European Business Organization Law Review 15: 191-233 191
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The Evolving Structure of Directors' Duties in Europe

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Abstract
Corporate mobility in Europe continues to be on the rise, both creating space for regulatory arbitrage by companies and influencing legislative decisions in corporate law and related fields. This has triggered debates in European company law that centre on questions of harmonisation, cross-jurisdictional convergence and the superiority of certain regulatory approaches and legal families. This article uses a large cross-country sample of EU Member States to classify legal strategies in corporate governance and assess claims of convergence and the superiority of legal families. We analyse board structure, the most important duties of directors, namely the duties of care and loyalty, questions of enforcement, and the position of directors in the vicinity of insolvency, and develop a taxonomy of legal strategies across the Member States. We find that, in spite of differences in regulatory technique and legal tradition, the effect of the legal strategies employed by the Member States is often remarkably similar and legal systems exhibit interconnections in the form of mutual learning across borders. In addition, we show that, in contrast to claims by parts of the literature, judicial innovation is not restricted to particular legal families. We argue that all legal families are, in principle, well equipped to react to new developments and draw on general or unwritten principles of law to fill regulatory gaps. However, a precondition for the emergence of effective rules seems to be a sufficiently large body of case law and, accordingly, access to the courts and an efficiently functioning judicial system. Consequently, we submit that questions of enforcement are of greater importance than a particular legislative or regulatory style.

Keywords: directors' duties, duty of care, business judgment rule, duty of loyalty, vicinity of insolvency, derivative action, legal transplants.

1. Introduction

Corporate mobility in Europe continues to be on the rise, both creating space for regulatory arbitrage by companies and continuing to influence legislative decisions in corporate law and related fields.[1] This naturally triggers debates about the har-

[1] See, e.g., J. Armour, 'Who Should Make Corporate Law? EC Legislation Versus Regulatory Competition', 58 *Current Legal Problems* (2005) p. 369; L. Enriques and M. Gelter, 'Regulatory Competition in European Company Law and Creditor Protection', 7 *European Business Organization Law Review (EBOR)* (2006) p. 417; M. Gelter, 'The Structure of Regulatory Competition in European Corporate Law', 5 *Journal of Corporate Law Studies* (2005) p. 247; J. Armour and W.G. Ringe, 'European Company Law 1999-2010: Renaissance and Crisis', 48 *Common Market Law Review* (2011) p. 125; C. Gerner-Beuerle and E.P. Schuster, 'The Costs of Separation: Friction Between Company and Insolvency Law in the Single Market', *Journal of Corporate Law Studies* (forthcoming 2014), also available as LSE Law, Society and Economy Working Paper 6/2014.

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monisation of company law[2] as well as questions about cross-jurisdictional convergence in this area.[3]

This article seeks to contribute to the discussion by providing an overview of some of the core aspects of corporate governance across Europe: board structures and the design and enforcement of directors' duties. Of course, it would be impossible for us to provide a comprehensive overview of how directors' duties are regulated across all European jurisdictions, and we do not attempt to do so. Instead, we want to create a starting point for a discussion of this topic by mapping some of the differences in, and common features of, the legal landscape in Europe.

The analysis proceeds as follows. Section 2 provides a brief overview of the prevalent board structures that can be found in the EU. Section 3 discusses the two main aspects of directors' duties, care and loyalty, and section 4 focuses on the enforcement of these duties. Section 5 describes the legal strategies used to address problems arising in companies approaching insolvency. Section 6 concludes.

2. Board structure

Before turning to the content of directors' duties in Europe, it may be useful to also review differences in board structures across the EU jurisdictions. Board structures can have an important impact on the functioning and performance of a board,[4] including on directors' attitudes towards risk.[5] They determine the allocation of decision-making – and, consequently, responsibility for the decisions – within a company.[6] Moreover, to the extent that a legal system relies on enforcement of directors' duties through the

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[2] See, e.g., European Parliament Resolution of 14 June 2012 on the future of European company law, 2012/2669(RSP) ('due consideration should be given to the resumption of work on the Fifth Company Law Directive').

[3] See recently P.L. Davies and K.J. Hopt, 'Corporate Boards in Europe – Accountability and Convergence', 61 *American Journal of Comparative Law* (2013) p. 301; P.L. Davies, K.J. Hopt, R.G.J. Nowak and G. van Solinge, 'Boards in Law and Practice: A Cross-Country Analysis in Europe', in P.L. Davies, et al., eds., *Corporate Boards in Law and Practice: A Comparative Analysis in Europe* (OUP 2013).

[4] See, e.g., K.J. Hopt, 'Modern Company and Capital Market Problems: Improving European Corporate Governance After Enron', in J. Armour and J.A. McCahery, eds., *After Enron: Improving Corporate Law and Modernising Securities Regulation in Europe and the U.S.* (Hart 2006) p. 453; P.L. Davies, 'Board Structure in the UK and Germany: Convergence or Continuing Divergence?', 2 *International and Comparative Corporate Law Journal* (2001) p. 435; C. Jungmann, 'The Effectiveness of Corporate Governance in One-tier and Two-tier Board Systems: Evidence from the UK and Germany', 4 *European Company and Financial Law Review* (2006) p. 426; K.J. Hopt and P.C. Leyens, 'Board Models in Europe – Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy', 1 *European Company and Financial Law Review* (2004) p. 135.

[5] See, e.g., A.B. Gillette, T.H. Noe and M.J. Rebello, 'Board Structures Around the World: An Experimental Investigation', 12 *Review of Finance* (2008) p. 93.

[6] See, e.g., Davies, et al., *supra* n. 3.

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company bodies themselves, different board structures may affect the incentives for holding managers to account.[7] Similarly, board composition, and in particular employee participation, may affect how directors' duties operate in practice.

Traditionally, most jurisdictions have mandated the way in which corporate boards are structured,[8] offering incorporators rather limited choice. Consequently, company law systems are often classified as following the one-tier or the two-tier system. Under the typical 'dualistic' or two-tier model, a company has two distinct boards, one with purely supervisory functions and a management board responsible for the day-to-day management. In the 'monistic' or one-tier model, on the other hand, the two functions are exercised by a unified board, as is typically the case in UK companies.

While this is a convenient starting point, three aspects limit the usefulness of this categorisation. First, a recent trend towards more choice can be identified. A growing number of Member States now allow companies to choose between two or more board models. It seems likely that this process has at least in part been influenced by a similar approach taken at European level in relation to the SE,[9] and perhaps by the increase in corporate mobility across the EU.[10] Consequently, fewer jurisdictions can be classified as clearly following either the traditional one-tier or two-tier system, as almost half of the Member States[11] now offer choice between at least two different board structures.[12] Of the remaining Member States, seven require one-tier structures,[13] another seven mandate a two-tier[14] board. One country,

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[7] The same is also true, of course, for corporate ownership structures, which also differ widely across Member States; see, e.g., M. Faccio and L.H.P. Lang, 'The Ultimate Ownership of Western European Corporations', 65 *Journal of Financial Economics* (2002) p. 365; F. Barca and M. Becht, eds., *The Control of Corporate Europe* (Oxford, OUP 2001).

[8] The UK is one of the few exceptions, as corporate law has traditionally left board structure to be regulated in the articles of incorporation; see, e.g., Davies, et al., *supra* n. 3.

[9] See Art. 38 of the SE Statute (Council Regulation (EC) No 2157/2001 on the Statute for a European Company (SE)). Research suggests that the added flexibility of governance (board) systems offered by the SE has been an important driver for SE creations; see H. Eidenmüller, A. Engert and L. Hornuf, 'Incorporating Under European Law: The Societas Europaea as a Vehicle for Legal Arbitrage', 10 *EBOR* (2009) p. 1.

[10] See, e.g., Armour and Ringe, *supra* n. 1, and the literature cited there.

[11] 13 of the 28 Member States (Bulgaria, Croatia, Denmark, Finland, France, Hungary, Italy, Lithuania, Luxembourg, the Netherlands, Portugal, Romania and Slovenia).

[12] For details on the available choices, see the study by C. Gerner-Beuerle, P. Paech and E.P. Schuster, *Study on Directors' Duties and Liability* (London 2013), available at <http://ec.europa.eu/internal_market/company/docs/board/2013-study-analysis_en.pdf>, at pp. 4-5 (last accessed 09/02/2014).

[13] I.e., Belgium, Cyprus, Greece, Ireland, Malta, Spain and the UK. Note that UK, Cypriot and Irish law does not formally require a one-tier structure, allowing for the adoption of a two tier-like structure; see Davies, *supra* n. 4. Nevertheless, these jurisdictions are still best classified as one-tier countries, given that the core powers and responsibilities of directors would remain unaffected by such a structure. Moreover, to our knowledge, no public company has yet attempted to replicate a two-tier structure in these jurisdictions.

[14] I.e., Austria, the Czech Republic, Estonia, Germany, Latvia, Poland and Slovakia.

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Sweden, is difficult to put into either category: here, the board consists entirely, or almost entirely, of non-executive directors, and management is delegated to the CEO (who may or may not be a director). The CEO, in turn, appoints the remaining executives, who are not formally directors of the company. The Swedish system thus has features of both one-tier and two-tier systems.[15] Similarly, while Italy offers a choice between three different board structures, the most popular board structure there[16] is also difficult to put into either category, although it more closely resembles a unitary board.[17]

Second, closer examination reveals significant differences even within the two (or three) categories. For instance, most jurisdictions with mandatory or optional two-tier structures insulate the management board from shareholders by assigning removal rights exclusively to the supervisory board, and typically requiring good cause for such removal.[18] A number of Member States, however, do permit removal of management board members by the supervisory board members without cause,[19] or direct removal by the shareholders.[20] Clearly, differences of this kind may affect the operation of corporate boards in practice.

Finally, *functional* differences between the different systems are increasingly hard to pin down. Delegation of powers to full-time managers and rigid separation of board functions carried out respectively by executive and non-executive directors on one-tier boards increasingly blur the line between them, as corporate governance practices converge.[21]

To a large extent, the choice of board structure seems to be influenced by the availability of employee participation arrangements. Thirteen Member States[22] provide some form of mandatory board-level employee participation, with France as the most recent

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15 See R. Skog, 'Corporate Boards in Sweden', in Davies, et al., eds., *supra* n. 3, p. 624. This 'Scandinavian model' is also available (as a choice) in Finland and Denmark.

16 The so-called 'traditional system', whereby a board of directors composed of both executive and non-executive members is supplemented by a board of auditors.

17 See the study by C. Gerner-Beuerle, P. Paech and E.P. Schuster, *Study on Directors' Duties and Liability* (London 2013), available at <http://ec.europa.eu/internal_market/company/docs/board/2013-study-analysis_en.pdf>, at p. 16 (last accessed 09/02/2014); see also G. Ferrarini, G.G. Peruzzo and M. Roberti, 'Corporate Boards in Italy', in Davies, et al., *supra* n. 3, p. 374.

18 This is the traditional German model, also applicable in Austria, Croatia, Estonia, Latvia, Poland and Slovenia.

19 E.g., the Netherlands, where consultation of the shareholder body is also required. Without cause, removal by the supervisory board is also available under the two-tier structures in Italy, Luxembourg, Finland, Denmark, Lithuania, Bulgaria and Slovakia.

20 E.g., in Portugal, as well as in the Czech Republic and Luxembourg if so provided by the articles of association.

21 See the discussion in Davies, et al., *supra* n. 3, at pp. 11-13.

22 Austria, Croatia, the Czech Republic, Germany, Denmark, Finland, France, Hungary, Luxembourg, the Netherlands, Slovenia, Sweden and Slovakia.

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addition.[23] In all jurisdictions with board-level employee participation, two-tier boards or 'Scandinavian-style' non-executive boards are either mandatory[24] or made available by company law.[25] This typically results in employee representatives not directly participating in the day-to-day management decisions, but rather in strategic planning and management supervision. Within these structures, employee representatives are however subject to essentially the same duties as board members appointed by the shareholders. Unsurprisingly, the jurisdictions providing for employee participation also tend to define directors' duties with reference to a more 'inclusive', stakeholder-focused understanding of the 'interest of the company', and mediate shareholder rights in relation to the appointment of the company's executives.[26]

3. DIRECTORS' DUTIES

It is widely accepted that directors' duties play an important role in constraining the discretion of directors and holding them accountable if they extract private benefits of control or fail to exercise due care. Accordingly, directors' duties can be found in the company laws of all Member States of the EU. However, the precise formulation of directors' duties varies considerably, both as far as the Member States' general regulatory approach is concerned and in terms of structure and content of the duties. In a few Member States, fiduciary duties are not codified but derive from general principles of law, notably from fiduciary principles. These principles are particularly well developed in common law jurisdictions, where they are trust-law based and largely uncodified.[27] Directors are conceptualised as trustees who have to

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[23] Since June 2013, but only for the largest companies; see Art. L225-79-2 of the French Commercial Code. An English translation of the Commercial Code is available at: <http://www.legifrance.gouv.fr/Traductions/en-English/Legifrance-translations>.

[24] In Austria, the Czech Republic, Denmark, Finland, Germany, Slovakia and Sweden. In Denmark and Finland, the choice is between a two-tier board and a Scandinavian-style board.

[25] In Croatia, France, Hungary, Luxembourg, the Netherlands and Slovenia.

[26] See for details, the study by C. Gerner-Beuerle, P. Paech and E.P. Schuster, *Study on Directors' Duties and Liability* (London 2013), available at <http://ec.europa.eu/internal_market/company/docs/board/2013-study-analysis_en.pdf>, at pp. 12-20 (last accessed 09/02/2014).

