directors (appointed by the supervisory board).

Private limited companies have the option of forgoing the election of a supervisory board, and may be managed by a single executive director. However, if the shareholders of a private limited company decide to elect a supervisory board, there is no requirement for the minimum amount of board members.

There is a rarely used additional option which is to have an independent supervisory board whose only role is to supervise the board of directors, which takes care of strategy and day-to-day operations. I will not refer to this option in the following as it is hardly used.

In companies with a two-tier management structure, a rough division of responsibilities among the supervisory board and the executive director(s) is established by the Danish Companies Act.

DISTRIBUTION OF RESPONSIBILITIES

The Danish Companies Act indicates through a number of provisions that the primary purpose and responsibility of the company's management is to ensure that the company's finances are handled in a sound manner. In the past, a number of transactions required a valuation report from an authorized auditor, but legislative reforms in the past decade have opened up for the possibility of forgoing these requirements in a number of events by having the company's management attest that the transaction is not detrimental to the company or its shareholders or creditors.

As for the distribution of duties between different tiers of management, the relevant provisions in the Danish Companies Act state that the supervisory board's responsibilities and duties include ensuring that the company's bookkeeping and financial reporting is conducted in a satisfactory manner, that necessary procedures for risk management and internal controls are established and that the company has the necessary capital to meet its present and future financial obligations.

The supervisory board is also responsible for ensuring compliance with legislation enacted in recent years regarding public ownership registration, and the supervisory board must establish rules of procedure for the board's own management of the company.

The role of executive directors in two-tier companies is focused on the day-to-day operations of the company, which excludes transactions or measures which are unusual for the company or otherwise of great importance.

However, seeing as executive directors in companies without a supervisory board assume all of the abovementioned duties, a great deal of Danish case law concerning the duties, responsibilities and liability of executive directors and supervisory board members overlap - at least in terms of general considerations regarding liability.

INTERNAL AND EXTERNAL DUTIES

While a company's management is ultimately appointed or elected by the shareholders of the company, the management must exhibit primary loyalty to the company rather than to the shareholders. Executive directors and supervisory boards are effectively able to - and have a duty to - veto dividend payments which might compromise the company's ability to meet its financial obligations, or which might compromise its financial status in general.

This constitutes a duty to safeguard the interests of the company against the interests of third parties - in this case the shareholders, which could be characterized as an internal duty/obligation.

However, the management is also obligated to safeguard the interests of third parties to a certain extent - this includes the company's creditors, shareholders and employees – what might be characterized as an external duty/obligation. An example of this would be the obligation to ensure that the company's creditors do not suffer unnecessary losses, or the obligation to ensure that the company's creditors are treated equally.

LIABILITY

A significant factor in assessing whether or not a breach of duty by a company's management entails liability is the Danish variation of the business judgement rule, which is also widely used in a number of common law jurisdictions (Denmark's legal system is based on civil law).

According to this standard, members of management are held up against an "ordinary and reasonable person", albeit one who possesses the requisite professional knowledge (pertaining to the company's area of business). This second aspect – the assumption that the person is professionally qualified to complete the task they have undertaken, whether or not they actually are qualified – is related to the general rule of liability assessment for professionals under Danish law. Persons acting as professionals - such as lawyers, auditors and engineers – are held to a higher standard as a consequence of their presumed expertise when acting in the capacity of their profession, which also applies to executive directors and board members.

One might presume that this professional liability standard would entail management decisions leading up to a bankruptcy being put under a great deal of scrutiny, but case law indicates that the management is entitled to fight for the company's survival nearly "to the bitter end", or at least for as long as serious negotiations are ongoing. Civil claims based on management's liability are rarely decided in the plaintiff's favor, which is indicative of the lenient standard to which executive directors and board members are generally held under Danish law.

THE IMPACT OF ABSENCE ON DUTIES AND LIABILITY

Regardless of Danish case law being lenient in its assessment of liability when it comes to breach of duty by an executive director or board member, it is stricter in certain areas.

A member of management who is absent during the adoption of a resolution or a policy which will ultimately cause the company or a third party to suffer losses, would not be responsible under traditional rules regarding liability for damages under Danish law due to the absence of causality but may be liable under Danish company law if his presence is needed to avoid losses.

So, this general rule is modified when it comes to executive directors and board members.

First of all, management is expected to stay informed with regard to the company's future plans and any planned resolutions which might entail losses for the company or third parties - even if they are unable to attend the deciding meeting in question, they are expected to know of and seek to prevent such measures, and for the same reason, they may become liable if they decide to leave the company immediately prior to such measures being enacted.

Furthermore, failure to safeguard relevant interests by abstaining from a critical vote or leaving the company before the vote is held may in itself constitute a breach of duty. Generally, a passive protest against a potentially damaging resolution is insufficient to relieve an executive director or board member of liability - they must actively seek to prevent its adoption.

So in short, Denmark has a two-tier system as the main rule, to be applied in all public companies and to be applied at wish in private companies, and directors in Danish companies have a general duty of care and diligence and a long list of specific duties depending on which tier in management they are a part of.

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MUNDAYS – England

GENERAL DUTIES OF DIRECTORS IN THE UNITED KINGDOM

The Companies Act 2016 (the "**Act**") codified certain common law and equitable duties of directors in the United Kingdom. In summary, the seven general duties under the Act are:

1. To act within powers.

A director of a company must:

- act in accordance with the company's constitution; and
- only exercise powers for the purposes for which they are conferred.

2. To promote the success of the company.

A director must act in the way they consider, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole. In so doing, the director must have regard (among other matters) for:

- the likely consequences of any decision in the long term;
- the interests of the company's employees;
- the need to foster the company's business relationships with suppliers, customers and others;
- the impact of the company's operations on the community and the environment;
- the desirability of the company maintaining a reputation for high standards of business conduct; and
- the need to act fairly as between the members of the company.

Where the company's purposes consist of or include purposes other than for the benefit of its members, the director must act in the way they consider, in good faith, would be most likely to achieve those purposes. Companies are therefore free to adopt other purposes in their constitutions.

3. To exercise independent judgment.

Directors must exercise their powers independently, without subordinating their powers to the will of others, whether by delegation or otherwise (unless authorised by or under the constitution to do so).

A director must exercise independent judgment. For example, a director could not agree with a third person (such as his or her appointing shareholder) to vote at board meetings in any particular way, even if voting in that way would not otherwise have breached his or her duties to the company.

The government has said that this duty will not prevent directors relying on advice, as long as the directors exercise their own judgment in deciding whether or not to follow the advice.

4. To exercise reasonable care, skill and diligence.

A director must exercise the care, skill and diligence which would be exercised by a reasonably diligent person with both:

- the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company (the objective test); and
- the general knowledge, skill and experience that the director actually has (the subjective test).

So, at a minimum, a director must display the knowledge, skill and experience set out in the objective test, but where a director has specialist knowledge, the higher subjective standard must be met. In applying the test regard must be had to the functions of the particular director, including their specific responsibilities and the circumstances of the company.

It follows that a person should not take on a directorship unless they are sufficiently qualified or experienced to be able to fulfil the functions that they might reasonably be expected to carry out. A particularly highly qualified or experienced director will be obliged to exercise a high level of skill and expertise.

A director will also be required to exercise their duties diligently, keep themselves informed about the company's affairs and join with their co-directors in supervising and controlling them. This will not prevent a director from relying on the experience and expertise of their colleagues or, generally, prevent sensible delegation or division of tasks, provided that the director does not attempt to abrogate all responsibility.

5. To avoid conflicts of interest.

A director must avoid situations in which they have or can have a direct or indirect interest that conflicts with, or may conflict with, the company's interests. That applies, in particular, to the exploitation of property, information or opportunity, and whether or not the company could take advantage of the property, information or opportunity. The test of whether there is a breach of the duty is objective, and does not depend on whether the director is aware that what they are doing is a breach of their duty.

6. Not to accept benefits from third parties.

Directors must not accept any benefit (including a bribe) from a third party which is conferred because of his or her being a director or doing or not doing anything as a director. “Benefit” is not defined. The government stated, during the parliamentary debates, that it intended the ordinary dictionary meaning of the word, and noted that the Oxford English Dictionary defined it as a favourable or helpful factor, circumstance, advantage or profit.

The duty will not be infringed if the acceptance of the benefit cannot reasonably be regarded as likely to give rise to a conflict of interest. Benefits conferred by the company, its holding company or subsidiaries, and benefits received from a person who provides the director’s services to the company, are excluded.

7. To declare an interest in a proposed transaction or arrangement.

Directors must declare to the other directors the nature and extent of any interest, direct or indirect, in a proposed transaction or arrangement with the company. The director need not be a party to the transaction for the duty to apply. An interest of another person in a contract with the company may require the director to make a disclosure under this duty, if the other person’s interest amounts to a direct or indirect interest on the part of the director. It would therefore be prudent for directors to do some due diligence into the interests of their connected persons.

The declaration must be made before the company enters into the transaction or arrangement.

The declaration may be made at a meeting of the directors, or by notice in writing.

This note only covers duties owed by a director, in their capacity as director, to the company under Chapter 2, Part 10 of the Act. Directors will have many other duties, both under the Act, such as the duty to deliver accounts, and under a wide variety of other laws and regulations, such as insolvency and health and safety legislation. Executive directors may also owe employee duties to the company.

Types of director

There are several types of directorship:

- **Executive director.** A director who carries out executive functions in the company and is usually a full or part-time employee of the company.
- **Non-executive director.** A director who is not an employee of the company or holder of an executive office. Such a director would usually devote part of their time to the affairs of the company as an independent adviser or supervisor.
- **De jure director.** A person validly appointed as a director.
- **De facto director.** A person who acts as if they are a director and is treated as such by the

board but has not been validly appointed.

Who are the duties owed by?

The general duties apply to all the directors of a company. "Director" is defined to include any person occupying the position of director, by whatever name called, which includes de facto directors and in some cases, shadow directors.

The Act makes no distinction between executive and non-executive directors.

Duties owed to the company

The duties are owed to the company. Only the company will be able to enforce them. Directors do not, by virtue of the office of director, owe fiduciary duties to the company's shareholders or creditors, although in certain circumstances shareholders may be able to bring a derivative action on the company's behalf.

Duration

In general, a director's duties to the company will start when they became a director, but after resignation, they will not continue to owe the general duties to the company.

Consequences of breach

Action by the company

As the codified duties are owed to the company then only the company will be able to enforce them, although in certain circumstances shareholders may be able to bring a derivative action on the company's behalf.

The Act introduced a new derivative procedure that replaced the common law. Such an action may be brought in respect of an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company. The effect of this provision is that a derivative claim may be brought in respect of an alleged breach of any of the general duties of directors set out above, including the duty to exercise reasonable care, skill and diligence. Further, there is no longer a requirement for the director to have benefited personally from the breach, as was the case under common law. The cause of action may arise before the person seeking to bring a derivative claim became a member of the company, in line with the common law position.