[27] In contrast, the law in civil law jurisdictions has predominantly evolved based on principles of agency law in defining the position and duties of directors. From the perspective of common law, the conceptualisation of directors as trustees has the consequence that more demanding expectations are placed on them than on agents: 'Directors are not only agents, but to a certain extent trustees. … The duty of directors to shareholders is so to conduct the business of the company, as to obtain for the benefit of the shareholders the greatest advantages that can be obtained consistently with the trust reposed in them by the shareholders and with honesty to other people; and although it is true that the directors have more power, both for good and for evil, than is possessed by the shareholders individually, still that power is limited and accompanied by at trust, and is to be exercised bona fide for the purposes for which it was given, and in the manner contemplated by those who gave it', N. Lindley, *A Treatise on the Law of Partnerships, Including its*

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act exclusively for the benefit of the beneficiaries (the shareholders). The trust-law origin of directors' duties is still discernible in some jurisdictions and with respect to specific issues, for example, remedies for a breach of duty.[28] In line with the historical development, the duties continue to be uncodified in the common law jurisdictions Ireland and Cyprus, and have only recently been codified in the UK.[29]

A second point of difference between Member States is the level of detail with which duties are formulated in statute or case law. Some jurisdictions provide for a largely exhaustive list of narrowly defined duties, and others rely on a general clause that lays down the behavioural expectations of directors in broad terms. This difference in structure and formulation of the duties does not follow the dividing lines between legal families or, more generally, between common law and civil law. Directors' duties may be uncodified but nevertheless distinguish between specific duties and attempt to regulate all relevant conflicts exhaustively. This is the case with Cyprus, Ireland and (until the company law reforms of 2006) the UK. On the other hand, civil law jurisdictions may simply provide for a broad formulation of directors' responsibilities, which we observe, for example, in some jurisdictions belonging to the French legal family[30] and in the Nordic and Baltic countries.[31]

Application to Companies (Callaghan & Company 1878), at p. 364. Civil law jurisdictions are less familiar with the concept of the trustee; they have not developed a clear distinction between trust and agency. Rather, they generally assume that certain principles of good faith and honesty underlie all contractual or commercial relationships (see, for example, s. 242 of the German Civil Code, requiring debtors to act in good faith and take account of customary practice).

[28] See UK Companies Act 2006, s. 178(2), providing that directors' duties (with the exception of the duty of care, which is not considered to be of a fiduciary nature) are 'enforceable in the same way as any other fiduciary duty'. The consequence is that directors may, for example, be treated as constructive trustees if they obtain the company's property in breach of directors' duties, see *JJ Harrison (Properties) Ltd* v. *Harrison* [2002] 1 B.C.L.C. 162 (CA).

[29] The Companies Act 2006 for the first time codifies directors' duties in ss. 171-177.

[30] See Belgian Commercial Code, Art. 527 (imposing liability on directors according to general law for faults committed in the exercise of their management; text available at: <http://www.ejustice.just.fgov.be/loi/loi.htm>); French Commercial Code, Arts. L225-251 (one-tier *société anonyme*), L225-256, L225-257 (two-tier *société anonyme*) (liability for management mistakes, breaches of the articles or the law; for the English text of the Commercial Code, see the reference *supra* n. 23); similar Luxembourg Companies Act, Art. 59 (text available at: <http://www.legilux.public.lu/leg/textescoordonnes/codes>, English translation available at: <http://law.au.dk/en/research/projects/europeanmodelcompanyactemca/nationalcompaniesactsofeumemberstates>); Dutch Civil Code, s. 2:9 (directors are responsible 'for a proper performance of the tasks assigned to [them]'; English translation available at: <http://www.dutchcivillaw.com>).

[31] See Danish Companies Act, s. 361(1) (directors are liable for damages if they intentionally or negligently cause damage to the company, shareholder or third parties; English translation available at: <http://danishbusinessauthority.dk/legislation>); similar Finnish Companies Act, Ch. 1, § 8, Ch. 22, § 1 (English translation available at: <http://www.finlex.fi/en>); Swedish Companies Act, Ch. 29 § 1; Latvian Commercial Law 2000, s. 169(1) (general duty to act as a prudent and careful manager). Unofficial English translations of the Swedish and Latvian acts are available at the website of the European Model Company Act (EMCA) Group: <http://law.au.dk/en/research/projects/europeanmodelcompanyactemca/nationalcompaniesactsofeumemberstates>.

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Other French legal origin countries, however, have recently moved towards a system of specific and express duties.[32] The picture is similar in countries belonging to the German legal tradition. We find jurisdictions that delimit directors' duties fairly precisely,[33] and jurisdictions that lack, for example, the requirement that directors shall avoid any conflict of interest with the company.[34]

In addition, all legal systems draw on principles of general contract law, tort law or fiduciary principles to supplement the company law-specific rules and amplify directors' duties, notwithstanding the extent to which the duties are codified.[35] Thus, the difference between common law and civil law, or between legal families, seems to have lost much of its relevance as corporate law reforms benefit from mutual learning and legal concepts are diffused internationally even without harmonisation efforts at European level.

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[32] See Spanish Corporate Enterprises Act 2010, ss. 225-232 (providing for a separate regulation of the duties of care, loyalty, non-competition, confidentiality, corporate opportunities and conflicts of interest; English translation available at: <http://law.au.dk/en/research/projects/europeanmodelcompanyactemca/nationalcompaniesactsofeumemberstates>); Portuguese Code of Commercial Companies, as amended in 2006, Arts. 64(1)(a), (1)(b), 397(2) and 398(3) (not as detailed as Spanish law but now also distinguishing between the duties of care, loyalty, the duty to disclose related-party transactions, and the duty of non-competition; English translation available at: <http://www.cmvm.pt/EN/Legislacao_Regulamentos/Legislacao%20Complementar/Emitentes/Pages/default.aspx>). In Italy, the company law reform of 2003 amplified directors' duties. In addition to the general clause of Arts. 1175 and 1375, which stem from the law of obligations and lay down the duty to act in good faith when fulfilling contractual obligations, the Civil Code contains an explicit duty of care (Art. 2392(1)), a duty of non-competition (Art. 2390), a corporate opportunities doctrine (Art. 2391(5)) and rules on the regulation of related-party transactions (Art. 2391). The Italian Civil Code (in Italian) is available at: <http://www.altalex.com/index.php?idnot=34794>.

[33] For example, Slovenia, see Slovenian Companies Act, Arts. 38a, 41 and 263(1), distinguishing between the duties of care, of non-competition, and the duty to avoid conflicts of interest (English translation available at: <http://www.mgrt.gov.si/en/legislation_and_documents/legal_acts_in_force>).

[34] The German Stock Corporation Act, for example, contains only an express duty of care (§ 93(1) Stock Corporation Act), but no duty to avoid conflicts of interest. For an English translation, see: <http://law.au.dk/en/research/projects/europeanmodelcompanyactemca/nationalcompaniesactsofeumemberstates>.

[35] For example, French, Belgian and Dutch law utilises the general liability provisions of the law of tort and negligence, see Belgian Civil Code, Arts. 1382 and 1383; French Civil Code, Arts. 1382 and 1383 (providing that '[a]ny act whatever of man, which causes damage to another, obliges the one by whose fault it occurred, to compensate it', translation available at: <http://www.legifrance.gouv.fr/Traductions/en-English/Legifrance-translations>); Dutch Civil Code, s. 6:162 (providing that '[a] person who commits a tortious act (unlawful act) against another person that can be attributed to him, must repair the damage that this other person has suffered as a result thereof', translation available at: <http://www.dutchcivillaw.com>). Other examples where the courts have developed unwritten principles to close gaps in the statutory regime are discussed below in the context of the duty of loyalty (section 3.2).

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In spite of the differences in detail, two basic behavioural expectations can be identified that all legal systems impose on directors. Using common law terminology, these are the duties of care and loyalty. The former deals with the care, skill and diligence that a director is expected to employ in managing the company, and the latter with situations where the director's interest conflicts with the interests of the company. We will address both duties in turn.

3.1 **Duty of care**

The duty of care has been a central feature of the governance structure of corporations since the emergence of the business corporation in the 19th century.[36] Broadly speaking, and abstracting from the differences in the detailed formulation of the standard of care in the Member States, it requires directors to make managerial decisions based on sufficient information and after careful assessment of the alternatives and likely outcomes, to ensure that they possess the necessary skills and experience to discharge their functions effectively, to establish information and monitoring systems, and generally to supervise business operations. Despite the fact that the duty, accordingly, addresses a key concern for the successful operation of business enterprises and can be found, in one form or other, in all EU Member States, its effectiveness in constraining managerial discretion and protecting the interests of the shareholders has been questioned in the literature, and the duty is generally regarded as being not well enforced.[37] Even in countries with relatively active shareholders and sophisticated courts, such as the UK, private enforcement of the duty of care is rare[38] and the determination of the duty's content relies to a significant extent on public enforcement mechanisms.[39] In many countries, enforcement – private or public – is close to zero and the behavioural expectations of the duty are, consequently, not well defined.[40] We will discuss two essential preconditions for the duty of care to function as an effective control strategy: the definition of the standard of care and the protection that the law accords to directors who make well-informed, good-faith business decisions.[41]

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[36] For an early case, see, for example, *Overend & Gurney Co* v. *Gibb* (1871-72) L.R. 5 H.L. 480.

[37] R. Kraakman, et al., *The Anatomy of Corporate Law*, 2nd edn. (OUP 2009), at pp. 78-79.

[38] J. Armour, B. Black, B. Cheffins and R. Nolan, 'Private Enforcement of Corporate Law: An Empirical Comparison of the United Kingdom and the United States', 6 *Journal of Empirical Legal Studies* (2009) p. 687, at p. 699.

[39] For example, in the context of disqualification proceedings, see *Re Barings plc (No. 5)* [1999] 1 BCLC 433, confirmed [2000] 1 BCLC 523, CA.

[40] Anecdotal evidence indicates that even in economies with accessible and well-functioning judicial systems and considerable corporate activity, such as Germany, private enforcement of the duty of care is very low.

[41] Below we also analyse the regulatory framework governing private enforcement of directors' duties, in particular by minority shareholders (section 4). For a more detailed discussion of the potential reasons for the low level of enforcement, see C. Gerner-Beuerle and E.P. Schuster,

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3.1.1 *Standard of care*

In many jurisdictions, the standard of care applicable to directors of business corporations is laid down in the company legislation in fairly precise terms. A good example is UK law, which stipulates that directors 'must exercise reasonable care, skill and diligence', which is defined as 'the care, skill and diligence that would be exercised by a reasonably diligent person with (a) 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, and (b) the general knowledge, skill and experience that the director has'.[42] A similar dual standard is used by Italian law.[43] Other jurisdictions, for example, Germany, Austria, Spain, and Portugal, require directors to 'apply the due care of a diligent and conscientious manager'[44] or discharge their duties 'with the diligence of an orderly businessman'[45] or 'a careful and organised manager'.[46] Yet others do not specify the standard of care, but impose liability on directors simply for tortious or negligent acts,[47] 'management mistakes'[48] or acts performed without 'due managerial care'.[49] Finally, a sub-

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'Mapping Directors' Duties: Strategies and Trends in the EU', in H.S. Birkmose, M. Neville and K. Engsig Sørensen, *Boards of Directors in European Companies. Reshaping and Harmonising Their Organisation and Duties* (Wolters Kluwer 2013) p. 13, at pp. 15-16.

[42] Companies Act 2006, s. 174. The text of the Act is available at: <http://www.legislation.gov.uk/ukpga/2006/46/contents>.

[43] Italian Civil Code, Art. 2392(1). For the text of the Code, see *supra* n. 32.

[44] German Stock Corporation Act, s. 93(1), sentence 1; Austrian Stock Corporation Act, s. 84(1), sentence 1. Translation by Gerhard Wirth, Michael Arnold and Mark Greene, *Corporate Law in Germany* (C.H. Beck 2004), at p. 313. For a reference to the German Stock Corporation Act, see *supra* n. 34. The Austrian Civil Code (in German) is available at: <http://www.ris.bka.gv.at/GeltendeFassung.wxe?Abfrage=Bundesnormen&Gesetzesnummer=10002070>.

[45] Spanish Corporate Enterprises Act, Art. 225(1), *supra* n. 32.

[46] Portuguese Code of Commercial Companies, Art. 64(1)(a), *supra* n. 32. The Article further provides that directors shall display 'willingness, technical competence and an understanding of the company's business that is appropriate to their role'.

[47] Danish Companies Act, s. 361(1): 'Promoters and members of management who, in the performance of their duties, have intentionally or negligently caused damage to the limited liability company are liable to pay damages. The same applies where the damage is caused to shareholders or any third party.' For the text of the Act, see *supra* n. 31. Similar Polish Code of Commercial Partnerships and Companies, Art. 483(1). For the text of the Code (in Polish), see: <http://www.forbusinessinpoland.com/wp-content/uploads/2012/05/Code-of-Commercial-Companies.pdf>.

[48] French Commercial Code, Art. L225-251: 'The directors and the general manager shall be individually or jointly and severally liable to the company or third parties either for infringements of the laws or regulations applicable to public limited companies, or for breaches of the memorandum and articles of association, or for management mistakes.' For the text of the Code, see *supra* n. 23. Similar Belgian Commercial Code, Art. 527, *supra* n. 30.

[49] Czech Commercial Code, s. 194(5): 'Members of the board of directors shall exercise their range of powers with due managerial care and not disclose confidential information and facts to third parties, if such disclosure might be detrimental to the company. If there is a dispute about

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set of Member States do not have a codified duty of care, but rely on general written or unwritten principles of law to hold directors responsible for negligent management. This is the case in the common law jurisdictions Ireland and Cyprus,[50] but also in the Netherlands and Sweden, which derive the duty of care from the requirement that directors shall be responsible 'for a proper performance of the tasks assigned to [them]'[51] or, more generally, from the fiduciary nature of their position.[52] Thus, we can identify gradual differences in the regulatory approach, ranging from a detailed description of the required behaviour, to the use of general clauses or no express regulation at all. These differences do not develop along the lines of legal families, and they do not seem to have a significant influence on the enforcement of the duty. As mentioned, the level of enforcement is generally low, but we observe at least some enforcement activity not only in Member States that provide for an explicit duty,[53] but also in states that rely on broadly phrased principles[54] or operate without a codified standard of care.[55] Conversely, in some states with clearly expressed duties, enforcement is close to non-existent.[56]

A possible classification of Member States as regards the formulation of the standard of care could distinguish between states that rely on objective elements in determining due care, thus often following the general negligence standard in the country (with appropriate modifications in order to take account of the professional environment in which the director operates), and those that (also) draw on subjective elements grounded in the person of the individual director. This difference is potentially important for the effectiveness of the duty, since a strict subjective standard would lead to laxer expectations if the director lacks the experience or skill of an average businessman.[57]

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whether a particular member of the board of directors exercised due managerial care (due diligence), *onus probandi* (the burden of proof) shall be borne by such member.' A translation of the Commercial Code is available at: <http://www.justiniano.com/codigos_juridicos/cheka/codigo_comercial.pdf>.

50 Before the codification of directors' duties in the Companies Act 2006, the UK also relied on unwritten fiduciary principles and the law of negligence.

51 Dutch Civil Code, s. 2:9(1): 'Each Director is responsible towards the legal person for a proper performance of the tasks assigned to him. All duties of Directors that have not been assigned by or pursuant to law or the articles of incorporation to one or more other Directors, shall belong to the duties (tasks) of a Director.' For the text of the Code, see *supra* n. 30.

52 For example, in Sweden, the duty of care is not expressly provided for in the Companies Act but is commonly accepted to exist; see Rolf Skog and Catarina Fäger, *The Swedish Companies Act* (Norstedts Juridik 2007), at p. 64.

53 Germany.

54 The Netherlands.

55 The UK before 2006.

56 For example, Spain and Portugal.

57 This used to be the standard under old English common law, established in cases such as *Re City Equitable Fire Assurance Co.* [1925] Ch. 407. Because of its laxity, this standard has also been called the 'amiable lunatic' standard, A. Hicks, 'Directors' Liability for Management Er-

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A majority of Member States defines the standard of care objectively by referring to the care exercised by a prudent businessman with the knowledge and expertise that can reasonably be expected of a person in a comparable situation.[58] Some Member States use this objective standard as a lower benchmark that has to be satisfied by all directors, notwithstanding their individual skills, expertise or experience, but provide that more is expected of a director who possesses particular knowledge or experience.[59] In this case, the law expects the director to deploy his or her abilities to the advantage of the company. The difference between the two approaches should not be overstated. Even where the general negligence standard is framed objectively, courts commonly take the circumstances of the individual case, including subjective attributes of the defendant, into account when applying the standard. Thus, while the *formulation* of the required standard of care may differ between the two groups, with a greater emphasis on the individual abilities of the director in the legal systems providing for an express dual objective/subjective standard, the *content* of the behavioural expectations imposed on directors is very similar.

In a few jurisdictions the law allows for a relaxation of the standard in particular situations. In Cyprus and Ireland, the definition of the standard of care still follows, to some extent, the subjective formulation of the old English common law.[60] Greek law distinguished between different types of director and applied a higher standard to some directors than to others.[61] However, even in these jurisdictions, the effect of the duty in practice may not be significantly different from that in the other legal systems.[62] Consequently, as far as the required standard of care is concerned, the laws of the EU Member States are characterised by a considerable degree of homogeneity.

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rors', 110 *LQ Rev.* (1994) p. 390, at p. 392. UK law is now more demanding, see s. 174 of the Companies Act 2006, codifying the standard that was developed in *Norman* v. *Theodore Goddard* [1991] BCLC 1027 and *Re D'Jan* [1994] 1 BCLC 561 (dual objective/subjective standard).

[58] Austria, Belgium, Bulgaria, the Czech Republic, Denmark, Estonia, Finland, Germany, Hungary, Latvia, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain and Sweden.

[59] France, Hungary, Italy, Lithuania, Malta and the UK.

[60] Cypriot courts follow the common law interpretation of the duty of skill and care as established by the English Court of Appeal in *Re City Equitable Fire Assurance Co.*, *supra* n. 57. The position in Ireland is ambivalent. Traditionally, Irish courts applied the subjective English standard that predated *Norman* v. *Theodore Goddard*, *supra* n. 57. With the codification of the more stringent objective/subjective standard in the UK Companies Act 2006, Irish law may also move towards a stricter test promoting objective minimum expectations. However, a generally applicable definition has not yet emerged, and Irish courts employ a flexible, fact-specific approach.

[61] Greek law before 2007 distinguished between the CEO, who was subject to liability for any type of negligence, and other directors, who faced a lower risk of liability. This distinction has now been abolished, but the formulation in the amended law still demands a differentiation between board members in light of subjective elements (their capacity) and the allocation of tasks on the board, see Art. 22a(2) Law No. 2190/1920 on Companies, as amended by Law 3604/2007 (available at: <http://law.au.dk/fileadmin/Jura/dokumenter/Greek_20Law_204072_20on_20private_20companies.pdf>).

[62] See the discussion *supra* nn. 60-61.

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Less coherence exists with respect to the question of who bears the burden of proving due care. A number of Member States stipulate that the claimant shall bear the burden of proving lack of due care, for example, the UK, Ireland, France, Spain, the Netherlands, Denmark and Sweden,[63] while a roughly equal number of jurisdictions provide for a reversal of the burden of proof, for example, Germany, Austria, the Czech Republic, Italy, Slovenia and Portugal.[64] However, the divide between these two approaches is not necessarily clear-cut. Some Member States, in particular France, Belgium and Luxembourg, distinguish between so-called 'obligations of means' (*obligations de moyens*) and 'obligations of result' (*obligations de résultat*). In the former case, the debtor undertakes to employ best efforts in performing a task, without assuming responsibility for achieving a specified result. In order to hold the director liable, the claimant needs to show that the director acted without due care. In the latter case, failure to achieve the result constitutes a breach of a contractual or statutory duty and shifts the burden of proof. The directors' duty to manage the company and act in the company's best interest is commonly interpreted as an obligation of means.[65] On the other hand, breaches of the company legislation or the articles of association are considered obligations of result. For example, it has been argued that the failure of the director to participate in board meetings and be actively involved in the management of the company constitutes a violation of an obligation of result.[66] In this case, the burden of proof shifts to the director, who has to show that his absence was excusable and that he challenged the wrongful board resolution at the earliest possible moment.

3.1.2 *Business judgment rule*

Most legal systems acknowledge that since directors have to make business decisions under conditions of uncertainty, a stringent standard of care poses the risk that courts, judging with the benefit of hindsight bias, may find directors liable only because a particular investment project turned out to be ultimately unsuccessful.[67]

[63] This approach simply follows the general rules of civil procedure law.

[64] German Stock Corporation Act, s. 93(2), *supra* n. 34; Austrian Stock Corporation Act, s. 84(2), *supra* n. 44; Czech Commercial Code, s. 194(5), *supra* n. 49; Italian Civil Code, Art. 1218, *supra* n. 32; Slovenian Companies Act (ZGD-1), Art. 263(2), *supra* n. 33; Portuguese Code of Commercial Companies, Art. 72(1), *supra* n. 32.

[65] However, once it has been established that a board decision constitutes a breach of duty, some legal systems provide for the rebuttable presumption that all directors, whether present or not when the decision was adopted, acted with the required degree of fault. The burden is then on the director to show that he or she opposed the decision and acted generally without fault. See French Supreme Court (*Cour de Cassation*), Cass. Com., 30 March 2010 (*Crédit Martiniquais*), *Revue des sociétés* 2010, p. 304, P. Le Cannu.

[66] For Belgium: M. Vandenbogaerde, *Aansprakelijkheid van vennootschapsbestuurders* (Intersentia 2009), at p. 63.

[67] See, e.g., S.M. Bainbridge, 'The Business Judgment Rule as Abstention Doctrine', 57 *Vanderbilt Law Review* (2004) p. 83, at pp. 114-116.

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In order to avoid stifling efficient risk-taking, US courts have developed the so-called business judgment rule, which provides that they will not review business decisions arrived at 'on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company'.[68] If this presumption is not rebutted by the claimant, i.e., if the claimant does not show that the directors did not act on an informed basis, in bad faith, or in breach of the duty of loyalty, the courts will respect the directors' business judgment, 'unless it cannot be attributed to any rational business purpose'.[69] If the presumption is rebutted, the burden of proof shifts to the directors, who have to demonstrate that the transaction was 'entirely fair' to the corporation.[70] Thus, the Delaware version of the business judgment rule consists of three elements: first, threshold requirements that have to be satisfied for the protection of the rule to be triggered (acting on an informed basis, in good faith, without conflict of interest); second, a procedural element that allocates the burden of proof and provides for a shift in the burden when the presumptions are rebutted; and third, a standard of review that is either very light (irrationality test) or, if the presumptions are rebutted, consists in a complete fairness review. These three elements make the Delaware business judgment rule very effective in protecting directors against liability, provided that they are not conflicted.[71] It is important to note that the effectiveness of the rule is the result of a *combination* of the relatively high threshold requirements, allocation of the burden of proof, and limited review if the presumptions cannot be rebutted.[72]

While an exact analogue of the Delaware business judgment rule cannot be found in Europe, similar instruments have spread to a number of European jurisdictions over the last six or seven years. Interestingly, the business judgment rule has been adopted with alterations by several civil law jurisdictions, rather than by the legal systems with the closest connection to US law, i.e., the UK, Ireland and Cyprus. The first country to introduce the rule was Germany,[73] followed by Portugal,[74]

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[68] *Aronson* v. *Lewis*, 473 A.2d 805, 812 (Del. 1984).

[69] *Re Walt Disney Co. Derivative Litigation*, 907 A.2d 693 (Del. Ch. 2005) (quoting *Sinclair Oil Corp.* v. *Levien*, 280 A.2d 717, 720 (Del.1971); *Unocal Corp.* v. *Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del.1985)).

[70] See, for example, *Walt Disney*, 907 A.2d 747.

[71] See, e.g., *In re Citigroup Inc. Shareholder Derivative Litigation*, 964 A.2d 106 (Del. Ch. 2009), dealing with the fallout from the global financial crisis. Under Delaware law, the defendant directors and officers of Citigroup were not found liable for the losses that the company had suffered from exposure to the subprime lending market.

[72] For a more detailed analysis, see Gerner-Beuerle and Schuster, *supra* n. 41, at pp. 20-21.

[73] *Gesetz zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts* (UMAG), Law of 22 September 2005, Federal Law Gazette I, p. 2802. The statutory amendment, in turn, is based on a decision of the Federal Court of Justice (*Bundesgerichtshof*) of 1997, BGHZ 135, 244 (ARAG/Garmenbeck), which adopted principles resembling the business judgment rule.

[74] Decree-Law No. 76-A/2006 of 29 March.

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Romania,[75] Croatia[76] and Greece.[77] Similar to US law, the European variants of the business judgment rule apply if several threshold conditions are satisfied, which typically require that the director made a business decision, the decision was based on appropriate information, the director was not subject to any conflicts of interest, and he or she reasonably believed that the decision was in the best interest of the company.[78] As opposed to Delaware's version of the rule, the threshold test of appropriate information is not based on a gross negligence standard, and the threshold requirements are generally not formulated as a presumption, but the director bears the burden of showing that the protections of the business judgment rule apply.[79] Thus, the European variants are, arguably, less protective of company directors than their Delaware counterpart.

Other Member States, in spite of not having adopted a codified business judgment rule, show similar restraint in reviewing the good-faith business decisions of directors. While clear definitions and bright-line rules are often missing, not least because of the general dearth of case law, courts accept a degree of managerial discretion and acknowledge that directors must be allowed to take risks inherent in economic activity.[80] In some Member States, the courts' restraint takes the form of

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75 Company Law Reform of 2006.

76 Amendments of 2007, Official Gazette 107/2007.

77 L. 3604/2007.

78 See, for example, German Stock Corporation Act, s. 93(1), sentence 2: Members of the management board 'shall not be deemed to have violated the aforementioned duty [to employ the care of a diligent and conscientious manager] if, at the time of taking the entrepreneurial decision, they had good reason to assume that they were acting on the basis of adequate information for the benefit of the company'. Translation available at: <http://law.au.dk/fileadmin/Jura/dokumenter/german-stock-corporation-act-2010-english-translation-pdf-59656_01.pdf>. Portuguese Code of Commercial Companies, Art. 72(2): 'This liability [for damages caused by acts or omissions resulting from dereliction of the directors' legal or contractual duties] shall be waived if any of the persons to which the previous paragraph refers is able to prove that he or she acted in an informed manner, free of any personal interest and using the criteria of corporate rationality.' Translation available at: <http://www.cmvm.pt/EN/Legislacao_Regulamentos/Legislacao%20Complementar/Emitentes/Documents/Final2009.Commercial%20Company%20Act.consol8.2007andDL357A.2007.pdf>.

79 Ibid.

80 See, for example, for Ireland: *PMPA Insurance Co Ltd* v. *New Ireland Assurance Co Ltd*, High Court, unreported, Kenny J, *The Irish Times*, 23 October 1975; *Re USIT World Plc*, [2005] IEHC 285 (10 August 2005); Italy: App. Milano, 28 March 1980 (1982) *Giurisprudenza Italiana* I, 2, c. 219; App. Milano, 21 January 1994 (1994) *Società*, 923; Lithuania: Supreme Court, *Vokietijos bendrovė 'Gretsch – Unitas Gmbh' and UAB 'Gretsch – Unitas Baltic'* v. *V. Semeška*, Case No. 3K-3-1590/2002; Poland: Supreme Court, judgment of 26 January 2000, I PKN 482/99; Spain: *Audiencia Provincial* of Pontevedra, judgment of 24 January 2008, no. 50/2008. Of course, differences remain in the Member States. For example, in the Netherlands, the investigator and the courts in inquiry proceedings (investigations conducted by an investigator appointed by the Enterprise Chamber (*Ondernemingskamer*) of the Amsterdam Court of Appeal upon the application of, among others, shareholders holding at least 10% of the issued share capital, see Dutch Civil Code, ss. 2:344-2:359, *supra* n. 30), conduct a thorough review of the company's

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a procedural mechanism. The courts will not review the content of the business decision if the *process* of decision-making was in conformity with certain standards, particularly concerning the information that the directors obtained before making the decision and the absence of conflicts of interest.[81] This understanding of the court's role in assessing potential duty of care breaches is clearly similar to the *modus operandi* of the Delaware business judgment rule and its European offshoots.[82] The threshold test outlined above is essentially process-focused and does not impose minimum requirements regarding the content of the decision. Thus, despite the differences in terminology and regulatory approach, and notwithstanding the fact that the respective rules are embedded in different legal families, the design of the duty of care in the Member States seems to be flexible enough to allow the courts to calibrate the duty's elements so as to encourage both efficient risk-taking and the exercise of due care in managerial decision-making.

3.2 Duty of loyalty

The duty of loyalty has a long tradition in the common law world, where it can be traced back to the partnership and trust roots of company law.[83] A considerable body of case law has given it well-defined contours. The duty applies comprehensively to any situation giving rise to a conflict, or potential conflict, of interest between the director and the company.[84] Legal systems belonging to the civil law tradition, in contrast, often have not developed an all-encompassing no-conflict rule or have not included an express formulation of the duty of loyalty in their company law statutes.[85] This does not necessarily indicate gaps in the legal system, because all jurisdictions are familiar with fiduciary principles derived from general civil law, for example, the

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affairs in order to assess whether mismanagement has occurred, without taking recourse to an unwritten business judgement rule.