Remedies

The remedy for a breach of the duty of care, skill and diligence was usually damages. Remedies for breaches of other fiduciary duties include:

- an injunction;
- setting aside of the transaction, restitution and account of profits;

- restoration of company property held by the director;
- damages.

A breach of duty may also be grounds for the termination of an executive director's service contract, or for disqualification as a director under the Company Directors Disqualification Act 1986.

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BERNARDS - France

1. <u>Duties of members of the Board of Directors of French *Sociétés Anonymes*</u>

The main role of the Board of Directors of a French *société anonyme* is to determine the orientations of the company's business activities as well as to ensure their implementation. Within the limit of powers expressly vested in shareholders' meetings and the limit of the corporate purpose of the company set forth in the by-laws, the Board of Directors deals with all matters relating to the conduct of the company's business and decides all pertinent issues through its deliberations. The Board of Directors is also supposed to carry out any control and verifications it deems appropriate. Such general duties of members of Directors of *sociétés anonymes* are set forth in article L. 225-35 of the commercial Code.

Within their mandate, the Directors have the following duties:

- Duty to comply with the laws or regulations applicable to *sociétés anonymes* and the company's by-laws pursuant to the article L. 225-251 of the commercial Code;

- Duty to act in the interest of the company. Although there is no legal definition of corporate interest ("intérêt social"), it is usually described as the superior interest of the legal person itself – *i.e.*, of the undertaking considered as an autonomous economic agent, pursuing its own aims, distinct from those of its shareholders, its employees, its creditors, its suppliers and its clients, but which corresponds to a general common interest to ensure prosperity and continuity of the undertaking. The corporate interest shall not be confused with the interest of the shareholders in general, nor the one of certain shareholders in particular, even those that control or have influence on the company. Often, this interest converges. However, when this is not the case, the Board of Directors shall always uphold the interest of the company – *i.e.*, the interest of the whole undertaking. Directors may be held liable for mismanagement of the company through any act or omission that is contrary to the company's corporate interest, or if they conduct the business in a careless, negligent or fraudulent manner.

- Duty to act as a reasonably diligent person, in good faith, and to exercise reasonable care, skills and diligence. Such duty includes mainly:

    - Duty to exercise diligence: the Director must take part regularly and effectively in the meetings and discussions of the Board;

    - Duty of care: the Director must request any information or documents he or she considers as important, follow up with major issues and ask for updates and clarifications if needed as per article L. 225-35 of the commercial Code;

- Duty of dissident: the Director must oppose to wrongful decisions or abstentions of the Board of Directors as per article L. 225-35 of the commercial Code.

- Duty to avoid conflict of interest. A Director must avoid situations where he or she has, or may have, a direct or indirect interest or duty that conflicts or may conflict with the company's interests.

2. <u>Liability of the members of the Board of Directors of French *Sociétés Anonymes*</u>

2.1 In civil liability

Directors may be held individually or jointly and severally liable to the company or to third parties in case of any breach of duties as mentioned above and in particular, as expressly provided for in the commercial Code, in case of (i) infringement of the laws or regulations applicable to *Sociétés Anonymes*, (ii) violation of the company's by-laws, and (iii) mismanagement of the company, as per article L. 225-251 of the commercial Code.

The civil liability of the members of the Board of Directors may be individual or joint and several, depending on situation.

A member of the Board may be held individually liable if he or she is personally accountable for his or her wrongful act or negligence, and other members of the Board will be external to such action. The Directors' liability shall be jointly and several when the action cannot be attributable to one single member, but is the result of the collective action of the Board.

Directors' liability may be challenged either directly by the company acting through its legal representatives ("action sociale *ut universi*"), or through an action brought by a shareholder or a group of shareholders acting on behalf of the company ("action sociale *ut singuli*").

Directors' liability may also be challenged directly by a shareholder or a third party provided that the third party is able to demonstrate that the Directors' misconduct exceeded the scope of their duties ("faute séparable"), provided that the third party has personal interest against the Directors.

In any event, a Director may be held liable only if, in addition to a breach of its duties as mentioned above, it is possible to demonstrate that the breach involved a loss and that a causal connection between the breach and the loss exists.

2.2 In criminal liability

Members of the Board of Directors may also incur specific criminal liability if they are offenders or co-offenders of, or accomplices to, a criminal offence, provided that they intentionally committed such acts. Criminal offences applicable to them are mainly the following:

- Distributing an unauthorized dividend;

- Failing to prepare the annual report on operations of the company as required by law, or publishing accounts that they know to be inaccurate or not presenting a true and fair view of the company's financial position;

- Using the company's credit or assets in a manner that is contrary to the company's corporate interest or that serves a personal interest or the interest of a third party;

- While acting in bad faith, misusing their powers or voting rights in a manner that is contrary to the company's corporate interest or that serves a personal interest or the interest of a third party.

Depending on the offence, convicted Directors could face a prison sentence of up to five years and/or be sanctioned to pay a fine of up to € 375,000. A court could also consider additional penalties like an order prohibiting the Directors from leading or managing a company for a period of up to fifteen years as per article 131-27 of the criminal Code.

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LATSOUDIS & ARVANITI – Greece

Duties of members of the Board of Directors of French Sociétés Anonymes

The status of a member of the Board of Directors of a societe anonyme ("SA") company does not in general confer any particular risk in relation to any obligations of the company vis-à-vis third parties, the State or insurance companies.

Unique exceptions are introduced by the Code of Income Taxation for Natural and Legal Persons (article 115 of Law 2238/1994) according to which persons who are directors, managers or liquidators of domestic societies or cooperatives at the time of dissolution or their merger, are personally and jointly liable for both the payment of the tax due under them (including legal entities) and for the withholding tax, regardless of the time of their assertion. In addition, the above persons have the right of recourse against the individuals who have acted by their capacity as consultants, as well as against board members or shareholders of the legal entity at the time of its dissolution in respect of taxes relating to periods prior to the commencement of liquidation, regardless of the time of their assertion.

This was also applied proportionally to the cases of SA's liabilities. from VAT, CBC and insurance contributions (article 22 par. 7 of Law 2648/1998 in combination with the case b of article 45 of Law 1642/1986 on VAT, Article 9 par. 4 of Law 2523/1997 in conjunction with article 5 of Law 2523/97, in proportion to the fines of ΚΒΣ, article 4 par. 4 of Law 2556/1997, regarding the provisions of article 115 of the CPC, as they apply each time, proportional application for the payment of the due insurance contributions to IKA.

Moreover, by way of exception under Article 20 (1) (a) and (6) of Law 2523/1997 on tax evasion, the members of the Boards of Directors of such companies are considered to be perpetrators of the tax evasion offense, if it is proven that they were effectively or temporarily involved in one of the offenses referred to in the law. This covers, in the absence of the chairman of the Board, the directors, co-directors, the directors-general and generally any person authorized either directly by law either by own will or by a court decision in the administration or management of these.

The law on kickstarting - as it is titled - the economy (Law 4321/2015), does not set new facts with Article 31 with regard to joint and several liability. In particular, persons who are legal representatives, chairmen, directors and liquidators of natural persons and legal entities (as defined in article 3 of law 4174/2013, Tax Code) at the time of dissolution or merger are personally and jointly and severally liable for the payment of insurance contributions, surcharges and other charges payable by such legal entities to the Social Security Institutions (FSA) regardless of the time of their assertion.

The personal and joint responsibility of the persons having the above qualities for the payment of insurance contributions, surcharges and other charges due from legal persons and legal entities exists also during the operation of the legal person or the legal entity that those individuals represent. In accordance with the above, those who are personally and jointly liable for the debts of a natural person or a legal entity to Social Security Institutions (FSA), by way of exception, may pay or settle independently in accordance with the provisions in force concerning the regulation of debts the debts owed by the legal person to the Social Security Institutions (FSA), which existed upon taking up their duties, as well as those incurred during their term of office, irrespective of the time of their assertion.

Lastly - always referring to instances that apply to SA companies - the non-executive members of the Board of Directors are not personally liable for the company's obligations, however it is possible that these members are personally liable on tortious grounds under Article 914 of the Greek Civil Code.

Consequently, a simple member of the Board of Directors of SA can be conferred protection against any liability in cases where: i) he/she remains as a single non-executive member of the Board of Directors; (ii) he/she systematically monitors the representation of the company who in fact carry out acts of management and representation; (iii) he/she avoids any act which can be construed as a genuine management of the company's affairs, and (iv) he/she refrains from performing any act that can give rise to a tort claim (914 TC).

Article 22a of Law 2190/1920 on SA stipulates in paragraphs 1 and 2 the following: 1.Each member of the Board of Directors is liable towards the SA company in case he/she performs management acts to the detriment of the company that can be attributed to his/her fault. 2. This responsibility does not come into effect if the member of the board of directors proves that he has acted diligently and within the accepted boundaries of a prudent businessman. This responsibility does not apply to acts or omissions based on a lawful decision taken by the general assembly or based on a reasonable business decision taken in good faith and on the basis of sufficient information provided at that time and solely for the benefit of the company's interest.

The law provides for a system of responsibility for the members of the board of directors of the SA companies, in return for the significant benefits that they enjoy. Such liability exists only in relation to the company and not to the shareholders, unless the loss-making act of the members of the management of the company, taken on its own merits, constitutes at the same time an unlawful interference with the existence of the shareholder's right, thus constituting a tort, which results in a direct and independent obligation to compensate.

Thus, in the event of an inadequate performance of management duties, resulting in damage to the company, there is an obligation to compensate the damaged parties. The members of the board of directors, as well as persons who are not members of it and who exercise powers in accordance with Article 22 par. 3 of the same law, are liable for any fault in the management, unless they prove that they have acted diligently and within the accepted boundaries of a prudent businessman.

This is a strictly objective liability and the burden of proof is reversed so that the members of the board and not the company have to prove that they have exercised due diligence. The measure of the responsibility of the directors varies according to the status of each member (managing director, etc.) and the tasks assigned to it.

Only the occurrence of a loss or the assumed risk of loss does not necessarily represent a misconduct of the management functions of the Board of Directors, resulting in an obligation to compensate, since the nature of the business decisions and plans always entails the risk of failure. Therefore, as long as the members of the Board of Directors have taken a reasonable business decision in good faith and solely in the interests of the company and before acting, they also received all the necessary information and prudently settled the risks assumed on the basis of the data existing at the time the decision was taken, they cannot be held liable, even if the company has incurred losses.

This is justified since the Board of Directors must have a wide margin of discretion with regard to its business choices and a reasonable risk is deemed to be legitimate and essential in a commercial enterprise. Thus, the mere fact that the company is in danger of incurring a loss of business and even mistaken business choices, does not in any way cause any liability, since excessive rigor would lead to a downturn in the business activity of the company and, in addition, would encourage abusive actions against the members of the board of directors. Finally, the conflict between the various interests of SA shareholders is aligned with the "corporate interest" referred to in the last sentence of paragraph 2 of Article 22a of Law 2190/1920, which is also provided for in Articles 747 of the CC and 2 of Law 3016/2002 "On Corporate Governance, etc."