[81] Italian Supreme Court (*Corte Suprema di Cassazione*), judgment of 23 March 2004, no. 5718 (2004) *Rivista del Notariato*, 1571; for the UK, see D. Kershaw, *Company Law in Context*, 2nd edn. (OUP 2012), at pp. 474-475.

[82] See, e.g., *Brehm* v. *Eisner*, 746 A.2d 244, 264 (Del. 2000), speaking of '*process* due care'.

[83] See, e.g., R.R. Formoy, *The Historical Foundations of Modern Company Law* (Sweet & Maxwell 1923); B.C. Hunt, *The Development of the Business Corporation in England, 1800-1867* (Harvard University Press 1936).

[84] For an early enunciation in English common law, see the House of Lords decision in *Bray* v. *Ford* [1896] A.C. 44. The no-conflict rule is now laid down in s. 175(1) UK Companies Act 2006. For Cyprus, see S. Triantafyllides and E. Papandreou, *Cyprus*, in K. Van Hulle and H. Gesell, eds., *European Corporate Law* (Nomos 2006) p. 81; *Giannakis Pelekanos, as Administrator of the estate of Christophoros Pelekanos, and others* v. *Andreas Pelekanos and Antonis Pelekanos*, Civil Appeal No. 1/2008 (2010) 1C S.C.J. 1746; and for Ireland, *Hopkins* v. *Shannon Transport Systems Ltd* (1972) [1963-1999] Ir. Co. Law Rep. 238; *Spring Grove Services (Ireland) Ltd* v. *O'Callaghan* [2000] IEHC 62 (31 July 2000).

[85] The most comprehensive regimes can be found in recent codifications of company law, such as the Spanish Corporate Enterprises Act of 2010, *supra* n. 32.

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law on agency. These fiduciary concepts inform much of company law and can be relied on where the rules on directors' duties do not address a particular conflict. Indeed, we observe this strategy in several civil law jurisdictions, for example, France, Germany and Poland.[86] Legal systems with a two-tier board structure often also use the allocation of authority between the different bodies as a mechanism to alleviate conflicts of interest, which may explain the absence of some rules regulating conflicts of interest that can be found in one-tier board systems.[87] Accordingly, in some Member States, legal instruments that are not duty-based in the strict sense perform the function of the common law duty of loyalty.

Because of these differences in regulatory technique, we will use as starting point for the following analysis the actual economic conflicts that have elicited some form of regulatory response in all Member States. The relevant conflicts of interest may conveniently be grouped into two categories: (1) related-party transactions (self-dealing), i.e., transactions between the company and the director, either direct or indirect because the director is involved as a major shareholder or partner in another business that transacts with the company; and (2) corporate opportunities, i.e., the exploitation of information that 'belongs' (in some sense of the word, which will be defined more precisely below) to the company, for example, information regarding a business venture that is of commercial interest to the company. Most other aspects associated with the expectation that the directors avoid conflicts of interest can be related to these two main applications of the duty of loyalty, even though they may be regulated separately in some jurisdictions. Examples are the duty not to compete with the company, not to accept benefits from third parties that are granted because of the directorship, or not to abuse the powers vested in the directors for ulterior purposes. In our analysis, we will focus on the two main expressions of the duty of loyalty: related-party transactions and corporate opportunities.

3.2.1 *Related-party transactions*

We can distinguish between two approaches to regulating related-party transactions in the EU, which largely follow the distribution of the one-tier and two-tier board structure models. First, jurisdictions may apply a broad rule to conflicted transac-

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[86] France: Cass. Com. 12 February 2002: Rev. Sociétés 2002, p. 702, L. Godon (duty of loyalty to the company); Cass. Com. 6 May 2008, n° 07-13198: Dr. Sociétés 2008, n° 156, H. Hovasse (duty of loyalty to the shareholders); Germany: BGH WM 1979, 1328; BGH WM 1985, 1443; Poland: Dominika Wajda, *Obowiązek lojalności w spółkach handlowych* (C.H. Beck 2009).

[87] See, for example, Austrian Stock Corporation Act, s. 97(1), *supra* n. 44; Estonian Commercial Code, s. 317(8) (available in English at: <http://www.legaltext.ee/en/andmebaas/ava.asp?m=022>); German Stock Corporation Act, s. 112, *supra* n. 34; Polish Code of Commercial Companies, Art. 379, *supra* n. 47; Slovakian Commercial Code, s. 196a (available in Slovakian at: <http://www.exekutor.sk/poradna/obchodny.htm>); Slovenian Companies Act, Art. 38a, *supra* n. 33.

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tions, making all or the most important of such transactions (exempting, for example, transactions in the ordinary course of business) conditional upon disclosure and approval by a disinterested body. Accordingly, the conflicted director is prevented from participating in the decision that authorises the interested transaction.[88] As a variant of this approach, legal systems may provide for a broad rule prohibiting interested transactions, but permit the interested director to participate in the decision-making or make conflicted transactions subject to a full fairness review by the courts.[89] The second main approach is used by countries employing a two-tier board structure consisting of a management board and a supervisory board.[90] The legal system may allocate decision-making power for transactions between the company and a member of the management board to the supervisory board and for transactions between the company and a member of the supervisory board to the management board. Finally, some Member States may not provide for any explicit regulation of related-party transactions and take recourse to general principles, for example, of agency law.[91]

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[88] This is the legal situation in Bulgaria, Denmark, Finland, France, Greece, Lithuania, Luxembourg, the Netherlands, Portugal, Romania, Spain and Sweden. Under Belgian law, conflicted directors do not have to abstain from participating in the decision approving the related-party transaction unless the articles of association provide otherwise or the company has issued shares to the public, Companies Code, Art. 523, § 1, 4, *supra* n. 30.

[89] Full fairness review in case the interested director does not abstain from the decision is provided for by the Delaware General Corporation Law, s. 144. In the EU, a number of Member States, namely Cyprus, Ireland, Italy, Malta and the UK, make all or the most important conflicted transactions conditional upon disclosure. Their company laws do not prohibit interested directors from participating and voting in the board meeting that decides on the interested transaction, but good practice requires the director to abstain from voting. In addition, in the UK, companies with a premium listing on the London Stock Exchange are subject to additional requirements, including shareholder approval of related-party transactions with the interested director (if he or she is a shareholder) abstaining from voting, UKLA Listing Rules, LR 11.1.7R.

[90] These are Austria, Estonia, Germany, Latvia, Poland and Slovakia. The Czech Republic, which also provides for a mandatory two-tier board structure, is a special case, see *infra* n. 91. Two countries that formally offer a choice between the one-tier and two-tier system also fall into this category: Croatia, where the unitary board system has only recently been introduced (2007) and has no tradition in company law, and Slovenia, where the majority of companies opt for the two-tier system. In Hungary, the choice between the one-tier and two-tier model only dates back to 2006 and most companies have a supervisory board, but the law does not use the supervisory board to reallocate decision-making power, see *infra* n. 91 for further details. In other countries that offer a choice between board models, for example, France, Italy, and Portugal, companies opting for a two-tier board are rare.

[91] This is the case in the Czech Republic and Hungary. In the Czech Republic, the law regulates only a limited number of specifically defined interested transactions, namely credit or loan contracts with directors, contracts securing the debts of directors, free-of-charge transfers of property from the company to directors, and transfers of assets for consideration exceeding 10% of the company's capital, Commercial Code, s. 196a, *supra* n. 49. In Hungary, the law does not contain any specific rules on related-party transactions in the public company (in private companies, authorisation of the general meeting is required). Therefore, it is necessary to take recourse

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Comparing the two approaches, broad prohibition and approval requirement versus the reallocation of decision-making power, we can observe clear similarities. Essentially, two-tier and one-tier board jurisdictions have developed the same solution to the conflict of interest: the insertion of an additional layer of decision-making in order to neutralise the presence of the interested director on the board. One-tier board systems have to deal with the problem that the interested director remains formally a member of the board that decides on the transaction. Therefore, even where the law requires the director to abstain from voting, the risk remains that the director is able to influence the other board members or that they are motivated by feelings of loyalty or dependence when authorising the transaction. This problem is particularly relevant where the interested director is the chief executive officer or chairman of the board. In legal systems with a two-tier board structure the conflict is somewhat less pronounced because of the formal separation of the two bodies, but it is nevertheless questionable whether the supervisory board always functions as an impartial guardian of the company's interests.[92]

On the other hand, two-tier board systems may be less flexible than a broadly defined and generally applicable no-conflict rule. In two-tier systems, the law simply reallocates decision-making power,[93] but it does not impose a duty on directors to avoid conflicts of interest of any kind. This has the consequence that particular questions are left unregulated, for example, the problem of who decides on a transaction that is not formally between the company and the director, but in which the director is interested. A good example is a contract between the director's company and another company in which the director is a substantial shareholder. In some countries, such as Germany, the management board continues to have the power to represent the company in such a transaction.[94] Of course, this is ultimately not a problem inherent in two-tier board structures, but a matter of definition. The two-tier solution of reallocating decision-making power could be designed so as to encompass also indirect conflicts.[95] Arguably, however, the no-conflict rule that originated in English common law can be interpreted more easily in an expansive way to capture different types of conflict.

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to general principles of civil law, notably the law on representation and agency. According to agency law, the agent is prohibited from contracting with himself or from acting if the other party is also represented by the agent. While a supervisory board exists in many companies, the board lacks authority to act on behalf of the company.

[92] See, e.g., G. Maassen and F. Van Den Bosch, 'On the Supposed Independence of Two-tier Boards: Formal Structure and Reality in the Netherlands', 7 *Corporate Governance: An International Review* (1999) p. 31.

[93] See *supra* n. 87.

[94] OLG Saarbrücken, AG 2001, 483.

[95] This is the case in Slovenian law, which requires authorisation by the supervisory board where the director (or a family member) holds 10% or more of the share capital, is a silent partner, or participates in any other way in the profits of another undertaking that transacts with the company, see Companies Act, Art. 38a, *supra* n. 33.

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3.2.2 *Corporate opportunities*

Corporate opportunities can be defined as business opportunities in which the corporation has an interest. The effectiveness of the regulation of corporate opportunities depends on the conditions under which such a legally recognised interest arises. In other words, it is of central importance how the law determines when a business opportunity 'belongs' to the corporation. In answering this question, the law may adopt a narrow approach (that is, the regulation is applicable to a narrowly defined set of cases) or a broad approach (applicable to a wide range of directors' activities). It could be said that the narrow approach imposes a smaller risk of liability on directors and facilitates the realisation of business opportunities, which may contribute to an efficient allocation of resources, while the broad approach ensures a more comprehensive protection of shareholders. For example, the law may require that the opportunity falls within the line of business actually pursued by the company or is covered by the company's objects, or it may provide, more broadly, that any type of economic activity shall be captured, notwithstanding the capacity of the company (financial or otherwise) to make use of the opportunity.

The Member States employ two general strategies to regulate corporate opportunities that follow roughly the broad/narrow dichotomy. The common law countries Ireland and the UK, as well as the mixed jurisdictions strongly influenced by English common law (Cyprus and Malta), as well as Lithuania impose a fairly broad duty on directors not to exploit any information or opportunity of the company. The paradigm of this doctrine, and its most developed version, can be found in the UK. The UK courts have produced a wealth of case law on corporate opportunities that has shaped the details of the doctrine and clarified that: (1) directors do not have to learn of the corporate opportunity in their capacity as director, but it is sufficient that they obtain knowledge of the opportunity in a private capacity, for example, during their spare time; (2) it is irrelevant whether or not the corporate opportunity falls within the company's line of business, as long as the possibility is not excluded that the company may now or in the future adjust or refocus operations so that the business opportunity becomes economically interesting to the company; and (3) the fact that the company is currently unable to exploit the opportunity for financial reasons or because of the existence of a legal impediment (for example, a restricted objects clause in the company's articles) that may be removed through appropriate action (for example, a resolution by the general meeting amending the objects clause) is immaterial.[96]

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[96] See, e.g., *Regal (Hastings) Ltd* v. *Gulliver* [1942] 1, All E.R. 378 (House of Lords); *Wilkinson* v. *West Coast Capital* [2005] EWHC 3009; *O'Donnell* v. *Shanahan* [2009] EWCA Civ. 751. For a comprehensive analysis of the case law, see P. Davies and S. Worthington, *Gower and Davies' Principles of Modern Company Law*, 9th edn. (Sweet & Maxwell 2012), paras. 16-145 to 16-164.

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In the other jurisdictions inspired by the English principles, the reach of the corporate opportunities doctrine is often less clear than in the UK. This is generally not a function of a conscious deviation from English law, but simply of the paucity of case law that could settle these questions. Often, the literature discusses in how far the English principles should apply, but the smaller size of the jurisdiction and possibly non-legal reasons for the less frequent use of the judicial system mean that the courts have not had the possibility to decide on the issue or develop their distinct solutions.[97]

Most civil law jurisdictions rely on the duty not to compete with the company.[98] They generally interpret the non-compete rule narrowly. 'Competing with the company' is understood as pursuing an economic activity within the scope of the company's business, i.e., engaging in actual, not only potential, competition with the company.[99] Does this narrow formulation of the duty mean that the non-compete strategy is inferior to the common law corporate opportunities doctrine? In many cases, the outcome of corporate opportunity cases will be the same under both

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[97] See, for example, D. Ahern, *Directors' Duties: Law and Practice* (Thomson Round Hall 2009), paras. 7-40 to 7-57 (Ireland); A. Muscat, *Principles of Maltese Company Law* (Malta University Press 2007), at pp. 452-459 (referring to both English and US law in analysing Maltese company law); E.A. Neocleous, K. Georgiades and M. Zalewski, *Corporate Law*, in D. Campbell, ed., *Introduction to Cyprus Law* (Yorkhill Law Publishing 2000), paras. 9-42 to 9-44.

[98] These are Austria, Bulgaria, Croatia, the Czech Republic, Denmark, Estonia, Greece, Hungary, Italy, Latvia, Poland, Portugal, Romania, Slovakia, Slovenia and Spain.