The corporate interest requires the members of the Board of Directors to direct their conduct taking into account of the commitments that result from the common (corporate) purpose and not to take advantage of their participation in the Board of Directors in order to seek to satisfy their individual interests, which contradict the corporate interests.

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EUGENE F. COLLINS - Ireland

<u>**An Overview of Directors' Duties in Ireland**</u>

1. Development of the Law on Directors Duties

Prior to the enactment of the Companies Act 2014 (as since amended), Ireland, as a common law jurisdiction, relied on the decisions of the courts for the development of the law in relation to the duties of directors. Under the Companies Act 2014, the principal fiduciary duties of directors have for the first time been codified and listed. These fiduciary duties are derived from certain statutory provisions and from common law and equitable principles developed by the courts.

2. Duties of Directors

A. Fiduciary Duties

A director of an Irish company must:

- Act in good faith in what the director considers to be the interests of the company.

  Without prejudice to this duty, a director may have regard to the interests of a particular shareholder if that director is appointed by a particular shareholder under a right set out in the constitution of the company or under a shareholders' agreement.

- Act honestly and responsibly in relation to the conduct of the affairs of the company.

- Act in accordance with the company's constitution (by-laws) and exercise his/her powers (a director of an Irish company must be a natural person and not a body corporate) only for purposes allowed by law.

- Not use the company's property, information or opportunities for his/her own or anyone else's benefit.

  A derogation from this duty is permitted if the director is expressly authorised to do so under the constitution of the company or by a resolution of its shareholder(s).

- Not agree to a restriction of his/her exercise of independent judgement.

  A director will however be permitted to 'fetter his/her discretion' (i) where this is expressly authorised under the constitution of the company; (ii) where a director in good faith believes that it is in the interests of a company to enter into a particular transaction and agrees to restrict his/her independent judgment in the future by agreeing to act in a particular way to achieve the entry into of the transaction; or (iii) where the director's *agreeing to so restrict his/her independent judgment has been approved by a resolution of the shareholder(s) of the company.*

- Avoid any conflict of interest between the director's duties to the company and his/her other interests.

  A director may be released from his/her duty to the company to avoid a conflict of interest whether under the constitution of the company or by a resolution of its shareholder(s).

- Exercise the care, skill and diligence which would be exercised in the same circumstances by a reasonable person (having both the knowledge and experience that may reasonably be expected of a person in the same position as a director *and* the knowledge and experience that the director [actually] has).

- Have regard to the interests of the shareholder(s) and employees of the company.

  While a director is obliged to consider the interests of the shareholder(s) and employees (and, in certain circumstances, creditors), the duty is owed to the company alone and is enforceable by the company alone. This duty is subservient to the duty of a director to act in the (best) interests of the company itself as a whole.

B. Statutory Duties

The Companies Act 2014 consolidated company law statutory duties applicable to directors. It also introduced an obligation requiring directors of certain companies to prepare a directors' compliance statement.

In summary, this requirement applies to all public limited companies (save for certain investment public limited companies) and applies to all private limited companies and guarantee companies where in any particular year the balance sheet exceeds €12,500,000 *and* the turnover exceeds €25,000,000. Directors of affected companies will be required to confirm, in the annual directors' report on the financial statements of the company, that the company has complied with all material company law obligations and tax obligations. Directors are also required to confirm that (i) they have drawn up an internal 'compliance policy statement' setting out the company's policies on compliance with such obligations; (ii) there are in place appropriate arrangements or structures that are in their opinion, designed to secure material compliance with those obligations; and (iii) the directors have conducted a review during the year of the arrangements or structures that have been put in place. If any of these actions has not been taken, the directors' must set out the reasons why.

Other key statutory duties of directors that are of particular practical importance are to:

- Ensure that the company complies with the Companies Act 2014:

  This duty is clearly very broad and includes defaults by a director and permitting a default by others. Where it is proven that a director was aware of the 'basic facts concerning the default', it is presumed that the director permitted the default unless he/she can show that *all reasonable steps were taken to prevent the default, or that, by reason of circumstances beyond his/her control, he/she was unable to do so.*

- Ensure that the company keeps at least adequate account records; to prepare and approve financial statements in respect of each financial year that give a true and fair view of the financial position of the company; and to have those financial statements audited where applicable.

- Convene board meetings and general meetings where applicable and ensure compliance by the company with a range of company secretarial and administrative obligations.

  Companies have a legal obligation to maintain certain statutory registers and records. Directors are responsible for ensuring that their companies comply with this obligation. Directors must therefore ensure that all such registers and records are maintained and updated and that all relevant returns are filed in the Irish Companies Registration Office within specified periods. As directors are entitled to rely on the advice of employees or external advisers relating to the performance of their duties, many companies utilise the services of lawyers or accountants to maintain these registers and records and make the appropriate filings.

- Declare and disclose the nature of any interest that a director has in any contract or proposed contract with the company at a meeting of the directors of the company.

  A fiduciary duty exists to avoid a conflict of interest. In that light, a director must declare any interest in a contract with the company. There is now, however, a derogation from this duty where the interest cannot reasonably be regarded as likely to give rise to a conflict of interest. A director is also obliged to disclose any interest (subject to certain de minimis exceptions) in shares held in the company or related companies and any payments made to him or her in respect of share transfers. Further, any contract of service entered into by a company with one of its directors must be made available for inspection to any shareholder of the Company.

- Ensure that no prohibited loans are made by a company to a director.

  Save for certain specific circumstances or with shareholder approval, companies are prohibited from giving loans to a director or persons connected with a director. If a prohibited loan is made and the company becomes insolvent and a court considers that the loan materially contributed to the company's inability to pay its debts (or has substantially impeded the orderly winding up of the company), the recipient of the loan may be made personally liable, without limitation, for all or part of the company's debts (in addition to the repayment of the loan amount itself).

- Ensure that all substantial property transactions between a company and a director are approved by the shareholder(s).

  Where a company is to acquire certain non-cash assets from a director (or vice versa) that are in excess of a certain value, the company's shareholder(s) must first approve of the *arrangement (although it is possible for the shareholder(s) to ratify the transaction within a reasonable time after it is entered into). If a director contravenes this provision, he/she may be liable to account to the company for any gain made by him/her or any loss made by the company.*

3. Liability for a Breach of Duties

As is the case in other jurisdictions, there is now an increased emphasis on compliance and corporate governance in Ireland. This is evidenced by the fact that the range and quantum of penalties and liabilities that may be imposed on a director found to be in breach of his/her duties has been significantly increased under the Companies Act 2014. Offences have been grouped into four categories. For a ‘category 1’ offence, the penalty, on indictment, may be imprisonment for up to ten years and/or a fine of up to €500,000 (an example would be the failure to ensure that the company keeps adequate accounting records). A ‘category 4’ offence may result in a fine of up to €5,000. In addition, a court may in certain circumstances, declare that a director is personally liable, without limitation, for the debts of a company (such as in a fraudulent trading case) or that a director account to the company for any gain made by the director or make good any loss suffered by the company. A court may also impose damages or grant equitable relief in any case.

As a general rule, directors who show they acted reasonably and honestly, and have met the standard of care required of them, will be able to use this as a defense in any action taken against them.

A company may in limited cases indemnify a director. It can do so in respect of liability incurred in defending proceedings (civil or criminal) where judgment is given in his/her favour or in which he/she is acquitted. A director may also be indemnified by a company against any liability incurred by him/her in bringing a successful application for relief on the grounds that he/she has acted honestly and reasonably in respect of a claim for negligence, default, breach of duty or breach of trust. It is possible for a company to purchase and maintain directors or officers’ insurance to cover certain such claims. The terms of the relevant policy and the types and extent of the cover being offered should be closely reviewed in each case.

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CORLETT BOLTON & CO – Isle of Man

<u>Directors' Duties in the Isle of Man</u>

Following the recent widely publicized case of the *Financial Services Authority v Irving & Irving*, director's duties in the Manx jurisdiction have been a matter of more public interest than other fiduciary relationships.[1] In this case, the Defendants were subject to an application for their disqualification as directors (which was subsequently ordered) after an octopus-like series of litigation relating to the dismissal of an attorney-general and a costs order being made against a well established Manx advocate, as well as Mr Irving Snr and Mr Irving Jnr being disqualified as directors for 8 and 7 years respectively. The reasons for the Irvings' disqualifications will be further explored below, but they range from failing to meet statutory filing obligations to entering the company into transactions for their personal, rather than the company's, benefit. While company law in the Isle of Man is generally divided between those constituted under the Companies Act 2006 and those constituted under certain acts prior thereto (commonly though somewhat erroneously known as "1931 act companies" due to the first act in that set), directors' duties in the small offshore jurisdiction are largely established by common law but some more specific duties are set out in statute. As a broad overview these duties are regulated by both the law of principal and agent as well as the equitable principle of fiduciary duties. These duties in practical terms are set out in an Isle of Man Government Guidance Note on the Responsibilities and Duties under the Laws of the Isle of Man (2007) as: loyalty to the company, obedience to the company's constitution, maintaining independence in decision-making, to not make a secret profit, to avoid a position of potential or actual conflicts of interest, to act with care, skill and diligence, and overall act with fairness in the management of their company.[2] It might be instructive that it is in particular transgressing their duties in relation to non-payment of tax and loyalty to the company that the court seems most affronted by in the *Irving* case despite the often sensationalized image of the Manx jurisdiction being one of tax avoidance and it being a utopia populated by the freewheeling ultra-rich!