[99] However, it should be mentioned that Austria, Germany and Slovenia distinguish between two types of activity: the operation of another business enterprise and the conclusion of transactions. The former is prohibited in a general and comprehensive way, notwithstanding the scope of the other enterprise's business, in order to ensure that the directors devote their undivided attention to the company. Therefore, this part of the prohibition is not, in essence, a non-compete rule but concerns a more general conflict of interest. The latter prohibition only applies if the director is active within the company's line of business and follows the traditional non-compete rules that can be found in other jurisdictions, see Austrian Stock Corporation Act, § 79(1), *supra* n. 44; German Stock Corporation Act, § 88(1), *supra* n. 34; Slovenian Companies Act, Art. 41, *supra* n. 33. In addition, particularly German law is flexible in that the existence of an unwritten duty of loyalty is accepted, which was used by the courts to address cases not caught by the codified duty (see, for example, BGH WM 1967, 679, where the court held that the director was in breach of fiduciary duties by acquiring property that was not required by the company for its current operations).

Furthermore, it is noteworthy that Italy and Spain provide for both a corporate opportunities doctrine and a duty not to compete with the company. The corporate opportunities doctrine was introduced fairly recently into the Italian Civil Code and the Spanish Corporate Enterprises Act, respectively; see Italian Civil Code, Art. 2391(5), as amended by Legislative Decree No. 6 of 17 January 2003, Gazz. Uff., n. 17 (22 January 2003), *supra* n. 32, and Spanish Corporate Enterprises Act, Art. 228, *supra* n. 32 (initially proposed by the Olivencia Code of Good Governance of 1998, s. 8.4). The traditional approach to regulating these issues was by means of the prohibition to compete with the company, which remains in force: Italian Civil Code, Art. 2390, and Spanish Corporate Enterprises Act, Art. 230. It is uncertain how the two provisions relate to each other and what the reach of the corporate opportunities doctrine is. Case law is scarce or nonexistent.

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strategies. If a director pursues an opportunity through another business, he or she will be liable pursuant to both approaches. However, the results are different if the director exploits the opportunity in his or her personal capacity, which does not qualify as operating a competing business. In addition, if the corporate opportunities doctrine is interpreted broadly, as is the case in English law, it captures business opportunities outside the company's line of business, as well as opportunities that cannot be exploited by the company due to financial incapacity or some other (non-structural) impediment[100] or that are declined by the company. In these instances, a non-compete rule that is triggered by *actual* competition may not apply. This is not a difference that lies in the nature of the regulatory strategy adopted, but it is simply a matter of how the boundaries of the no-conflict and non-compete duties are defined and interpreted. Nevertheless, it may be argued that the structure of the corporate opportunities doctrine as found in common law jurisdictions is more conducive to an open-ended, flexible interpretation, given that it is based on a broadly understood requirement to avoid conflicts of any kind, whereas the use of the term 'competition' implies a proximity of the prohibited activity and the company's business. On this view, the differences in the scope of the prohibition are a natural consequence of the different legal strategies initially adopted.

Conversely, in the absence of a statutory or contractual duty not to compete, a director would be free to serve on the board of a competing company, as long as he or she does not exploit any corporate opportunity. Thus, in theory, jurisdictions that employ only the corporate opportunities doctrine may not prohibit conduct potentially detrimental to the interests of the director's company.[101] In practice, however, it is unlikely that the corporate opportunities doctrine leads to regulatory loopholes. If the companies operate in the same line of business, they will inevitably encounter business opportunities attractive to both. In addition, the general no-conflict rule underlying the corporate opportunities doctrine is flexible in its scope of application and may well be used by the courts to intervene and hold the director responsible where the companies engage in actual competition.[102]

Finally, the following jurisdictions do not provide for any binding rules in their company legislation, nor have they developed a corporate opportunities doctrine along the lines of the common law jurisdictions: France, Belgium, Luxembourg, the Netherlands and the Scandinavian legal systems. However, this does not mean that the issue is left without any regulation. The service contract concluded with the

[100] For a discussion of the distinction between 'structural impediments' and 'practical inability' see Kershaw, *supra* n. 81, at p. 552.

[101] This was indeed the position under early English common law, see *London and Mashonaland Co Ltd* v. *New Mashonaland Exploration Co Ltd* [1891] WN 165.

[102] Several English judgments (predating the Companies Act 2006) can be understood in this sense, see *Bristol & West Building Society* v. *Mothew* [1998] Ch. 1; *CMS Dolphin Ltd* v. *Simonet* [2002] B.C.C. 600. Some Irish cases also suggest that this is the case, see *Spring Grove Services (Ireland) Ltd v. O'Callaghan*, High Court, unreported, Herbert J, 31 July 2000.

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directors may contain a non-compete clause, as a result of which they are contractually liable when engaging in competitive behaviour. This is common practice in most jurisdictions. In addition, the legal mechanisms of the jurisdictions in this group are, in general, flexible enough to address the usurpation of corporate opportunities by the director. In French law, the existence of a general duty of loyalty is commonly acknowledged, although the legal basis of the duty is somewhat unclear.[103] In addition, some French commentators have argued that the exploitation of corporate opportunities may constitute the criminal offence of *l'abus de biens sociaux*.[104] In Belgium, liability for disloyal behaviour is based on the general provision establishing responsibility of directors for management mistakes and failures to exercise their mandate properly.[105] In Luxembourg, the duty of loyalty can also be derived from general provisions, but the courts tend to be reluctant to intervene in cases of competitive behaviour or exploitation of corporate opportunities by directors, given the generally liberal approach of Luxembourg company law.[106] In the Netherlands, general principles of, for example, the duty of care or tort law have been utilised in some cases to arrive at suitable solutions.[107] In Finland, the duty of directors to 'promote the interests of the company', set out as a general principle in Part 1 of the Finnish Limited Liability Companies Act,[108] is interpreted broadly as the statutory basis of an unwritten duty of loyalty. Directors who take advantage of corporate opportunities may be judged as not having promoted the interests of the company. Similarly, in Sweden, the lack of explicit regulation of corporate opportunities or competitive behaviour is potentially compensated for by the application of the duty loyalty.[109]

This analysis indicates that in all three groups of jurisdictions the law seems to be elastic enough to address conflicts of interest where regulatory intervention is deemed expedient, notwithstanding the regulatory technique employed by the legal system. Even jurisdictions with no express regulation of corporate opportunities

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[103] See *supra* n. 86, and for a more detailed discussion, P. Merle, *Sociétés commerciales*, 15th edn. (Dalloz 2011), para. 388.

[104] M. Cozian, et al., *Droit des sociétés*, 25th edn. (LexisNexis 2012), para. 651.

[105] Art. 527 of the Belgian Commercial Code, *supra* n. 30, provides: 'Les administrateurs … sont responsables, conformément au droit commun, de l'exécution du mandat qu'ils ont reçu et des fautes commises dans leur gestion.' [The directors are responsible, in accordance with general legal principles, for the performance of their duties and for tortious or negligent acts of management.]

[106] See A. Prüm, 'Luxembourg Company Law – A Total Overhaul', in M. Tison, et al., eds., *Perspectives in Company Law and Financial Regulation: Essays in Honour of Eddy Wymeersch* (Cambridge University Press 2009), p. 302, at pp. 303-304 and passim.

[107] See, for example, Court of Appeals Arnhem, 29 March 2011, LJN BQ0581, JOR 2011/216, holding a director liable for starting a competing business on the basis of sections 2:8 and 2:9 Dutch Civil Code, *supra* n. 30.

[108] See *supra* n. 31, Ch. 1, s. 8.

[109] R. Dotevall, 'Liability of Members of the Board of Directors and the Managing Director – A Scandinavian Perspective', 37 *International Lawyer* (2003) p. 7, at pp. 20-21.

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and no comprehensively codified duty of loyalty have achieved results driven by case law and judicial innovation that are similar to UK law, which may be regarded as the paradigmatic case of the corporate opportunities doctrine.[110] The main difference with regard to outcomes seems to be the increased legal uncertainty due to the lack of clearly specified rules addressing different conflict situations. In most jurisdictions without express rules, the scope of the prohibition to compete with the company or exploit corporate opportunities is evolving and authoritative case law is rare. It should be emphasised that this is not a result of the lack of *codified* rules, but more generally of *clearly specified rules*, which may derive from statutory law or case law, as can be seen in the UK, where the corporate opportunities doctrine was, of course, entirely case-law based until 2006. Arguably, however, the distillation of rules tailored to specific conflict situations from general (and possibly unwritten) principles of law requires that certain conditions are satisfied, notably that the courts have the opportunity to adjudicate and refine the legal principles.

4. Enforcement

In order to ensure effective investor protection, the enforcement of directors' duties is a necessary complement to the substantive rules on directors' duties and liability. Enforcement of directors' duties can take different forms. First, the breach of duty may give rise to a civil liability claim of the company against the director, which may be enforced either by the authorised corporate bodies, in general the board of directors in one-tier systems and the supervisory board in two-tier systems, or by minority shareholders by way of a derivative action. Second, as an alternative (or complement) to private enforcement, some legal systems provide for public investigation procedures, which can lead to the imposition of administrative sanctions or orders that interfere with the governance of the company.[111] Finally, in cases of

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[110] See *supra* n. 99 (German law).

[111] Two practically relevant examples of public enforcement are the Dutch inquiry proceedings and directors' disqualification, available in many legal systems and playing an important role, for example, in the UK and Ireland. Under the Dutch inquiry proceedings, regulated in the Dutch Civil Code, *supra* n. 30, ss. 2:344-2:359, the Enterprise Chamber of the Amsterdam Court of Appeal appoints, upon the application of, among others, shareholders holding at least 10% of the capital or a nominal value of 250,000 euro, an investigator to conduct an inquiry into the policy and conduct of the business of the company. The court may order the suspension of directors, the appointment of supervisory directors with special powers, the suspension of resolutions of the management board or the suspension of voting rights. Similarly, in a number of Member States, minority shareholders holding between 1% and 10% of the share capital may request the court to appoint a special investigator who examines the conduct of the members of the company's management bodies (see, e.g., Austrian Stock Corporation Act, *supra* n. 44, § 130(2) (10% if facts indicate a material violation of the law or the articles ('*grobe Verletzungen des Gesetzes oder der Satzung*')); German Stock Corporation Act, *supra* n. 34, § 140(2) (1%, with the

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serious breaches, criminal sanctions apply. The three strategies operate to some extent as functional substitutes. Thus, deficiencies with respect to private enforcement may be compensated for by effective public enforcement.[112]

Given that enforcement of directors' duties by the authorised body of the company is rare and generally presupposes a change in management, enforcement by minority shareholders through a derivative action is of central importance. In the following sections, we focus on this strategy in order to assess the level of shareholder protection in the EU. We analyse the ease with which shareholders can bring a minority action along three dimensions that are, arguably, of equal importance in assessing the effectiveness of the minority shareholder suit: standing requirements, further conditions for bringing the action, and cost rules.[113] Standing rules specify whether anyone holding at least one share can file a derivative action or whether the claimants must satisfy a holding threshold expressed in percentage terms or as a minimum nominal value amount. Further conditions may relate to minimum holding periods, the requirement that the claimants have deposited their shares with the central depository, or, more restrictively, that the defendant director is in control of the general meeting.[114] Cost rules, that is, procedural rules determining whether the company or the claimant bears the costs of the proceedings and, in case of the latter, whether the claimant has to be indemnified by the company, are important because enforcement through minority shareholders faces a collective action and free-rider

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same proviso as under Austrian law); Lithuanian Civil Code (available in English at: <http://www3.lrs.lt/pls/inter3/dokpaieska.showdoc_l?p_id=245495>), Art. 2.124 (10%)). Disqualification of directors in the UK and Ireland requires, among other reasons, that the conduct of the director 'makes him unfit to be concerned in the management of a company', UK Company Directors Disqualification Act 1986, ss. 6(1) and 8(2); Irish Companies Act 1990 (available at: <http://www.irishstatutebook.ie/1990/en/act/pub/0033/index.html>), s. 160(2)(d). In addition to disqualifications, Irish company law also contains a restrictions regime, i.e., the possibility to apply for a court order prohibiting directors of insolvent companies from acting as a director of another company for a period of five years, unless the court is satisfied that the director 'has acted honestly and responsibly in relation to the conduct of the affairs of the company' (with the burden of proof resting on the director) or the company meets heightened capital requirements, see Irish Companies Act 1990, s. 150.

[112] For example, the Dutch inquiry proceedings compensate to some extent for the lack of a derivative action mechanism in the Netherlands, and the UK and Irish directors' disqualification mechanisms attenuate the negative consequences of the restrictive conditions of *Foss* v. *Harbottle* (now superseded by a statutory derivative action mechanism in the UK, but still in force in Ireland).

[113] See also M. Gelter, 'Why Do Shareholder Derivative Suits Remain Rare in Continental Europe?', 37 *Brooklyn Journal of International Law* (2012) p. 843, at pp. 856-880 (arguing that four preconditions have to be satisfied for the derivative action to be an efficient shareholder protection tool: standing requirements must be favourable and not include a minimum ownership threshold, the claimant must not bear the litigation risk, access of the shareholders to information must be secured, and it must be possible to include controlling shareholders as potential defendants).

[114] This is the famous rule in *Foss* v. *Harbottle* (1843) 67 ER 189: the defendant directors must have committed a wrong that benefitted them personally, i.e., they committed a fraud, and they must have *de jure* or *de facto* control of the general meeting.

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problem. If the company's claim is successfully enforced, it is the company that recovers damages. The pay-off accrues only indirectly to the shareholders in proportion to their shareholdings. The shareholders' incentives to bring a derivative action are, therefore, inefficiently low if they have to bear the costs of the proceedings.[115]

4.1 Derivative action: regulatory framework

We summarise the operation of the minority shareholder suit along the above-mentioned three dimensions in all Member States except Estonia, Luxembourg and the Netherlands, where no derivative action exists, and Malta, where it plays only a marginal role in practice.[116] Table 1 below lists the Member States according to standing requirements that shareholders have to satisfy to bring a derivative action. Percentages refer to the required proportion of the registered share capital that the claimants must hold in aggregate. Legal systems generally also provide for a minimum amount in absolute terms, which is omitted here. The figures are based on the public, stock exchange-listed company. In private companies, the threshold for standing may be higher.[117]

We can see that the Member States vary greatly with regard to the relevant minimum threshold. The requirements range from 1 share in Cyprus, France, Ireland, Lithuania, Poland, and the UK, to 10% in Austria, Croatia, Denmark, Finland, Greece, Slovenia and Sweden.[118]

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[115] For this reason, the derivative action may be qualified as a public good, see A. van Aaken, 'Shareholder Suits as a Technique of Internalization and Control of Management. A Functional and Comparative Analysis', 68 *RabelsZ* (2004) p. 288.

[116] In theory, English common law (including the rule in *Foss* v. *Harbottle*) should apply in Malta, but due to the scarcity of case law it is difficult to assess how precisely the English rules would operate within the Maltese legal system. In practice, minority shareholders tend to rely on the unfair prejudice remedy pursuant to Art. 402 of the Maltese Companies Act, which is, however, more limited in its scope of application since it requires that the company's affairs have been conducted in a manner that is 'oppressive, unfairly discriminatory against, or unfairly prejudicial to, a member'.

[117] For example, in Italy the threshold for non-listed, closely held companies is 20%, see Civil Code, *supra* n. 32, Art. 2393*bis*. For an analysis of the Italian derivative action mechanism, see M. Ventoruzzo, 'Experiments in Comparative Corporate Law: The Recent Italian Reform and the Dubious Virtues of a Market for Rules in the Absence of Effective Regulatory Competition', 40 *Texas International Law Journal* (2004) p. 113, at pp. 140-142 (pointing out that in listed companies the derivative action had not been used a single time in six years since its reform in 1998, and mentioning as possible reasons the misaligned incentives because minority shareholders bear the financial risk of the litigation (see also *supra* n. 115 and accompanying text), the absence of class actions, contingency fees, and party-controlled discovery, as well as the significant length of civil law suits in Italy, which is well above the European average).

[118] References to the relevant legal rules can be found in the study by C. Gerner-Beuerle, P. Paech and E.P. Schuster, *Study on Directors' Duties and Liability* (London 2013), available at: <http://ec.europa.eu/internal_market/company/docs/board/2013-study-analysis_en.pdf> (last accessed 09/02/2014).

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Table 1: Standing[119]

Threshold	*Country*
1 share	CY, FR, IE, LT, PL, UK
> 1 share, but < 5%	BE, CZ, DE, IT, PT
5% to ≤ 10%	BG, HU, LV, RO, SK, ES
10% or more	AT, HR, DK, FI, EL, SI, SE
No derivative action	EE, LU, NL

Second, once the claimant reaches the required standing threshold as depicted in Table 1, a clear majority of Member States allows the derivative action to proceed without further restrictive requirements. The only conditions that these Member States may impose relate to minimum holding periods before the action is brought or the requirement that the responsible body, generally the shareholder body or supervisory board, must have decided not to pursue the action.[120] However, four Member States warrant closer attention: Germany, the UK, Cyprus and Ireland. The first two, Germany and the UK, provide for a claim admission procedure and grant the court discretion in assessing whether the interests of the shareholders in pursuing the claim are outweighed by the interest of the company in avoiding litigation, for example, because litigation would be disruptive, damage the reputation of the company, or come at a challenging time for the company when the loyalty of the executives is particularly important.[121] The detailed structure of the minority shareholder suit differs between the UK and Germany,[122] but the common denominator is

[119] The country abbreviations follow the rules set out in the EU Interinstitutional Style Guide, available at: <http://publications.europa.eu/code/en/en-370100.htm> (last accessed 09/02/2014).

[120] In some cases, the additional requirements, while generally easy to satisfy, may however prove to be onerous, depending on the position of the shareholder and the shareholder's intentions with regard to the investment. For example, in Slovenia, the claimants must deposit their shares with the central clearing and depository house and may not dispose of them until the issue of a final decision on the claim.

[121] See German Stock Corporation Act, *supra* n. 34, s. 148; UK Companies Act 2006, ss. 260-264.

[122] The German procedure is structured in a way that refusal by the court to grant permission is the exception if the other requirements of the law are satisfied (the claimants must have been shareholders at the time they learned about the alleged breach of duty; they requested the company to instigate proceedings, and the company failed to do so within a reasonable time; and the claimants present a *prima facie* case that the loss suffered by the company is due to dishonesty or gross violation of legal provisions or the articles, German Stock Corporation Act (ibid.), s. 148(1)). The limited discretion of the courts can be derived from the formulation of the statute: the courts shall reject the application only if enforcement of the claim is 'outweighed by the interests of the company' (ibid.). In contrast, UK courts enjoy a wider discretion. If one of the grounds of a mandatory refusal to grant permission is not present, the courts shall, in considering whether to give permission, 'take into account' a number of factors listed non-exhaustively in the

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that the courts in both countries balance a number of criteria, including the severity of the alleged breach and the good faith of the parties involved in the proceedings, in order to ensure that minority shareholders have an effective tool at their disposal to enforce breaches of duty, while the risk of strike suits that are brought merely for their settlement value is contained. Therefore, compared to the situation before the claim admission procedure was introduced, minority shareholder suits have been greatly facilitated.[123] However, in comparison with the countries that do not impose any additional conditions, the German and UK mechanisms are, arguably, still more restrictive, if only because some uncertainty remains as to how the statutory framework is to be interpreted and how courts will make use of their discretion.[124]

Cyprus and Ireland continue to apply the rule in *Foss* v. *Harbottle* with no significant modifications. Thus, in principle, the company's claim can only be enforced by the company as the right holder (this is the so-called 'proper plaintiff' rule). The company must act through its authorised bodies, i.e., the board of directors or the general meeting. In derogation from this principle, minority shareholders have standing to sue under narrow circumstances. The action is permissible if: (1) it is brought bona fide for the benefit of the company for wrongs to the company and not for an ulterior purpose; (2) it is brought against persons who have majority control of the company and have blocked an action being instituted in the name of the company; and (3) the claimant shows that those in control committed a wrong that benefitted them personally, while resulting in a loss to the company.[125] As a consequence of the requirement that the wrongdoer must be in control of the general meeting, derivative actions for breaches in widely held companies are effectively impossible. Indeed, in

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Companies Act, for example, the good faith of the claimant or the importance that a director acting in good faith would attach to continuing the claim, Companies Act 2006, s. 263(2) and (3).

[123] The claim admission procedure was introduced in the UK with the Companies Act 2006 and in Germany with the *Gesetz zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts* (UMAG), Law of 22 September 2005, Federal Law Gazette I, p. 2802. The German reforms comprehensively amended and rationalised the minority protection regime, which did not allow minority shareholders to bring the lawsuit in their own name, but required the appointment of a special representative. In addition, the reforms decreased the standing threshold from 5% to 1% and changed the cost rules.

[124] See, for example, D. Kershaw, 'The Rule in Foss v Harbottle is Dead; Long Live the Rule in Foss v Harbottle', LSE Law, Society and Economy Working Papers 5/2013 (2013) (arguing that wrongdoer control, a corollary of the proper plaintiff rule established in *Foss* v. *Harbottle*, remains as a threshold condition to derivative litigation).

[125] So-called 'fraud on the minority' exception. Common law developed a number of other exceptions to the proper plaintiff rule, which are, however, of limited relevance. For a summary of the rule in *Foss* v. *Harbottle* and the exceptions, see *Edwards* v. *Halliwell* [1950] 2 All ER 1064 (CA). For an application in Ireland, see *Fanning* v. *Murtagh* [2008] IEHC 277; and for Cyprus, see C. Gerner-Beuerle, P. Paech and E.P. Schuster, *Study on Directors' Duties and Liability* (London 2013), available at: <http://ec.europa.eu/internal_market/company/docs/board/2013-study-analysis_en.pdf>, at pp. A188-A190, with references to Cypriot case law (last accessed 09/02/2014).

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Ireland, it has been pointed out that 'the derivative action as a minority shareholder governance mechanism seems to be almost a dead letter'.[126]

Third, cost rules also exhibit considerable variation among the Member States. In a majority of countries, the shareholder bears the litigation risk, either because he or she has to pay the necessary fees and is not indemnified by the company if the lawsuit is unsuccessful, or because the company can reclaim the litigation costs from the minority shareholder.[127] The common law countries Cyprus, Ireland and the UK apply a more nuanced rule that was initially established by the English Court of Appeal in *Wallersteiner* v. *Moir*.[128] In this case, the court held that 'where a shareholder has in good faith and on reasonable grounds sued as plaintiff in a minority shareholder's action, the benefit of which, if successful, will accrue to the company and only indirectly to the plaintiff as a member of the company, and which it would have been reasonable for an independent board of directors to bring in the company's name',[129] it is appropriate for the courts to make use of their judicial discretion to grant the minority shareholder a cost indemnification. Translated to the new UK statutory derivative action mechanism, this rule means that when the court has reached the conclusion that the shareholder suit is in the interest of the company and hence has given permission to continue the claim, it will generally order the company to indemnify the claimant.[130] The German amendments reforming the minority shareholder suit introduced a similar rule. The claimant has to bear the costs of the admission procedure if the application is dismissed, unless the dismissal is due to facts relating to the interest of the company that the company could have disclosed prior to the application but did not. If the application is successful, but the claim is dismissed in whole or in part, the company has to reimburse the claimant.[131] The last group of countries relieve the shareholders of the litigation risk by treating the company, not the shareholder, as the plaintiff, and applying the general cost rules of civil procedure law to the company as party to the lawsuit, or by providing explicitly that the company shall bear the costs of the proceedings.[132]

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[126] I. Lynch Fannon, 'A Transatlantic Case: The Derivative Action as a Corporate Governance Tool', 12 *Dublin University Law Journal* (2005) p. 1, at p. 27. See also D. Ahern, 'Directors' Duties: Broadening the Focus Beyond Content to Examine the Accountability Spectrum', 33 *Dublin University Law Journal* (2011) p. 116.

[127] This is the case in Austria, Belgium, Bulgaria, Croatia, Denmark, Finland, France, Italy, Lithuania, Poland, Portugal, Romania, Slovakia, Spain and Sweden.

[128] [1975] QB 373. The rule is now laid down in Civil Procedure Rule 19.9E.

[129] *Wallersteiner* v. *Moir (No. 2)* [1975] QB 373, 403-404.

[130] *Iesini* v. *Westrip Holdings Ltd* [2010] B.C.C. 420, 450. For a discussion of this and other cases granting an indemnification order under the statutory derivative action procedure, see Kershaw, *supra* n. 81, at pp. 635-636.

[131] Stock Corporation Act, *supra* n. 34, s. 148(6).

[132] See the references to the laws of the Czech Republic, Greece, Hungary, Latvia and Slovenia in C. Gerner-Beuerle, P. Paech and E.P. Schuster, *Study on Directors' Duties and Liability* (London 2013), available at: <http://ec.europa.eu/internal_market/company/docs/board/2013-study-analysis_en.pdf>, at pp. 196-203 (last accessed 09/02/2014).

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Thus, about one third of the Member States that make provision for a derivative action are responsive to the disincentives that the default cost rules of civil procedure law create for minority shareholders. In the other Member States, the distribution of the litigation risk renders the derivative action largely unattractive.[133]

4.2 Ease of enforcement

It may be useful to integrate the three elements of derivative actions discussed above (standing, conditions to bring the derivative action, and cost rules) into a minority shareholder enforcement index in order to facilitate cross-country comparison and allow an appreciation of the overall ease with which shareholders can enforce breaches of directors' duties in each Member State if the authorised bodies of the company fail to do so. We therefore quantify the three elements on a scale from 1 to 4, with 4 indicating the most advantageous rule for purposes of minority shareholder protection, and aggregate the scores. The assignment of the scores to different statutory rules regarding the three components of the derivative action mechanism is shown in Table 2, and the constituent as well as aggregate scores per country are listed in Table 3.

Three methodological points are in order. First, the allocation of values from 1 to 4 is not intended to translate the differences between legal rules into a metric that has a quantitative interpretation, in the sense that the difference in importance between, say, a rule requiring the claimant to hold 5% of the company's registered share capital, and one setting the threshold at 10% is accurately reflected in the different scores received by the countries. Rather, the values carry *relative* importance in that they are intended to facilitate the comparison between legal systems. In the first instance, they are, therefore, categorical and simply serve to provide a ranking of countries.

Second, however, we make the assumption that the three components of the enforcement index are of roughly equal importance, and here the allocated values accordingly have a quantitative meaning. This assumption is, in our view, warranted. Restrictive provisions on standing and the conditions for bringing a deriva-

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[133] Another question that is of importance for the attractiveness of the derivative action is the permissibility of contingency fee arrangements that allow the claimant to shift the litigation risk to the lawyer. In the US, contingency fees have long been available and explain in part the higher levels of litigation there, although this fact is not always seen in a positive light. For a critical discussion, see, for example, J.R. Macey and G.P. Miller, 'The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform', 58 *University of Chicago Law Review* (1991) p. 1. A detailed analysis of this question is outside the scope of the article. Contingency fees are, in any case, not common in the EU. However, it should be noted that the introduction of such fee arrangements, as has recently happened in the UK (see Legal Aid, Sentencing and Punishment of Offenders Act 2012, s. 45, and the Damages-Based Agreements Regulations 2013 No. 609), may significantly alter the mix of incentives as described in the text.

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tive action impose clear statutory limitations on the possibility for shareholders to enforce the claims of the company against the directors. Either element may have the propensity to render minority shareholder suits altogether impractical. For example, the very generous rule on standing that exists in Cyprus, Ireland and the UK (1 share) is all but neutralised by the restrictive conditions of *Foss* v. *Harbottle* (now superseded in the UK[134]). On the other hand, the absence of burdensome additional conditions in Denmark, Greece and a number of other countries is outweighed by the requirement that shareholders must hold at least 10% of the outstanding capital. Furthermore, disadvantageous cost rules create practical, but no less effective, impediments.[135] Nevertheless, such schematic quantification inevitably involves simplifications and a value judgment. It must be emphasised, therefore, that the enforcement index is only intended as a rough approximation of the conduciveness of the regulatory environment to minority shareholder suits. The availability of the derivative action in a given case will depend on a host of other factors that are not part of our calculus.

Table 2: Minority shareholder enforcement index – Quantification

	Standing	*Conditions*	*Cost rules*
4 points	1 share: CY, FR, IE, LT, PL, UK	No further conditions: AT, BE, BG, HR, CZ, DK, FI, FR, EL, HU, IT, LV, LT, PL, PT, RO, SK, SI, ES, SE	Company pays all costs: CZ, EL, HU, LV, SI
3 points	> 1 share, but < 5%: BE, CZ, DE, IT, PT	The court has to grant permission: DE, UK	The claimant has to advance some costs, but can claim reimbursement under certain conditions without bearing the litigation risk: CY, DE, IE, UK
2 points	5% ≤ 10%: BG, HU, LV, RO, SK, ES	–	–
1 point	10% or more: AT, HR, DK, FI, EL, SI, SE	The shareholders can only bring the derivative action if restrictive requirements are satisfied: CY, IE	The shareholder pays and bears the litigation risk: AT, BE, BG, HR, DK, FI, FR, IT, LT, PL, PT, RO, SK, ES, SE

[134] Companies Act 2006, ss. 260-264.
[135] See *supra* text to n. 115.