In the Isle of Man, a limited company is a separate legal entity from its directors. This therefore limits the liability of directors for a company's actions, but directors may expose themselves to personal liability by breaching their directorship duties as, for example, they would be liable to the company for damages resulting from their negligence.[3] It is notable that the duties are owed to the company itself, not the shareholders or any beneficial owners. The directors therefore must act in compliance with their standard of care in relation to the best interests of the company – meaning in practical terms, for example, they do not recommend a dividend is paid if they do not see that there are adequate finances in the company and paying such a dividend may result in

[1] FSA v Irving & Irving CHP13/130 found at https://www.judgments.im/content/J2001.htm
[2] Found at https://www.gov.im/lib/docs/ded/companies/companiesReg/practicenotes/pn62007directors.pdf
[3] There are further exceptions to the limitation of personal liability in terms of the offences of fraudulent trading and misfeasance in both 1931 and 2006 companies acts, as well as unlawful distribution in the 2006 act only but these will not be dealt with in depth here as they can be seen more as criminal acts rather than a civil breach of a duty.

the company's insolvency. The standard of care required of a director is based on two tests, one objective and one subjective but in both tests they must be "reasonable diligent". Respectively the tests are if the director has acted to a standard of care expected of a reasonably diligent person:

- Acting with the general knowledge, skill and experience that may reasonably be expected from a person carrying out the same functions as are carried out by that director in relation to the company (objective test), and
- Acting with the actual general knowledge, skill and experience that that director personally has (subjective test)[4]

These tests do not however provide an excuse for ignorant directors – the Isle of Man Financial Services Authority's ("FSA") guidance provides that if directors are in doubt they should seek professional advice.[5] Further, an individual director's duties form part of the collective whole of the board's duties, and in relation to this a director should keep the board well informed so they will best perform their duties.[6] The standard of care directors in the Manx jurisdiction is therefore multi-faceted – it contains an obligation to be diligent but also to be diligent in knowing one's owns limits, to act in accordance in his/her own ability but also to act in accordance with a the ability of a director in a similar position, and to make sure he/she acts in accordance with his/her own individual duties but also make efforts to ensure the board's collective duties are also complied with. Returning to the examination of the *Irvings* case, the court refers to the "incompetence" of the Defendants in not performing one of their statutory obligations as directors. In this way it can be seen that the Manx High Court sees the standard of care and statutory obligations of directors not as two different sources of obligations but two sides of the same coin.[7]

In addition to the standard of care, a central obligation on a director of a Manx company is the fiduciary duty to act bona fide in the interests of the company and with a proper purpose. Within this is the obligation to avoid a position of an actual or potential conflict between their personal interests and their duties to the company. It is notable however that despite the above-mentioned duty not to make a secret profit, a director of a 2006 act company may be allowed to retain the benefit from an interest in a transaction provided that he/she has disclosed his interest to the board prior to the transaction being made in accordance with sections 103 to 105 of the 2006 Act. Despite this, a director must ensure that they maintain independence in assessing whether any transaction would be for the benefit of the company and particularly not be bound by any third party obligations in relation to their decision-making. Central to this is the principle that a company is a separate legal entity, which, while it affords the benefit of limited liability to the owners and directors, means that a company must not purely be a vehicle for a dominant director to benefit him or her-self. This is a thread that runs through the issues the court found with the Irvings' conduct in their use of a company in order to benefit themselves rather than the company. In particular, the judgment states:

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[4] Appleby – Guide to Directors and Their Duties in the Isle of Man (February 2015) at https://www.applebyglobal.com/publication-pdf/guide/guide-to-directors-and-their-duties-in-the-isle-of-man---february-2015.pdf
[5] Isle of Man Financial Services Authority – Financial Services Act 2008 and Guidance on the responsibilities and duties of directors under the laws of the Isle of Man (January 2017) at https://www.iomfsa.im/media/1699/guidanceontheresponsibilitiesand.pdf
[6] Appleby, *Ibid.*
[7] *FSA v Irvings, Ibid.*

"Given the way in which assets were passed around the various companies it is not clear to me that the Defendants ever understood the concept of corporate personality […] [concerning a transaction involving an apartment]. That was a misapplication of SHL's funds for the benefit of Mr Irving personally and in breach of his duty to SHL"

The presiding Deemster later states that a disqualification order is necessary partially in order to regulate the abuse of limited liability.[8]

The Manx jurisdiction has a series of duties imposed on the directors of Manx companies but arguably retains a level of flexibility in enforcing the said duties. It is, on the one hand, well advised for directors to brief themselves on their duties as set out in various government department's/statutory bodies' notes, but the duties as discussed above should not be so onerous that a layman is dissuaded from wanting to start and manage his own company from a scratch. The central theme running through directors' duties in the Isle of Man could be seen to encourage good, flexible and honest business in order to benefit firstly the company. The benefits of limited liability for a natural person is therefore not afforded freely, that is to say a person cannot manage a company purely to directly provide himself wealth and limit his/her liability but must ensure his/her company continues to exist as a solvent separate legal entity. It is unlikely that directors' duties could be seen as unfairly onerous on the individual, and rather they help provide assurance to those trading with the Island that the corporate body they are trading with will not suddenly be dissolved by a rogue director seeking to enrich himself solely from the company's success. The tests imposed on directors in terms of their standard of care and fiduciary duties, much like the larger English/Welsh jurisdiction neighbouring the Island, allow for both a stringent test on the actions of the director as an individual, as well as ensuring that their diligence is in line with what is expected from directors of Manx companies generally. Manx law, therefore, retains a desirable balance between opening opportunities up to the layperson, while also making sure directors of Manx companies are bound by high standards.

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[8] *FSA v Irvings, Ibid.*

STUDIO LEGALE AFFERNI CRISPO & C. – Italy

Duties Of Directors Under Italian Law

The directors (sole directors or members of the board of directors) constitute the only organ entrusted with the management of the corporate business; they are required to perform all the activities that are necessary for the implementation of the company's objectives.

Companies may have a single director or a board of directors, but the latter is mandatory for companies listed on regulated markets, thus ensuring the possibility to appoint at least one "independent" director and/or one chosen by minority shareholders. The appointment of a legal person as a director is also legitimate, under certain circumstances and provided that a natural person is identified to act on behalf of such legal person. The present contribution focuses on the rules applicable to joint stock companies ("*società per azioni*"), whilst the regime applicable to other kind of companies may vary slightly.

In order to manage companies in a more agile manner when a board of directors exists, one or more directors may be assigned specific powers by way of proxies. This can be provided for in the articles of association or by a resolution of the shareholders' meeting. Such proxies do not deprive the board as a whole of the same powers but, rather, create a competing capability of the board on the one hand and the delegated bodies on the other hand.

Directors may be shareholders or not, and the law requires specific requirements of integrity, professionalism and independence. The appointment has to be made in a shareholders' meeting except for the first director(s) (or board) to be appointed in the deed of incorporation. The position lasts a maximum of three financial years, but is renewable unless otherwise provided for in the articles of association. The shareholders' meeting also has the power to revoke the directors at any time except for the right of the director to claim compensation for damages, if the revocation takes place without a just cause.

Management powers are reserved to directors. Additionally, directors who are entrusted with the power to represent the company, act on behalf of the company by carrying out those behaviours through which the corporate mission takes place.

They give impulse to the activity of the shareholders' meeting and implement its resolutions; they are also vested with the rights and obligations to challenge those resolutions that are adopted in breach of the law or of the articles of association.

The directors must take care of the keeping of books and accounting records, produce on an annual basis the draft financial statements to be submitted to the approval of the shareholders' meeting and provide for the disclosure obligations required by the law.

They must prevent acts that may be prejudicial to the company or at least eliminate or mitigate the harmful consequences thereof. They must also prevent situations that may enhance conflict of interests. In fact, they cannot assume the status of shareholders with unlimited liability in competing companies and exercise competing activities on their own behalf. This prohibition can, however, be waived by means of an *ad hoc* authorization of the shareholders' meeting.

When a director has an interest in a given operation, even if not necessarily in conflict with that of the company, he or she is required to inform the other directors and the board of statutory auditors by carrying out the so-called disclosure, indicating the nature, terms, origin and scope of his or her interest. If a managing director is involved, he or she must also refrain from carrying out the operation and request the whole board to take the appropriate decisions. In any case, the board of directors must adequately justify the reasons and the convenience of the operation for the company. When a sole director is in charge, he or she must inform the board of statutory auditors and also the shareholders as soon as possible.

Greater caution is imposed on companies that make use of capital risk in relation to transactions with related parties, that is to say transactions involving one of the parties indicated by the Italian Commission for Companies and the Stock Exchange (CONSOB) as counterparties: parent companies, senior managers and their close relatives, subsidiaries, sisters companies, etc. Subjects, in other words, with respect to which the risk of decisions taken in conflict of interests is higher. For such operations, the board of directors must adopt procedures that ensure the transparency and correctness of the decisions, also by requiring the assistance of independent experts and by making the relevant details known in their report on the management of the company.

Alongside the specific duties identified above, there are also generic duties that consist in assessing the adequacy of the administrative and accounting organizational set-up of the company, assessing the general performance of operations, and acting in an informed manner.

The criterion on which the conduct of the directors must be assessed in order to evaluate their fulfilment of the duties imposed by the law or by the articles of association is that of the diligence required by the nature of the assignment and their specific skills, and therefore of professional diligence.

For the violation of the duties imposed on the directors, these are civilly and jointly responsible for their conduct in three directions: towards the company, towards the corporate creditors and towards the individual shareholders or third parties who have suffered direct damage from the unlawful conduct of the administrator. Criminal liability of directors is not dealt with in the present contribution.

Liability must, in any case, be based on guilt, since an objective liability cannot be assumed. Liability, in fact, does not extend to those directors who have made their dissent known without delay in the book of the deliberations of the board of directors and if the dissent has been notified in writing to the chairperson of the board of statutory auditors.

Finally, *de facto* directors should also be mentioned. These are those persons who, without the formal role of director due to the absence of an appointment, are in fact systematically ingested in the direction of the corporate business (by, e.g., giving instructions to the apparent directors, conditioning operational choices, dealing directly with third parties, etc.). These directors are in fact equated with the legally appointed directors with regard to the application of the rules on civil and criminal liability.

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GARFIELD BENNETT – Jersey

Directors' Duties Under Jersey Law

Under the Companies (Standard Table) (Jersey) Order 1992, "the business of the company shall be managed by the directors who may exercise all the powers of the company". With this extensive power comes a wide range of duties. In Jersey law, a director's duties derive from customary law, statute and the Jersey regulator's Codes of Practice. The courts have a wide discretion to impose liability to avoid fraud, or if the company is considered a "device" or "sham", for breach of fiduciary duty or for breach of a statutory duty.

Liability of Jersey directors

Companies are separate legal persons that can enter into contracts, sue and be sued. However, a company can only act through its directors and the directors are its agents. In general, this means that as long as a director makes it clear that he acts for the company and not in his own right, he will not incur personal liability. Jersey directors are therefore protected by a "veil of incorporation". Jersey courts will pierce the veil and impose liability on a company's owners and controllers if they consider such action justified, for example where a fraud has been committed. This well-established liability has been extended by statutory law which has evolved to impose a wide range of liabilities on directors for their acts and omissions. The result is that personal criminal and civil liability may be imposed if a director fails to conduct himself and the company's affairs to the required standard against the current legal and regulatory framework. It is therefore essential that all directors fully understand their duties and obligations and are suitably qualified and experienced for their role. In addition, it should be noted that in 2017, the UK High Court ruled that, as a matter of Jersey law, a director may be sued personally for breach of fiduciary duty for up to 10 years after the duty was breached.

Jersey Directors' Duties Under Customary Law

Under Jersey customary law, a director has a fiduciary relationship with the company, which imposes duties of loyalty and good faith and requires him to place the company's interests above those of the shareholders. He also acts as the company's agent which means that he must also act with due care and skill. According to the principles of customary law, a director must:

1. **Act in good faith with the best interests of the company in mind**

   The duty to act "in the best interests if the company" confirms that the director owes his duty to the company, not individual shareholders. The Jersey Appeals Court case of Vilsmeier v. AI Airports International Ltd and Power International Ltd (2013) confirmed the English decision in Re Smith & Fawcett Limited (1942), concluding that the test used to determine whether they have discharged this duty is subjective, i.e. what the directors consider to be in the interests of the company.

2. **Use his powers for a proper purpose**

   If a director uses a power or discretion conferred by the Articles of Association, but not for the purpose that power or discretion was given, he will be in breach of this duty. For example, if directors issue shares with the intention of maintaining their own control over a company, they would be in breach. The test established by the Vilsmeier case is objective, i.e. would a reasonable director, with the experience of the director in question, have made the same decision in the same circumstances. The result is that a director can be liable for a breach of duty even if he honestly believed he was acting in the best interests of the company.

3. **Avoid conflict between personal interests and his duty towards the company**
   Actual and potential conflicts of interest must be avoided.

4. **Account to the company for profits that arise as a result of his position**
   Any benefits or profits obtained by a director as a result of his position must be paid to the company, even if that director is acting honestly and in the company's interests.

5. **Participate in the company's affairs**
   A director must keep himself informed about the company's business and financial position, perform any particular function delegated to him and attend board meetings. A director's level of participation will depend on the role he takes on and his experience and skills.

Jersey Directors' Duties Under Statute

The fiduciary duties developed by customary law are captured in the Companies (Jersey) Law 1992 (the "Companies Law"). The Companies Law broadly reflects, but does not codify, the duties established under Jersey customary law. Customary law still plays an important role in the interpretation of the statute. The most important Articles that relate to directors' duties are Articles 74 and 75:

Article 74 provides that:

(1) A director, in exercising the director's powers and discharging the director's duties, shall –

(a) act honestly and in good faith with a view to the best interests of the company; and

(b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

Article 75 provides that:

(1)A director of a company who has, directly or indirectly, an interest in a transaction entered into or proposed to be entered into by the company or by a subsidiary of the company which to a material extent conflicts or may conflict with the interests of the company and

of which the director is aware, shall disclose to the company the nature and extent of the director's interest.

It is important to note that under the Companies Law, any person who effectively acts in the position of a director will be regarded in law as a director and be subject to the duties and liabilities that accompany that position. Therefore, an individual who instructs the appointed officers will be a de facto director under Article 1(1) of the Companies Law

The Significance of the Regulatory Climate in Jersey

The finance industry is essential to the economic prospects of the island and Jersey law has developed with the aim of promoting public safety, strengthening the economy and protecting investors. Jersey has earned a reputation as a world leader in anti-money laundering compliance and regulation. The regulatory climate is characterised by regulation and case law that clearly illustrate the role directors are expected to play in upholding and promoting standards.

A Jersey director may face personal civil and criminal liability from a wide variety of laws other that the Companies Law, for example:

- The Financial Services Law
- The Collective Investment Funds Law
- The Proceeds of Crime Law
- The Terrorism Law

As potential liability grows, directors are faced with increasing expectations with regard to their standards of conduct. There is a trend to criminalize neglect, which means that directors must have a more proactive approach to governance, for example being alert to and questioning conduct that should give rise to concerns.

An example of a statutory offence of negligence can be seen in the Corruption (Jersey) Law which targets the making of payments or other inducements to public officials. Under this Law, an offence will be committed by a company if committed with the consent and connivance of a director but also if an offence is attributable to neglect by a director.

Directors may also find themselves criminally liable under the Proceeds of Crime (Jersey) Law if the company commits an offence under the Money Laundering Order which is attributable to any neglect on their part. A director could benefit from a defense under this Law if he can prove he took all reasonable steps and exercised due diligence to avoid committing an offence.

The potential for liability for negligence is also seen in case law. The case of AG v Bhojwani (2010) concluded that directors would be criminally liable if an offence was committed by the company with the "consent, connivance of, or with the neglect of the director" or if the director "knew, suspected or had reasonable grounds to suspect" that an offence had been committed. The Bhojwani case also confirmed that incompetence and "blind eye" defenses were invalid. Directors must ensure they have sufficient knowledge and understanding of their company's affairs to enable them to fulfil their duties (Re Barings plc (No5) (1999)).

In addition to understanding duties and liability imposed by statute and case law, directors of companies regulated by the Jersey Financial Services Commission must also follow the Codes of Practice issued under regulatory laws. The codes are admissible in court if such a director's conduct is questioned. The board's duties under the Codes include:

- Conducting business with integrity;
- Organising and controlling affairs effectively for the proper performance of its business;
- The ability to demonstrate adequate risk management systems;
- Transparency in business arrangements with clients.

The Influence of UK Law and Practice

The UK Companies Act goes further than Jersey's Companies Law in its description of directors' duties (Companies Act 2006, s.170-181), including, for example, obligations to exercise independent judgement and having regard to likely long term consequences. It is likely that these provisions will inform any interpretation by Jersey courts of the meaning of skill, care and best interests of the company. The standards set out in the UK Act are a useful guide to Jersey directors.

The Corporate Governance Code 2016 issued by the UK Financial Reporting Council also informs good practice in Jersey. Broadly, the Code confirms that directors are collectively responsible for the success of the company, that the running of the board and the operation of the business should be clearly distinguished, that no individual should have unfettered powers, and that the board is responsible for assessing the risk appetite of the company and achieving its strategic objectives. The Code also addresses the duties of non-executive directors.

Conclusion

Expectations upon directors to understand and fulfil their duties are growing and the consequences of failure are ever more serious. If a director is called to account for his conduct, he will not only be judged on what he did or knew. Directors will be judged with the benefit of hindsight on what they should have done and should have known. Knowing, understanding and using best endeavors to discharge fiduciary and statutory duties is the best protection for individual directors and the company.

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TAMBERGA & PARTNERS – Latvia

DUTIES AND LIABILITY OF THE BOARD OF DIRECTORS OF A LIMITED LIABILITY COMPANY (SIA) UNDER LAWS OF REPUBLIC OF LATVIA

A board of directors of a limited liability company is the executive institution of the company, which manages and represents the company. It may consist of one or more members. (Section 221, Paragraph one of the Commercial Law).

The board of directors shall elect a chairperson of the board of directors from among themselves, who shall organize the activities of the board of directors. If the company has established a council, the articles of association may provide that the chairperson of the board of directors is appointed by the council. (Section 221, Paragraph two and seven of the Commercial Law).

1. Liability of the members of board of directors and the council of a capital company for losses in accordance with the Section 169 of the Commercial law and Section 1635-1650 of the Civil Law

Members of the board of directors and council shall perform their duties as would an honest and careful manager. Members of the board of directors and council shall be jointly liable for losses that they have caused to the company. (Members of the board of directors for management, representation; Members of the council for the supervision of the company's board of directors.)

Members of the board of directors and council shall not be liable if they prove that they have acted, as would an honest and careful manager (*presumption of guilt, 07.06.2016. SKC-7/2016.)*. A member of the board of directors and council shall not be liable for losses caused to the company if he or she has acted in good faith within the framework of a lawful decision of the meeting of shareholders. The fact that the council has approved the actions of the board of directors shall not release the members of the board of directors from liability to the company. (If, in accordance with the articles of association of the company, the board of directors has to obtain the consent of the council for the operation of the board of directors, and the council has given its consent, but this action has caused losses to the company, then members of the council will be jointly and severally liable together with the members of the board of directors, as they have acted with consent with unreasonable diligence.)

Claims against the members of the board of directors and council may be delayed for up to within five years from the date of the loss.

As an honest and careful manager the Members of the board of directors and council shall:

- Comply with the Commercial Law and other laws or regulations (*07.06.2016. SKC-7/2016.*);

- Observe the documents of incorporation of a capital company (memorandum of association, articles of association);

- Comply with decisions of shareholders’ or stockholders' meetings;

- Be loyal towards the company (commercial secrets; prohibition of competition);

- Be loyal towards a group of shareholders or stockholders.

Voting "against" the decision at shareholders’ or stockholders' meeting that could accrue losses or absenteeism does not itself rule out the liability of the respective members of the board of directors and council. To avoid liability for loss, the members of the board of directors and council shall:

- Do everything in order to not incur such losses (to inform the members of the council and shareholders or stockholders);

- Resign.

In front of the company the members of the board of directors and council as an honest and careful manager are also responsible for ordinary negligence, ***25.01.2012. SKC-25/2012*** (Section 1646 of the Civil Law: Ordinary negligence shall be considered to be that lack of care and due diligence as must be observed by any reasonably prudent and careful manager).

Basis of responsibility: the Members of the board of directors and council shall be liable for damages in front of the Company if all of the following circumstances arise at the same time:

- The company suffered a loss;
- There has been an action or inaction by the members of the board of directors and council;
- There is a causal link between the action and the loss.

The circumstances shall be proved by the company in the person of the shareholders’ or stockholders' meeting or the insolvency administrator who is bringing an action against the Members of the board of directors and council.

the members of the board of directors and council are responsible in front of third parties for damages which are caused as a result of unlawful acts (Section 1635-1650 of the Civil Law).

Basis of responsibility: the Members of the board of directors and council shall be liable for damages in front of the third persons if all of the following circumstances arise at the same time:

- The company suffered a loss;
- There has been an action or inaction by the members of the board of directors and council;
- There is a causal link between the action and the loss;

- Fault for such action.

2. Detection of the financial position of the company; convening of a meeting of shareholders in special cases

Section 221, Paragraph six of the Commercial Law: The board of directors has the duty to submit to the council (if such has been formed), at least once every quarter, a report on the activities and financial circumstances of the company, as well as it shall, without delay, notify the council regarding deterioration of the financial condition of the company, or other significant circumstances related to the company's commercial activities.

*A. Section 219, Paragraph one of the Commercial Law: the board of directors shall notify the council (if such council has been established) and convene a meeting of shareholders in which the board shall provide explanations**, if***

*B. - the losses of a company exceed half of the equity capital of the company**;***

*C. - the company has limited solvency, the signs of insolvency have been determined**;** or*

D. *- they are likely to occur in the compan**y.***

3. Liability for submitting false information

The members of the board of directors shall be jointly liable for such losses caused as a result of false information, which is submitted after the entering of the company in the Commercial Register. For the submission of false information to the Commercial Register, persons shall be held to administrative liability or criminal liability (Section 165, Paragraph two and three of the Commercial Law).

4. Liability of members of the board of directors for the violation of provisions for keeping the Register of Shareholders

A member of the board of directors shall be liable for the losses caused to a shareholder, a lienor of the share or acquirer of shares, which have arisen upon the member of the board of directors violating the provisions of Section 187 (Register of Shareholders) and 187.[1] (Making of an Entry in the Register of Shareholders and Submission of an Application for Changes in the Register of Shareholders to the Commercial Register Office) of the Commercial Law (Section 169.[1] of the Commercial Law)).

5. Prohibition of competition in relation to members of the board of directors of a company

According to Section 171 of the Commercial Law, a member of the board of directors, without the consent of the council or, if such has not been formed – without the consent of the meeting of shareholders, may not:

1) be a general partner in a partnership, or a shareholder with supplemental liability in a capital company which is engaged in the field of commercial activities of the company;

2) conclude transactions in the field of commercial activities of the company in his or her own name or in the name of a third party;

3) be a member of the board of directors of another company which is engaged in the field of commercial activities of the company, except in cases when the company and the other company are part of the same group of companies.