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Third, a high or low score in the enforcement index should not be equated with a high or low level of minority shareholder protection in the respective jurisdiction. The jurisdiction may have developed substitute mechanisms that supplement private enforcement and give minority shareholders other avenues to complain of an alleged breach of duty, or focus on public enforcement through administrative sanctions and criminal law.[136]

Table 3: Minority shareholder enforcement index – Scores per country

Country	*Standing*	*Conditions*	*Cost rules*	*Total*
AT	1	4	1	6
BE	3	4	1	8
BG	2	4	1	7
HR	1	4	1	6
CY	4	1	3	8
CZ	3	4	4	11
DK	1	4	1	6
FI	1	4	1	6
FR	4	4	1	9
DE	3	3	3	9
EL	1	4	4	9
HU	2	4	4	10
IE	4	1	3	8
IT	3	4	1	8
LV	2	4	4	10
LT	4	4	1	9
PL	4	4	1	9
PT	3	4	1	8
RO	2	4	1	7
SK	2	4	1	7
SI	1	4	4	9
ES	2	4	1	7
SE	1	4	1	6
UK	4	3	3	10

[136] See *supra* nn. 111-112.

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5. Directors' duties in the vicinity of insolvency

As is evident from the preceding sections, the behavioural expectations towards company directors differ significantly across Europe, as do the legal frameworks designed to ensure that directors meet these expectations. Jurisdictions of course also differ in relation to their definition of concepts such as the 'interest of the company', with some countries using the concept almost synonymously with shareholder interests, while others use broader, more 'inclusive' definitions so as to also include stakeholders – primarily creditors and employees, or even the public interest as such.

Directors' duties have, in most jurisdictions, primarily been shaped with (a version of) the managerial agency problem in mind. Depending on the prevalent corporate ownership structures, possible conflicts between majority and minority shareholders have received more or less attention from European legislators. Underlying this approach is, of course, the notion of shareholders as residual risk bearers within the corporation.[137] This view is based on the company possessing a non-negligible amount of equity capital – the value at risk from the shareholders' perspective – and is thus rendered increasingly problematic as a company approaches insolvency. With equity capital continuously 'evaporating' in this situation, the economic risk borne by shareholders likewise disappears, which in turn changes their incentives as well as those of company directors.[138] In this situation, the economic risk is mainly borne by the company's creditors, who then increasingly take over the role of the residual claimants.[139]

As a consequence, shareholders' and directors' private optimal risk levels increasingly exceed the social optimum, leading to inefficient risk-taking: while shareholders often effectively control the use of the distressed company's remaining assets, the devaluation of their residual claim means that they can externalise the costs of risky projects, while fully keeping the claim to a project's potential profits. Shareholders of course always benefit from this option-like pay-out profile, but in well-capitalised firms the risks flowing from most business projects will not be of a scale so as to threaten wiping out the entire equity capital. Thus, losses of

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[137] See at European level, e.g., J. Winter, et al., *Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe* (Brussels 2002), available at: <http://ec.europa.eu/internal_market/company/docs/modern/report_en.pdf> (last accessed 09/02/2014), at p. 7: 'Being the residual claimholders, shareholders are ideally placed to act as a watchdog.' See also the discussion in P.L. Davies, 'Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency', 7 *EBOR* (2006) p. 301.

[138] See Davies, ibid.; H. Eidenmüller, 'Trading in Times of Crisis: Formal Insolvency Proceedings, Workouts and the Incentives for Shareholders/Managers', 7 *EBOR* (2006) p. 239; T. Bachner, 'Wrongful Trading – A New European Model for Creditor Protection?', 5 *EBOR* (2004) p. 293.

[139] Davies, *supra* n. 137, at p. 324.

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most projects will be borne (almost) entirely by shareholders, creating a *prima facie* case for their efficient decision-making. In near-insolvent firms, however, the asymmetry of shareholders' pay-outs becomes much more important, as all or most business projects pose a threat to the thin layer of remaining equity. Consequently, shareholders are unlikely to be efficient decision-makers under these circumstances, as they do not have to internalise the costs of their decisions. Instead, they have an incentive to try to 'gamble' their way out of insolvency.[140]

Similarly, insolvency is very costly for directors, even non-shareholder directors, due to the risk of reputational losses, the firm-specific human capital they invested in the firm, and the threat of losing their employment. Absent legal constraints, high-risk strategies leading either to a recovery of the firm or to aggravation of the insolvency are thus tempting for directors, unless they share the costs inflicted on creditors by risky business decisions taken in the vicinity of insolvency. In addition, where directors' duties are designed primarily to align interests of shareholders and managers, leaving in place the 'normal arrangements' – i.e., the regulatory approach designed with financially stable companies in mind – would incentivise directors to pursue the projects shareholders prefer, which, as mentioned above, would be inefficient.[141]

Member States use four main legal strategies to address these concerns. First, the vast majority of European jurisdictions impose a separate duty on company directors to file for the opening of insolvency proceedings upon the company reaching certain pre-defined insolvency triggers, with liability attached to a failure to timely make the relevant filing.[142] Second, in some Member States no formal duty to file for insolvency exists; instead, liability attaches to directors for 'wrongful trading', i.e., the continuation of business activities beyond a particular 'triggering point'.[143] Third, in some jurisdictions the content of directors' duties changes as the company approaches insolvency, particularly by requiring directors to act in the interests of creditors, or at least take their interests into account.[144] Fourth, the Second Company Law Directive[145] provides for a duty to call a general meeting in case

140 See also Gerner-Beuerle and Schuster, *supra* n. 1, at p. 14.

141 See also the detailed analysis by Eidenmüller, *supra* n. 138.

142 23 of the 28 Member States, i.e., Austria, Belgium, Bulgaria, Croatia, the Czech Republic, Estonia, Finland, France, Germany, Greece, Hungary, Italy, Latvia, Lithuania, Luxembourg, Malta, Poland, Portugal, Slovakia, Slovenia, Spain and Sweden. Denmark combines a duty to file for insolvency with a separate wrongful trading prohibition.

143 See in particular the UK Insolvency Act 1986, s. 214(2)(b), defining this triggering point with reference to the moment where 'there was no reasonable prospect that the company would avoid going into insolvent liquidation'. Cyprus, Denmark, Ireland, the Netherlands and Romania also follow this approach.

144 Such an explicit change of directors' duties (or their reference point) exists in Cyprus, Denmark, Estonia, Hungary, Ireland, Latvia, Malta and the UK.

145 Now Directive 2012/30/EU, *OJ* 2012 L 315/74.

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of a 'serious loss', which is defined as a loss of half[146] of the subscribed share capital (i.e., the reduction of the company's *net assets* to less than half of the share capital).[147] In implementing what is now Article 19 of the Directive, a number of Member States[148] require shareholders to resolve on a recapitalisation of the company or else its winding-up. This 'recapitalise or liquidate' rule addresses the problem set out above insofar as it tries to reduce the number of (public) companies that operate with very low capital levels.

5.1 Duty to file and wrongful trading

The 'duty to file' strategy is clearly most widely spread. It is triggered by the insolvency of the company, rather than merely by a *threat of* insolvency, and it is complemented by a consequential liability of directors for the reduction of the company's assets resulting from the delayed insolvency filing. Across the Member States using this strategy, differences exist as to the calculation of damages. In some Member States, where the insolvency is declared 'wrongful', which is the case if intentional or grossly negligent acts of the director have caused or aggravated the state of insolvency, the relevant courts may order the director to cover all or parts of the shortfall in the company's assets.[149] Thus, the exact amount of damage causally connected to the delayed filing is of less relevance. In other Member States, a delay in the insolvency filing only leads to a claim for damages up to the difference between the insolvency dividend that the creditor could have obtained if insolvency proceedings had been opened in time, and the actual dividend.[150] Such damages may still exist, as all jurisdictions effectively allow the continuation of trading beyond the point where the company is balance-sheet insolvent on the basis of liquidation values (which will often be significantly lower than the book values of assets assuming a going concern).

The wrongful trading remedy can, at least in theory, be triggered *even before* the company is formally insolvent, since it is linked to an assessment of the company's ability to avoid insolvent liquidation in the future.[151] At the same time, it does allow companies, for at least a limited time, to continue trading in a state of (balance-

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[146] See ibid., Art. 19; Member States can also set the threshold for serious losses at a lower level, ibid., Art. 19(2).

[147] This is assessed on a cumulative basis; see J. Rickford, 'Reforming Capital: Report of the Interdisciplinary Group on Capital Maintenance', 15 *European Business Law Review* (2004) p. 919, at p. 940.

[148] I.e., Bulgaria, the Czech Republic, Estonia, France, Italy, Latvia, Lithuania, Luxembourg, Portugal, Spain and Sweden.

[149] See, e.g., the Spanish Insolvency Act (available in Spanish at: <http://www.boe.es/buscar/act.php?id=BOE-A-2003-13813>), Art. 163.

[150] For example, in Germany and Austria, where liability is limited to the so-called '*Quotenschaden*', i.e., the additional pay-outs to creditors, assuming timely filing.

[151] See, e.g., s. 214(2)(b) of the UK Insolvency Act 1986.

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sheet) insolvency.[152] Of course, jurisdictions following the 'duty to file' strategy will also permit the continuation of trading beyond the point in time where the company is balance-sheet insolvent,[153] but this will involve an adjustment to the 'insolvency trigger' itself, rather than an adjustment of the duty to file. Thus, under a wrongful trading rule, directors of a formally insolvent company that has a realistic chance to trade its way out of its situation may avoid liability even where the company ultimately fails, while directors in a not yet insolvent company may be obliged to cease its operations if avoidance of (future) insolvency seems highly unlikely.

Overall, no systematic differences seem to exist regarding the point in time at which either remedy is triggered. English courts, for instance, tend to enforce the wrongful trading prohibition only in relation to trading that took place after the company entered a state of insolvency,[154] and it has been suggested that, in practice, the UK's wrongful trading prohibition tends to be triggered at a later stage than duties to immediately file for insolvency once the relevant triggering event has occurred.[155] But the effect of the two rules ultimately depends on the exact definition of the 'insolvency trigger' under the applicable law. Depending on the definition, the 'duty to file' strategy can be 'stricter' or less strict in its operation than a wrongful trading rule.

5.2 Changes to the core duties owed by directors

In addition, some Member States provide for an explicit change in the definition or the scope of directors' duties as the company approaches insolvency. This typically involves moving from a shareholder-centric towards a more creditor-regarding set of objectives.[156] The need for such an 'explicit' change, however, depends at least in part on the emphasis the relevant jurisdiction places on shareholder interests as compared to those of other stakeholders. Jurisdictions that define directors' duties with reference to the interests of a broad set of constituencies may well leave it for the courts to balance these interests depending on the company's financial situation. Such a flexible approach may then, for instance, lead courts to require different levels of risk aversion, caution or diligence as the company approaches insolvency.[157] In shareholder-value oriented jurisdictions, the change may be seen as being more pronounced, since a duty to act in the interest of, effectively, the shareholder body is replaced by a creditor-focused duty.

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152 See also Davies, *supra* n. 137, at p. 311.
153 See, e.g., the comparison of German and English law by Bachner, *supra* n. 138.
154 See, e.g., the analysis by Bachner, ibid.
155 Bachner, ibid., exemplifies this by comparing German and English law.
156 See, e.g., Davies, *supra* n. 137, at pp. 327-329.
157 E.g., in Germany and Austria.

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5.3 Recapitalise or liquidate

As mentioned above, the 'recapitalise or liquidate' rule at least *indirectly* addresses the problems posed by companies trading once they approach insolvency. Throughout the EU, public companies are obliged to call a general meeting where the (cumulated) losses of a company exceed 50% of the subscribed capital.[158]

Somewhat oddly, however, the Second Directive does not provide for any particular action to be taken at a general meeting called under the relevant implementing provision. Insofar as Article 19 of the Directive only requires a meeting of the shareholders, the rule does not seem to follow a clear economic rationale: first, the reference to the subscribed capital is, in itself, not a meaningful triggering event. The subscribed share capital will not be a particularly useful reference point, as this figure says virtually nothing about the assets or capital needs of a company.[159] Second, even (or particularly) where the event of losses amounting to more than 50% of the subscribed share capital *does* constitute a significant point in time in the company's life, it is at the very least questionable whether this is the right time to encourage shareholders to become more active in the company's affairs given the perverse incentives that exist at this point.[160]

A majority of the Member States have indeed implemented what is now Article 19 of the Directive in this way – as a mere duty to call a meeting. About a third of the Member States, however, go beyond this minimum requirement and force companies to choose, upon losing half of the subscribed share capital, between either recapitalising the company or winding down its operations and liquidating it.[161] The possible effect of the 'recapitalise or liquidate' rule on near-insolvency trading is twofold. First, the rule aims at making it less likely that companies with very low equity levels are present in the market. However, this assumes that the subscribed share capital is indeed a significant figure for the company in question. European law mandates a minimum capital of 25,000 euro,[162] suggesting that this will only be a meaningful triggering point for very small companies. The more important point may be that duty-related enforcement mechanisms are directly linked to this strategy. Failure to ensure that appropriate capital measures are taken, or else the company is wound up upon reaching the trigger point, leads to liability of the directors. One advantage of this approach may well be the relative ease with which both noncompliance with this rule and a causal link between non-compliance and the losses inflicted on the company (and hence its creditors) can be proven ex post, as com-

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[158] See Art. 19 of Directive 2012/30/EU, *supra* n. 145.

[159] Rickford, *supra* n. 147, at p. 919; see also J. Armour, 'Legal Capital: An Outdated Concept?', 7 *EBOR* (2006) p. 5.

[160] See text to nn. 137-141.

[161] This is the case in the Czech Republic, Estonia, France, Italy, Latvia, Lithuania, Portugal, Spain and Sweden.

[162] See Art. 6 of Directive 2012/30/EU, *supra* n. 145.