If a member of the board of directors violates the provisions of Section 171, Paragraph one of the Commercial Law, the company is entitled to request compensation for losses or the recognition of the relevant transactions as such that are concluded in the name of the company, and to the transfer the income acquired or the right of claim to such to the company.

The statute of limitations period for these claims shall be three months from the date when the other members of the board of directors or members of the council (if such has been formed) had found out about the violation against the prohibition of competition, but no more than five years from the day of the committing of the violation.

6. Bringing an action by a company and release from liability

A company may bring an action against the founders, members of the board of directors or council or the auditor, on the basis of a decision taken by a meeting of shareholders, which has been taken by a simple majority of votes of those present. The articles of association may not specify a larger majority for the bringing of an action. Actions by a company against the board of directors shall be brought and maintained by the council. If a company has no council, then the meeting of shareholders, which took the decision on bringing of an action against the members of the board of directors, shall elect one or several representatives of the company to bring and maintain the action (Section 172, Paragraph one and three of the Commercial Law).

A meeting of shareholders may release members of the board of directors or council from liability, or make a decision to enter into an amicable settlement only for specific actions which were actually performed by them and were revealed at the meeting of shareholders, and as a result of which the company has incurred losses. A decision of a meeting of shareholders regarding the release from liability or to enter into an amicable settlement with the members of the board of directors or council, shall not restrict the right of a minority of shareholders to bring an action in accordance with the provisions of Section 172, Paragraph two of the Commercial Law. A decision of a meeting of shareholders to approve the annual accounts shall not of itself release members of the board of directors and council from liability for their actions during the relevant accounting period (Section 173 of the Commercial Law).

7. Liability of the members of board of directors of a capital company for losses in accordance with the Insolvency Law

Section 65, Paragraph one, Clauses 8 and 9 of the Insolvency Law: After proclamation of insolvency proceedings of a legal person an administrator shall:

- evaluate and bring an action in court against the members of the administrative bodies of a legal person and the participants (shareholders) of a capital company for the compensation of the losses caused thereby, as well as against the personally responsible members of a partnership in connection with their responsibility for the liabilities of the partnership with their property;
- request that the participants (shareholders) of the debtor honour their obligations in respect of the basic capital or other property of the debtor, and submit claims to court for the honouring of such obligations.

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BIERMAN ADVOCATEN – Netherlands

Directors' Duties In The Netherlands, An Overview

The word 'Director' is a rather confusing word in the Netherlands. A director can either be a board member (*Bestuurder*), usually appointed by the general meeting, or a member of the management team with a title 'director' (*Titulair directeur*), e.g. 'commercial director', the latter being an employee, appointed by a board member representing the company.

In this article, when referencing a 'director' it will be as a board member, appointed as such by the general meeting (*Algemene Vergadering*) or, in case the articles do contain a supervisory board (*Raad van Commissarissen*) with this power, appointed by the supervisory board.

This article does not elaborate on the special position of the non-executive director in a one tier board. Also the position of directors other than directors of private limited liability companies (*Besloten vennootschappen or B.V.*'s) is not included in this article.

a. Duties in Title 1 Book 2 Dutch Civil Code (*BW*) – General provisions.

Common for all legal entities are the general provisions listed in Title 1 Book 2 Dutch Civil Code.

a.1) The duty to act reasonable and fair (Article 2:8 DCC)

Being a person or persons involved in the organization of a legal entity, any director and the entire board of directors are obliged to behave in accordance with what is required by standards of reasonableness and fairness.

a.2) The duty to perform assigned tasks properly (Article 2:9 DCC)

Each director has his own duty of care for the proper performance of the tasks assigned to him. He furthermore has the duty to take action to avoid or to prevent the consequences of mismanagement of others. Unless no serious reproach for a director exists, failing to take action, triggers the joint liability of this director, also for mismanagement not attributable to him.

a.3) The duty to keep books (Article 2:10.1 DCC)

The board of directors is obliged to keep accounting records of the assets and liabilities of the legal entity and of everything regarding the activities of the legal entity in accordance with the requirements arising from these activities. This must be kept in a written statement in the company records, along with documents and other data in a storage media in such a way that at all times the rights and obligations of the legal entity can be known.

b. Duties in title 5 book 2 DCC - private limited liability companies

b. 1) The duty to file the company in Dutch commercial register (handelsregister) (Article 2:180 DCC)

b.2) The duty to keep a shareholders' register (Article 2:194 DCC)

As the Netherlands currently has no public shareholders' register, a shareholders' register of a legal entity (B.V.) is kept by the company. This register must contain the names and addresses of the shareholders, the date on which they became shareholder, the kind of shares and the amount paid. The register must also contain the persons having a lien (*pandrecht*) or usufruct (*vruchtgebruik*) on the shares. The register must also contain the name of holders of depository receipts issued for shares, in case a right to attend the shareholders' meeting (the *vergadergerechtigden*) is attached to such depositary receipts.

b.3) The duty of care regarding the acquisition of own shares (Article 2:207 DCC)

This duty comprises the (successful) performance of a balance test and a distribution test. The balance test should learn that the company's equity minus the acquisition consideration exceeds the formal reserves (the reserves which have to be maintained by virtue of law or the articles) of the company. The distribution test should learn that, after acquisition and payment thereof, the company can go on with the payment of its due and collectable debts.

b.4) The duty to withhold permission for reducing the company's capital (2:208 DCC)

The general meeting may decide to reduce the issued share capital through elimination of shares or by way of the reduction of the nominal amount of the shares. Such resolutions do not take effect as long the permission of the board therefore has not been given. The permission of the board should not been given once the board reasonably can foresee that, after execution of the shareholders' resolution, the company cannot continue the payment of its due and collectable debts (the distribution test).

b.5) The duty to draw up a balance sheet and a P&L account (Article 2:210 DCC)

The Board of Directors must, within five months after the end of the accounting year of the Company (except limited extension options), draw up the accounts, and deposit these together with the board report at the office of the Company for inspection by its shareholders.

b.6) The duty of care regarding dividend resolutions (Art. 2:216)

The general meeting may allocate the profits after the adoption of the accounts, and decide on dividends, to the extent that the equity exceeds the formal reserves. According to Dutch law such resolutions have no effect as long as the board does not approve such resolution. The only time the board should not approve if the distribution test fails.

b.7) The task and duty to convene meetings (Articles 2:218 to 221 DCC)

At least once a year a general meeting has to be convened. The right to convene is attributed to the board, but the articles may grant this right to other persons, such as any director or any shareholder. At a specific request of shareholders representing at least one (1) percent of the issued capital, the board has to convene a meeting within four weeks after such a request on subjects which were specified in it, unless a material interest of the company contravenes with this request (in which case the requesting shareholders can address the court in order to obtain a leave to convene a meeting themselves).

b.8) The duty to keep a record of the resolutions of the general meeting (article 2:230 BW)

b.9) The task and duty to manage the company in accordance with the interests of the company and the enterprise of the company (Article 2:239 DCC)

This is of course the key task of the board of directors. Restrictions in the articles may however apply: The articles can include an approval authority for other bodies of the company (e.g. the meeting of priority shareholders or the general meeting). The articles can also include a provision according to which the board has to live up instructions by such other bodies of the company. Such instructions must be respected, unless they conflict with the interests of the company.

The interests of the company and its affiliated enterprise should in any case be the interest to which the directors should focus. A director does not participate in the deliberations and decision-making if he has a direct or indirect personal interest contravening the interests of the Company.

What that interest exactly means depends on the circumstances of the case. If an enterprise is affiliated with the company, the corporate interest is generally determined by promoting the continuing success of this company. In the case of a joint venture company, the interests of the company are also determined by the nature and content of the cooperation agreed between the shareholders. The nature and content of the partnership in a joint-venture company in which the shareholders have an equivalent share, it may also mean that the company's interest benefits from the continuation of balanced relationships between the shareholders; this may mean that the relationships between the shareholders may not change further than is required in the light of the circumstances.

The corporate interest is also formed by the interests of its stakeholders, beside the shareholders the interests of employees and creditors need to be taken into account. For this contribution, it must be concluded that both the continuity of the company and the weighing of the interests of various stakeholders - whatever the starting point of that consideration - is relevant for the interpretation of the corporate interest to be taken into account.

b.10) The task to represent the company (Article 2:240 DCC)

b.11) The duty to present non misleading accounts and – if made available by the company – non misleading interim figures and annual board reports (Article 2:249 DCC) b.12) The duty to inform the Supervisory Board (Article 2:251 DCC)

c. Duties in title 9 book 2 DCC – financial reporting

c.1) Duty to insert specific data in the accounts (Article 2:392 DCC)

c.2) Duty to engage an accountant if the general meeting (of the supervisory board) fails to do so (Article 2:393 DCC)

c.3) Duty to publish the accounts in time (article 2:394 DCC)

This is an important duty and of the same importance as the duty to keep the books of the company in a proper way. Failing to do so may trigger a liability towards the trustee (*curator*) in a bankruptcy (*faillissement*) totalling the amount of the debts of the company as far as these cannot be recovered after realization of the assets of the Company (article 2:248 DCC). This liability can be invoked by the trustee once the board has performed its duties 'apparently improperly' (*kennelijk onbehoorlijk bestuur*) and this improper performance likely caused the bankruptcy. Failing to keep proper books or failing to publish accounts in time is apparent improper performance and triggers a legal presumption that this underperformance caused the bankruptcy. Apparent improper performance of directors may also cause personal liability of the director's towards the Dutch revenue service (*Belastingdienst*).

d. Other Duties

Various other directors' duties are mentioned in other regulations. e.g. the Works Council Act, in tax and environmental regulations and so on. In general any obligation imposed on companies requires a director to act. Failing to do so may trigger a liability towards the company using article 2:9 DCC mentioned above or a liability towards the trustee in a bankruptcy.

A special duty for directors in tax regulations is the duty mentioned in article 21 of the Tax Collection Act (*Invorderingswet*). According to this rule the board of directors must, within two weeks after its taxes have become due, report to the receiver of the revenue service (*de Ontvanger*) that the company is unable to pay. A failure to do so may lead to personal liability for unpaid taxes and social security premiums.

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CONNER & CO – Russia

I. Introduction

Russian law provides for around 10 types of commercial legal entities. Consequently, in this article, we are going to describe only the regulation of directors' duties in Limited Liability Companies ("**LLC**") and Joint Stock Companies ("**JSC**"), namely those entities which are more commonly used because of their comparable flexibility. As a rule, please note that directors' duties are established in the Russian Civil Code.

II. General

The Russian Civil Code[9] states that all executive officers and directors (i.e. members of the board of directors) ("**Directors**") must act in the interests of the legal entity that they represent both:

(1) in good faith; and
(2) behaving reasonably.

The same rules are established in the Federal Laws[10] [11] relating to LLCs and JSCs.

III. More detail as to their duties

Russian court practice[12] (hereinafter "**the Ruling**") states that if the Director either: (i) refuses to provide for his/her actions; or (ii) such explanation to a court is deficient, the court will be entitled to impose the burden of proof upon that Director to demonstrate that he/she acted in good faith. This means that there is **the presumption of the Director's bad faith** as an instrument of effective punishment. But, shareholders (claimants) still must approve losses and logical link between the Director's bad faith and losses.

Moreover, the Ruling provides us with an **open** list of examples of **acting in bad faith**. These are as follows:

(1) acting in conflict of interest between the personal interests of the director and the interests of the legal entity for which he/she works;
(2) concealing information from the shareholders of the company relating to a transaction the Director has, or providing false information the shareholders with respect to such a transaction;

[9] Russian Civil Code. Article 53, section 3.
[10] Federal Law as of 08.02.1998 No. 14-ФЗ "About Limited Liability Companies". Article 44, section 1.
[11] Federal Law as of 26.12.1995 No. 208-ФЗ "About Joint Stock Companies". Article 71, section 1.

[12] Ruling of the Plenum of the Supreme Arbitration Court of the Russian Federation No. 62 of July 30. section 1, paragraph 5

(3) concluding a transaction without the relevant approval of the other executive bodies of the legal entity, in cases where such approval is required as a matter of law or under the company's charter;
(4) retaining and refusing, after termination of his/her appointment, to relinquish to the legal entity any documents relating to circumstances which might have adverse consequences for the legal entity;
(5) acting in such a way that the Director knew or should have known that his/her actions (omissions) at the time they were committed did not meet the interests of the legal entity.

The Ruling[13] also provides us with a detailed description of **acting unreasonably**. This list is fairly open-ended and looks something like the following:

(1) making a decision without taking into account the relevant information;
(2) failing to request information usually requested in accordance with prudent business practice, before making a directorial decision;
(3) concluding a contract without observing the internal procedures that are usually required or taken within that legal entity for transactions of a similar nature.

What is more, negative consequences themselves do not mean that the Director breached his duties[14]. Russian law draws special attention to the need to act reasonably and in good faith.

As mentioned above, both executive officers and members of the board of directors have the same duties. Consequently, where the relevant legal entity suffers losses, there would usually be an issue as to how to split the liability between the Directors. It is stated that a shareholders' approval does not save the Directors from liability if they have also breached their own liabilities. However, if some of the members of the board of directors voted against the decision, which resulted in losses or, acted in good faith, ignored such voting, there will be no punishments for them.

IV. Conclusion

Broadly speaking, Russian law has similar regulation to most other jurisdictions. The duties of loyalty and care, as well as a variety of established liabilities force Russian Directors to participate in and control the business activity of their organization. This system attempts to protect shareholders' property rights.

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[13] Ruling of the Plenum of the Supreme Arbitration Court of the Russian Federation No. 62 of July 30, 2013. Section 3.
[14] Ruling of the Plenum of the Supreme Arbitration Court of the Russian Federation No. 62 of July 30, 2013. Section 1, paragraph 2.

BONACCORD – Scotland

Munday's article describes the legal responsibilities of directors in the United Kingdom. These apply to all directors and are quite straightforward but there are areas where businessmen still seem to become confused.

One area where particular care must be taken is in relation to start-ups. There are two main sources of concern here – an academic founder who is still active in the university, and an "Investor-director".

Unlike in the U.S., it is common in the U.K. for a founding academic to retain an academic position as well as becoming a director of a start-up, which may or may not be spun out of the university where he holds the post. The new company may contract with the university to have development work undertaken by the university, often in the same academic's laboratory and under his supervision. The potential for conflicts of interest is enormous. There is also potential for cross contamination of intellectual property or funding within the laboratory or for an over optimistic interpretation of results. In the very early stages where perhaps it is really only a one person company it is hard to avoid some duplication of role and the potential for conflict may not greatly matter but as more shareholders join the company the situation may become more sensitive. Appointing strong independent directors to the board or to a scientific advisory board as soon as is feasible may offer at least a partial solution. A lawyer experienced in the area or a patent agent with a close relationship to the project can also work with the company to ensure some clarity of function and demarcation between the company and the academic institution.

As the company grows investors are usually brought in and they will often want to appoint a representative to the board of a company into which they are putting funds. This usually suits both parties: the investor gains confidence that its funds are being appropriately applied and a better understanding of the business while the company gains a board member from outside the day to day management team who can bring a different perspective to the board's deliberations. Problems may arise however where the investor-director sees his role more as a representative of the investor rather than a co-director with exactly the same responsibilities and duties as the other board members.

Legally the position is very clear, every director has an obligation to take his decisions independently and in good faith to promote the success of the company for the benefit of its members as a whole. Directors cannot base their decisions of what is in the best interests of the investor that has appointed them and both the investor and the investor-director must be made to understand this. It is rarely much of a problem in large established companies as the people appointed and the investors concerned are usually well aware of their responsibilities and in any case the board will likely be quite large and diverse so their influence may well be limited. With a small company, especially a start-up, the investor and the investor-director are likely to have much greater influence over the company and the other directors and may also be less experienced in holding a directorship. Again it may be the company's lawyer that has to bring this up.

The law provides that any director, subject to compliance with certain formalities, can be removed by a vote of the holders of the majority of shares in the company. This should offer a remedy in situations where a director fails to live up to his responsibilities in particular to act in the interests of all the shareholders. Many investors try to get around this by putting a provision in the investment agreement obliging all the other shareholders to vote in favour of the appointment of "their" candidate and to refrain from voting for his subsequent removal. These provisions are to the benefit of no one as it can lead to a dysfunctional board and should be resisted. The agreement could easily provide for the investor to put forward an alternative if their first director were rejected however investors will argue hard to retain the clause.

A further argument that is sometimes put forward in relation to investor directors having a privileged position is that they are "only" non-executives and so should not be held to the same level of responsibility as those directors who are involved with the day-to-day running of the company. This is a misunderstanding of the law. U.K. law does not make any distinction between the responsibilities of different directors. Anyone appointed to the board of a company is expected to familiarise themselves sufficiently with the company to carry out their duties effectively and management should ensure that not only is this facilitated on the appointment of any director but that staff and information are made available thereafter at the director's request when they feel they need more information or to understand a matter more thoroughly. The availability of training and access to information and staff should be made clear in the contract appointing the director. Some estimate of the time commitment should also be included and discussed in advance with the proposed director as some investors appoint the same person to the board of a number of their investee companies and this can mean that your company is not getting the level of engagement you expect.

Young companies need strong and well organised boards so it is important to ensure that everyone understands and accepts their responsibilities from the beginning.

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MARIF UGURLU – Turkey

DUTIES AND LIABILITIES OF DIRECTORS IN A LIMITED LIABILITY COMPANY

I. INTRODUCTION

The purpose of this paper is to give a brief overview as to duties and liabilities of directors in a limited liability company (**“Company”**) under the Turkish Commercial Code (“**TCC**”) and related legislation. In general, directors of a Company are responsible for the management and the representation of the Company. Directors are authorized to decide all issues in relation to the management of the Company which are not explicitly reserved by law or the articles of association for resolutions of the shareholders’ general assembly. In principle, directors use this authority jointly; however, it is common to share management tasks among directors through internal regulation. Unless provided otherwise by the articles of association and unless the Company has only one director, a Company is represented through the signatures of at least two directors.

II. DUTIES OF DIRECTORS

The directors owe a duty of care and loyalty to the Company which compels them to act prudently and diligently, and to always pursue the interests of the Company and its shareholders in the performance of their roles and tasks. Directors shall be liable for violation of their obligations imposed by the law and the articles of association of the Company. Although the TCC allows for directors’ authority to be selectively transferred to the scope of the shareholders’ general assembly through means of stipulations included in articles of association; the exception to this are the non-transferable and compulsory duties of directors set forth in the TCC.

The TCC defines principle duties and responsibilities of directors as follows:

- To execute ultimate direction and management;
- To act prudently and diligently when conducting business and performing their duties and the business of the Company;
- To monitor and supervise the management and the business of the Company to ensure that it is in compliance with the principles of good faith and the interests of the Company and its shareholders;
- To supervise people to whom management functions have been delegated;
- To keep confidential information obtained during and after the term of duty;
- To attend board of directors meetings but refrain from attending board meetings regarding their own interests or the interests of certain close relatives;
- To establish a committee for early risk detection and management, if it is deemed necessary;
- To prepare the Company’s financial statements and annual report;

- To organize shareholder’s general assembly meetings and to implement general assembly resolutions;
- To notify the court if the Company’s liabilities exceed its assets and the Company is in bankruptcy;
- Not to engage in transactions with the Company unless authorised by the general assembly meeting, which can be for a maximum period of five years in relation to the repurchase of shares and to avoid any conflict of interest with the Company;
- Not to conduct or perform any action/transaction that may fall into the scope of Company’s business (non-competition);
- Not to become indebted to the Company in cash or any other non-cash benefit such a having guarantees, securities from Company.

Besides above duties, directors also have an equal treatment obligation towards shareholders, where they are expected to act in the same way towards any of the shareholders where conditions are comparable.

Last but not least, articles of association can be used to regulate those decisions adopted by directors which concern shareholders, or where there is a necessity to get the approval of shareholders, these may be presented to shareholders’ general assembly for such decisions. This is designed to allow a defined relationship between the general assembly and the Board of Managers to provide harmony and clarity for shareholders and further guard against deadlock scenarios. The existence of this consent mechanism (to transfer certain authorities to shareholders’ general assembly), which is not imperative, does not remove the responsibilities of directors arising from their primary decision making authority obligations under the TCC.

III. LIABILITIES OF DIRECTORS

Directors are liable towards the Company for any damage incurred if they fail to fulfil their duties. In this regard, it is necessary to prove fault on the part of the directors. If more than one director is held liable for the same damage, each of the directors is severally liable for such damage to the extent to which such damage may be attributed to that director personally.

In the event of a breach of duty, the Company, its shareholders and creditors may be entitled to bring a claim against the relevant director. However, creditors are only entitled to bring a claim against directors for indirect damages if the Company becomes insolvent. In this case creditors must first make an application to the Bankruptcy Administration to file a compensation claim against the directors.

Article 553 of the TCC sets out conditions for the existence of directors’ liability as follows:

- The director must have breached his duties under the legislation or the articles of association;
- The director must have acted with fault (including negligence);
- The Company, shareholders or creditors must have suffered a loss/damage as a result of the breach;
- There must be a causal link between the loss/damage and the director's breaches.

Directors who have delegated their duties (to the extent legally possible) arising from the law or the articles of association do not bear any liability for the acts and decisions of the director unless it is established that they failed to show due care in the selection of delegates. In relation to directors' negligence, the required standard of care is that given by a prudent director, who acts cautiously and considering the interests of the Company in good faith.