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pared to, e.g., incompetent or imprudent management or foreseeability of insolvency, which could render the strategy attractive despite the arbitrary nature of its trigger. The second element, i.e., causation of loss, will often not be present where no obligation to recapitalise the business exists under national law, although some Member States relax the general principle of causation as a prerequisite for liability where duties have not been complied with preceding insolvency.[163] Moreover, a 'recapitalise or liquidate' remedy may generally be relevant in small companies, especially when combined with significant minimum capital requirements. In this case, the rule may well result in fewer under-capitalised companies operating in the market, which may offset problems of enforcement in such companies – i.e., companies where the remaining assets will often not suffice to fund costly litigation against the former management.

5.4 Additional elements of a regulatory response to near-insolvency trading

As 'general' duties of directors continue to apply in the vicinity of insolvency, the effectiveness of a regulatory framework will also depend on the effectiveness with which these general duties can be enforced.[164] In addition, Member States differ in their reliance on administrative and criminal sanctions to discourage excessive risk-taking in near-insolvent companies.[165] Rigid criminal law enforcement with regard to insolvency-related misconduct by company directors often also plays a role in producing evidence that may then be used in civil actions.

Some jurisdictions require the competent insolvency administrators or liquidators to bring or examine potential claims that the insolvent company may have against its directors.[166] Likewise, anecdotal evidence suggests that the incentives of administrators or liquidators play an important role: practitioners in jurisdictions where administrators do not receive a share of the proceeds from legal actions brought against a director perceive this as an important factor contributing to low levels of enforcement of near-insolvency duties. Finally, directors of – especially small – insolvent firms will often not possess enough assets to economically justify the enforcement of civil claims.[167]

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[163] To some extent, this seems to be the case in both Spain and France.

[164] See *supra* section 4.

[165] One important aspect of this is, of course, the disqualification of directors. See on this, K.E. Sørensen, 'Disqualifying Directors in the EU', in H.S. Birkmose, M. Neville and K. Engsig Sørensen, *Boards of Directors in European Companies. Reshaping and Harmonising Their Organisation and Duties* (Wolters Kluwer 2013) p. 327.

[166] This is true, for instance, in Spain, where claims against directors are brought in more than 80% of the cases.

[167] Directors of small companies are typically also shareholders of these companies and will often have invested a significant portion of their available assets in the (now insolvent) firm.

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From that perspective, the perceived low levels of enforcement of directors' duties in the insolvency context – a perception shared by practitioners across almost all Member States – may have little to do with insufficiencies in the design of the duties as such, but should rather be seen as a consequence of the reliance on quasi-private[168] enforcement mechanisms in a situation where economic incentives are almost necessarily diluted.

5.5 **Choice of law and directors' duties in the vicinity of insolvency**

It is worth noting, first, that some of the legal strategies described above – especially the duty to file and wrongful trading prohibitions – can be classified as forming part of either company law or insolvency law. This seemingly meaningless classification gains significance when viewed through the lens of the European private international law framework, which effectively renders applicable the national rules from these two legal areas on the basis of different connecting factors.[169] Second, legal strategies to address problems in near-insolvent companies interact with and depend on the legal and institutional framework in each jurisdiction. Given that free corporate mobility is a relatively new feature in the European corporate landscape, it is perhaps not surprising that, until recently, the resulting 'classification problem' – i.e., the problem that different connecting factors exist for company and insolvency law, as well as for, e.g., tort law – has received little attention from national legislators. As we have discussed elsewhere, this can potentially lead to significant cross-border frictions in relation to European companies making use of their Treaty rights.[170]

6. Conclusion

As opposed to other areas of company law, directors' duties have not been the subject of an extensive harmonisation programme at European level.[171] Therefore, the

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[168] We refer to enforcement by administrators as 'quasi-private' since – while also fulfilling a public function – their main task is to maximise the return for creditors, who as the residual claimants will press for an efficient use of the remaining assets. Thus, absent government intervention, actions are likely to be brought only where legal proceedings are positive net value investments from the creditors' perspective.

[169] On the basis of the country of incorporation for company law, and of the 'centre of main interest' (COMI) for insolvency law; see in detail, Gerner-Beuerle and Schuster, *supra* n. 1.

[170] See Gerner-Beuerle and Schuster, ibid.

[171] The proposal for a Fifth Company Law Directive (COM(72) 887 final, 27 September 1972, Bulletin of the European Communities, Supplement 10/72) contained some provisions on directors' duties and liability (Arts. 14-21) but was withdrawn in 2004, see *OJ* 2004 C 5/2. More recently, the European Parliament expressed the belief that 'due consideration should be given to the resumption of work on the Fifth Company Law Directive with regard to the structure and

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system of directors' duties in the EU continues to be characterised by a variety of approaches and legal strategies. On the other hand, we can observe that, in spite of the differences in regulatory technique and legal tradition, the effect of the legal strategies deployed in the Member States is often remarkably similar. In addition, legal systems exhibit interconnections in the form of mutual learning across borders. Legal strategies developed in one jurisdiction are transposed into another because they are considered to provide adequate solutions to an identical social conflict.[172] A striking example of this type of international coordination and interaction is the dispersion of the US business judgment rule in the EU.[173]

In all Member States, directors' duties are used as a strategy to address the managerial agency problem and protect investors, and to a lesser degree to deal with conflicts between minority and majority shareholders. All analysed jurisdictions make use of legal institutions that can be characterised, using common law terminology, as the duty of care and the duty of loyalty. However, the approach to regulating these duties, and their precise definition and content, vary between Member States. In some Member States, notably those in the common law tradition,[174] but also in other jurisdictions such as the Netherlands or the Nordic countries, the duties are not comprehensively regulated and the law relies on broadly phrased constraints. In other countries, the law combines broad standards with clearly specified duties addressing specific circumstances, for example, by supplementing general duties of care and loyalty with a duty to disclose related-party transactions, not to take advantage of business opportunities, not to compete with the company, and to keep business secrets confidential.[175]

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operation of public limited companies' (see European Parliament Resolution, *supra* n. 2), but based on past experience we believe it is highly unlikely that Member States will be able to reach an agreement on the most relevant issues, including in particular directors' duties. Adopted measures focus on the responsibility of board members for financial statements (Directive 2006/46/EC of 14 June 2006 amending Council Directives 78/660/EEC on the annual accounts of certain types of companies, 83/349/EEC on consolidated accounts, 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions and 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings, *OJ* 2006 L 224/1) and on corporate governance in financial institutions (Commission Recommendation 2009/384/EC on remuneration policies in the financial services sector, *OJ* 2009 L 120/22; Green Paper 'Corporate Governance in Financial Institutions and Remuneration Policies', COM(2010) 284 final).

172 This has also been called 'natural convergence': 'the uncoordinated adoption of identical or very similar concepts by a growing number of national legal systems', B. Markesinis and J. Fedtke, *Engaging with Foreign Law* (Hart 2009), at p. 335.

173 See the explicit reference to the 'Anglo-American' business judgment rule in the explanatory memorandum to the law introducing a business judgment rule into the German Stock Corporation Act, *Bundestags-Drucksache* 15/5092 of 14 March 2005, at p. 11 (available in German at: <http://dip21.bundestag.de/dip21/btd/15/050/1505092.pdf>).

174 With the exception of the UK since the codification of directors' duties in the Companies Act 2006.

175 Spanish Corporate Enterprises Act, *supra* n. 32, Arts. 225-232.

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As far as the duty of care is concerned, some Member States lay down the behavioural expectations in precise terms and give a definition of what is meant by standards such as 'reasonable care'. Others simply refer to 'the diligence of an orderly (or prudent) businessman' or, even more generally, impose liability for 'negligent acts'. Finally, a subset of Member States relies on general considerations, such as the fiduciary nature of the director's position.[176] No substantive or systematic difference, however, seems to follow from these variations in formulation. The effectiveness of the duty of care as a mechanism to align the interests of directors and shareholders and, at the same time, grant directors a sufficiently broad margin of discretion to promote efficient risk-taking depends on the level of care expected of directors and the restraint that the courts show in reviewing business decisions. We have no reason to conclude that these elements can be specified more appropriately by one regulatory technique than another. Countries that adopt similar strategies may still differ in the interpretation of the required behavioural standard and the approach of their courts to reviewing business decisions, while jurisdictions that follow different approaches may well arrive at similar results. In particular, the difference between the dual objective/subjective standard of care and the purely objective standard that we identify in the Member States seems to be of secondary importance for outcomes in practice.[177] The courts' understanding of what constitutes a careful and prudent discharge of directors' responsibilities is, arguably, of far greater relevance for the position of the director than the formal distinction between the two standards in the law.

The regulation of the duty of loyalty exhibits greater variance than that of the duty of care. Here, we can observe differences that run roughly along the lines of legal families, which is partly a function of the difference between the one-tier and two-tier board structure. Common law countries provide for broad duties to avoid any type of conflict of interest between the company and the directors. Directors are required to disclose their interest in a transaction with the company and must generally abstain from deciding on the transaction. In addition, they are prohibited from exploiting business opportunities that are, or could potentially be, of commercial interest to the company. Jurisdictions in the French legal tradition also require approval of related-party transactions by the disinterested directors, but business opportunities are traditionally addressed through the duty not to compete with the company, instead of a broadly interpreted corporate opportunities doctrine. Legal systems following the German tradition, which commonly provide for a mandatory two-tier board, address the problem of related-party transactions by means of a reallocation of decision-making power to the supervisory board. Similar to the French legal tradition, a broad corporate opportunities doctrine often does not exist, and instead the duty not to compete is employed. Finally, the Nordic countries re-

[176] See *supra* text to nn. 42-52.
[177] See *supra* text to nn. 58-59.

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quire disclosure and disinterested approval of related-party transactions, but do not provide for binding regulation of corporate opportunities.[178]

Of course, many differences exist with respect to the details of the applicable rules between countries grouped together in this way, and jurisdictions do not always fit neatly within one group. In addition, it would be fallacious to derive generalisations regarding the effectiveness of a given investor protection regime from the allocation of the jurisdictions to one group or another. While we have identified a generally narrower scope and less flexible contours of some strategies, namely the reallocation of decision-making power to regulate related-party transactions and the non-competition duty to address the problem of corporate opportunities, it is submitted that these potential disadvantages are not inherent in the legal strategies as such. Rather, they are a consequence of the narrow or broad formulation of the elements of the respective duty and the preparedness of the courts to develop the law flexibly and draw, where necessary, on general or unwritten principles to solve social conflicts adequately. In fact, it seems that courts, given the opportunity, are willing to amplify the codified rules and make use of different legal mechanisms to fill regulatory gaps. For example, in France and Germany, the courts have established an unwritten, broadly applicable duty of loyalty to supplement the codified rules on conflicts of interest.[179] In the Netherlands and Finland, the regulation of the duty of loyalty was, until recently, fragmentary.[180] The courts have built on the general formulation of the directors' position as set out in the relevant legislation and utilised duties not specifically designed to address related-party transactions or corporate opportunities. The Dutch rules state that directors must act 'in accordance with what is required by standards of reasonableness and fairness'[181] and hold directors responsible 'for a proper performance of the tasks assigned' to them.[182] In Finland, the requirement to 'act with due care and promote the interests of the company' is applied to conflicts of interest.[183] Thus, the courts have displayed some ingenuity in finding solutions where the law does not provide for an explicit answer.

As can be seen, such judicial innovation is not restricted to individual legal families. Access to the courts and reliance on the proper functioning of the judicial system seem to be more important than a particular legislative or regulatory style. A

[178] See *supra* text to nn. 88-110.

[179] *Supra* nn. 86, 99 and 103.

[180] Dutch law on related-party transactions has been reformed by the Act on Management and Supervision of NV and BV Companies (*Wet bestuur en toezicht in naamloze en besloten vennootschappen*) of 6 June 2011, Legislative No. 31.763. The new rules introduce a prohibition for directors who have a direct or indirect interest in a transaction to participate in the decision-making process regarding that transaction.

[181] Dutch Civil Code, *supra* n. 30, s. 2:8(1).

[182] Ibid., s. 2:9(1). For an application of these provisions to conflicts of interest, see *supra* n. 107.

[183] Companies Act, *supra* n. 31, Ch. 1, s. 8.

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precondition for the emergence of effective rules is a sufficiently large body of case law. Therefore, the framework for the enforcement of directors' duties is of central importance. While we do not give a comprehensive analysis of all relevant enforcement mechanisms, our examination of the derivative action shows that very few Member States provide for a regulatory environment conducive to minority shareholder suits along all three relevant dimensions – standing, additional conditions for bringing the action, and cost rules.[184] Indeed, where judicial innovation does occur, it is partly realised through the channel of substitute mechanisms of shareholder suits.[185] Here, arguably, the need for reform is greatest.

Enforcement, rather than the content of the substantive legal rules, also seems to account for most practical differences in the operation of duties designed to specifically address the problems arising in near-insolvent companies. While we do find a certain degree of variance across jurisdictions, private enforcement mechanisms seem to face particular problems in this area. Here, the difficulties can mainly be found in the incentives for bringing actions against directors who do not typically possess significant assets after the company enters into insolvent liquidation. To some extent, the problems seem to be of a self-perpetuating nature: as wealth constraints on the part of the possible defendants weaken the economic case for bringing actions, the body of case law remains weak. This, in turn, limits the ability to predict ex ante the likelihood of success in bringing a legal action and increases the costs of enforcement. Some jurisdictions seem to have been (modestly) successful in increasing the levels of enforcement by incentivising insolvency administrators to start proceedings or by relying on public enforcement of a criminal or administrative law nature. In this area, as with directors' duties more generally, Member States will of course be aware that low levels of enforcement do not necessarily imply *inefficient* enforcement activity. As demonstrated by the rising popularity of the business judgement rule as well as similar legal techniques restraining judicial control over managerial decisions, European legislators are well aware of the fact that overly cautious corporate executives pose as real a threat to their national economies as imprudent or lethargic managers and reluctant providers of capital.

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[184] See *supra* text to nn. 116-136.

[185] For example, UK disqualification and winding-up proceedings (see, e.g., *Re D'Jan of London Ltd* [1993] B.C.C. 646; *Re Barings plc (No. 5)* [1999] 1 BCLC 433; *Re Kaytech International plc.* [1999] B.C.C. 390); Dutch inquiry proceedings (see J.M.M. Maeijer, G. van Solinge and M. Nieuwe Weme, *Mr. C. Assers Handleiding tot de beoefening van het Nederlands Burgerlijk Recht 2-II* (Kluwer 2009), at pp. 931 et seq.); and criminal proceedings for *abus de biens sociaux* in France (for references, see Merle, *supra* n. 103, para. 416) have produced important decisions shaping directors' duties.

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