Last but not least, Article 10 of the Tax Procedural Law states that the authorized representatives of the Company are compelled to fulfil tax obligations. This includes the directors of the Company as well as the individuals to whom power has been duly delegated. In cases where taxes and related receivables have not been paid to the governments by the Company, the authorized representatives shall endorse liability on their private assets in cases where the assets of the Company did not allow the taxes to be paid partially or totally. Concerning other forms of public receivables, Article 35 of the Law on the Procedures of Collection of Public Receivables states that authorized representatives of Limited Liability Company shall also be accountable in situations where the assets of the Company are not sufficient to recover public debts other than taxes. Directors and their delegates shall be severally and jointly liable for taxes and public receivables that have accrued in their office terms.

IV. RELEASE AND DISCHARGE OF DIRECTORS

The liability of directors may be limited or fully discharged upon resolution of shareholders’ general assembly. This resolution is only effective for disclosed facts and only against the Company and those shareholders who approve the resolution or who have since acquired their shares in full knowledge of the resolution.

The release of directors by a shareholders’ general assembly resolution constitutes an affirmation by the Company that the director’s actions during the term covered by the resolution have been in compliance with the law and in the interests of the Company. The resolution may be adopted by simple majority of votes represented at the meeting. This resolution cannot be withdrawn by another shareholders’ resolution. However, a court decision ordering the cancellation of the resolution may be granted under certain conditions based on conflict with the articles of association or with applicable legal provisions.

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DUNNINGTON, BARTHOLOW & MILLER – United States

DIRECTOR DUTIES

New York Law

Director's duties can be found in § 717 of the New York Business Corporation Law. In addition to this, New York Courts have made significant contributions to these duties, defining clear responsibilities and liabilities for Directors, thus enabling them to act in a way that protects the corporation, the shareholders and their own interests. Director's duties arise from the fiduciary relationship they have towards the corporation and its shareholders; generally, a fiduciary relationship is a situation where one person rests special trust in another or where a special duty exists on the part of one person to protect the interests of another. *In re Bear Stearns Litig.*, 23 Misc 3d 447 (NY Sup 2008) quoting *Wal–Mart Stores, Inc. v. AIG Life Ins. Co.*, 872 A.2d 611 (Del.Ch.2005) .

Director's fiduciary duties and obligations are as follows:

(a) Obligation to act in Good Faith:

A Director shall perform his duties as a Director, including his duties as a member of any committee of the board upon which he may serve, in good faith and with that degree of care which an ordinarily prudent person in a like position would use under similar circumstances.

In performing his duties, a Director shall be entitled to rely on information, opinions, reports or statements, including financial statements and other financial data. This information may come from:

i. One or more officers or employees of the corporation who are believed to be reliable;

ii. Counsel, public accountants or other persons, as to matters within their professional or expert competence; or

iii. A committee of the board upon which the Director does not serve as to matters within its designated authority.

When acting in good faith, Directors are safeguarded by the Business Judgment Rule. The Business Judgment Rule states a presumption that in making a business decision, the Directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the corporation. A decision which is made based on information and diligence will be covered by the Business Judgment Rule, in which case, if the decision ends up being prejudicial for the corporation, the Director will only be liable in cases of gross negligence or worse misconduct.

(b) Obligation to Consider the Effects of Change in Control

When making decisions that may entail a change in the control of the corporation, Directors shall be entitled to consider the long and short term interests of the corporation, and its shareholders. According to § 717, Directors shall be entitled to consider the effects upon any of the following:

i. The prospects for potential growth, development, productivity and profitability of the corporation;

ii. The corporation's current employees;

iii. The corporation's retired employees and other beneficiaries receiving or entitled to receive retirement, welfare or similar benefits from or pursuant to any plan sponsored, or agreement entered into, by the corporation;

iv. The corporation's customers and creditors; and

v. The ability of the corporation to provide, as a going concern, goods, services, employment opportunities and employment benefits and otherwise to contribute to the communities in which it does business.

Control shall refer to the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of the corporation, whether through the ownership of voting stock, by contract, or otherwise. (N.Y. Bus. Corp. Law § 717)

(d) Duty of Loyalty:

The fiduciary duty of loyalty imposes on Directors an obligation not to assume and engage in the promotion of personal interests which are incompatible with the superior interests of their corporation as they owe the corporation their undivided and unqualified loyalty. *Foley v. D'Agostino*, 248 N.Y.S.2d 121 (N.Y. App. Div. 1st Dept. 1964)

Accordingly, Directors should not be permitted to gain personal profit at the expense of the corporation. It is of the utmost importance that Directors don't allow their private interests to conflict with the interests of the corporation. Simply put, Directors must place the interests of the corporation above their own personal gains.

In addition to the aforementioned, the duty of loyalty prevents Directors from taking opportunities that belong to the corporation for themselves, such as:

i. Use of corporation property: Directors cannot use corporation property, information, or resources to develop their own business or for personal use. This means Directors cannot use anything they learned while performing their duties for the corporation for other ventures;

ii. Corporate expectancies: Directors may not assume for themselves properties or interests in which the corporation is “interested,” or in which the corporation can be said to have a tangible “expectancy;” or which are important to corporation’s business or purposes. For instance, if the corporation has leased a property, a Director can’t buy the property for himself. If it’s reasonably foreseeable that the corporation would be interested in a property, then there is expectancy on the part of the corporation, or if opportunity relates very closely to business of corporation, there is also expectancy.

<u>(c) Duty of Care:</u>

When performing their duties, Directors must act with such care as an ordinarily prudent person in a similar position would under the same circumstances. The fiduciary duty of due care, obligates Directors to act on an informed and <u>reasonably diligent</u> basis in considering material information. *Hanson Tr. PLC v. ML SCM Acq., Inc.,* 781 F.2d 264 (2d Cir. 1986).

This duty is also related to the aforementioned Business Judgment Rule. Director’s decisions are protected by the Business Judgment Rule only to the extent that their decisions actually show their business judgment, absent fraud, oppression, arbitrary action, and breach of trust. This entails that Directors must show formalities were followed when making a decision, such as discussing the information on which the decision was based or when facing a task that a Director doesn’t know have the personal expertise to handle, Directors must either make an inquiry to gain necessary knowledge or relinquish their duties and step down. Bearing this in mind, a Director must:

i. Keep informed of the corporation activities;

ii. Monitor corporate affairs;

iii. Maintain familiarity with corporate finances.

A showing that the Director was not prudent or that there was an alternative course of action will not suffice to prove that he or she breached their duty of care.

Delaware Law

In light of the flexible statutory treatment which the State of Delaware offers and the depth of the body of caselaw decided by the Delaware court system, Delaware is often the jurisdiction of choice for incorporation given its flexibility and predictability. Many of the rulings made by Delaware’s courts are referenced in New York disputes to shine a light on the case. Bearing this in mind, it is customary for New Yok Attorneys to routinely advise on matters involving Delaware corporate law.

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KIMURA LONDON – United States

Directors' Duties in California

I. Introduction - The Role of Directors

Unless it chooses to delegate any of its authority, all powers of management and control of a corporation are vested in its Board of Directors. (California Corporations Code §300(a)). Typically, the Board delegates to the corporation's elected officers the authority to conduct the corporation's day-to-day operations in the ordinary course of business.

However, specific board action will be required for any action that has not been delegated or is not in the ordinary course of business. Such actions can include everything from adoption of business policies, to authorizing significant transactions (for example, acquisitions, leases, contracts), to approval of changes in the corporation's structure. Further such matters can include:

- Election or removal of officers
- Mergers, reorganizations
- Adoption or amendment of bylaws
- Authorizing sale and issuance of securities
- Corporate borrowing and loans
- All transactions between the corporation and any of its officers, directors, or shareholders
- Employee compensation
- Calling shareholder's meetings
- Amendment of articles

II. Directors' Duties and Standards

Duty of Loyalty:

A Director's duties must be executed in good faith and performed in a manner the Director believes to be in the best interests of the corporation and its shareholders. (Corp C §309(a)). There is also to be no self-dealing, such that a corporate Director might appear on both sides of a transaction or receive benefits not generally shared by the shareholders. And lastly, a Director must act in the best interests of the corporation, even if that is at the expense of their own interests.

Duty of Care:

A Director's duties must be performed with such care, including reasonable inquiry, as an ordinarily prudent person in a similar position would use under similar circumstances. (Corp C §309(a).) Notably, a Director can be held liable for acting negligently, even if a Director does not personally gain from the questioned transaction. Directors must attend and participate in meetings, so they can be informed about the association's business. They must make reasonable inquiries regarding maintenances issues or rule violations, and must also make decisions, keep corporate records, and enforce and follow the governing documents of the corporation.

Business Judgment Rule:

In exercising their duty of care, Directors are usually protected from mere negligence by the business judgment rule. A director who exercises reasonable diligence and who, in good faith, makes an honest, unbiased decision will not be held liable for mere mistakes and errors in business judgment. Directors who abdicate their responsibilities by not adequately informing themselves about the corporate business, however, are not protected by the business judgment rule, because they simply fail to exercise any judgment.

Corporate Opportunities:

A corporate officer or a director may not usurp for himself or herself business opportunities that are within the corporation's line of activities, and in which the corporation might have a legitimate business interest, without first offering that business opportunity to the corporation, with full disclosure.

Transactions Between the Corporation and its Directors (Insider Transactions):

Transactions between the corporation and its Directors are generally permitted if, after full disclosure, the transaction is approved by either shareholders or a disinterested majority of the board. (Corp C §310(a)). Even if it is not properly approved, the transaction is not voidable if the interested Director can prove that the transaction was fair and reasonable to the corporation when it was entered into.

Statute of Limitations:

Any lawsuit for breach of fiduciary duties by a director must be brought about within three years.

III. Applicability of California Law to Directors of Foreign Corporations

Generally, the laws of the state where the corporation is formed will govern the internal affairs of a corporation.

However, in some circumstances, the law of the state of incorporation is NOT applied where another state has a "more significant relationship" to the parties and transaction at issue.

Many provisions of the California Corporation Law apply if the corporation has sufficient "presence" here in California. In such a case, the corporation is treated as a "pseudo-foreign corporation," and is thus subject to specified provisions of California law.

Sufficient "presence" in California can include, for example, where more than half of the corporation's business (based upon property, payroll, and sales) occurs in California, or, more than half its voting securities are held of record by persons having addresses within the state. (Corp C §2115).

Specific California provisions that apply to these “pseudo-foreign corporations” are, among others, shareholder’s rights to elect Directors, Directors’ duties of care to the corporation, limitations on indemnification of Directors, and limitations on corporation distributions. Further, California’s statutory prohibitions on insider trading (Corp C §25402) also apply to Directors of such foreign corporations.

In contrast, “pseudo-foreign corporation” rules do NOT apply to listed companies, nor do they apply to subsidiaries of foreign companies that are owned by a corporate parent and where the corporate parent itself does not meet the above definition of a “pseudo-foreign corporation.”

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