

# MAPPING DIRECTORS' DUTIES: THE EUROPEAN LANDSCAPE

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# Directors' duties in the EU

- Study to be prepared for the European Commission
- Analysis of the legal systems of all Member States plus Croatia
- Focus on:
  - Structure and content of directors' duties
  - Conditions of liability
  - Duties in the vicinity of insolvency, but not insolvency law
  - Cross-border frictions that may impede the free movement of companies or allow for regulatory arbitrage

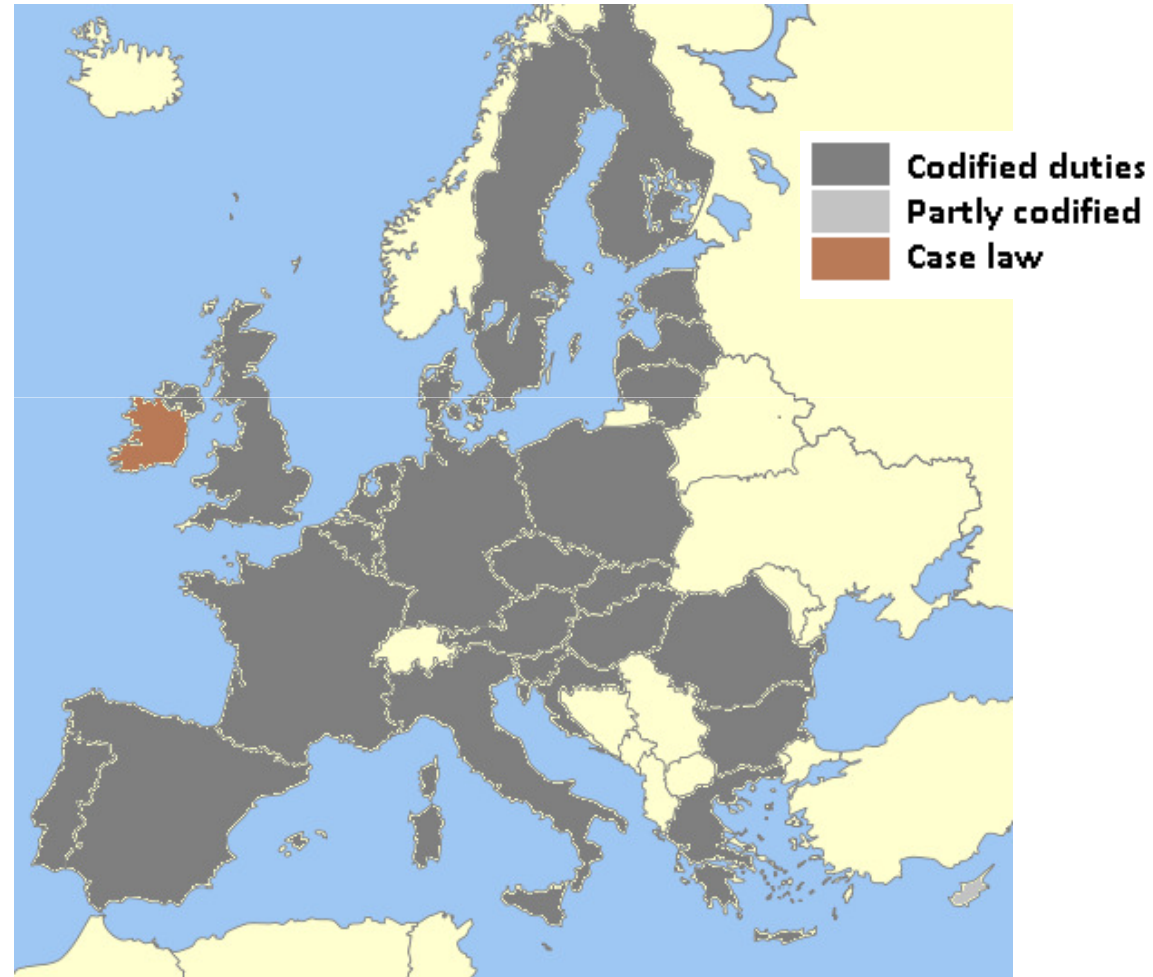
# Directors' duties in the EU

- Organisation of boards
- Substantive provisions on directors' duties
  - Structure of directors' duties: codified or case law; general clause or different types of duty?
  - Who owes the duties? De jure directors, de facto directors, shadow directors?
  - To whom are the duties owed (company, shareholders, creditors, etc.)?
  - The "interests of the company"
  - Duty of care
  - Duty of loyalty
  - Limitation of liability
  - Insurance
- Directors' duties and liability in the vicinity of insolvency
  - What are the rules applicable in near-insolvency situations?
  - How can such rules be classified from a PIL point of view?
- Enforcement
  - Who represents the company in litigation?
  - When can shareholders sue in their own name?
  - Derivative action
  - Other enforcement mechanisms (disqualification, administrative sanctions, criminal law)
- Cross-border issues
  - Reach of the free movement rights of companies
  - Opportunities for regulatory arbitrage?
  - Determination of the applicable law
  - Functional substitutes: risk of cumulative application of liability provisions or regulatory loopholes?

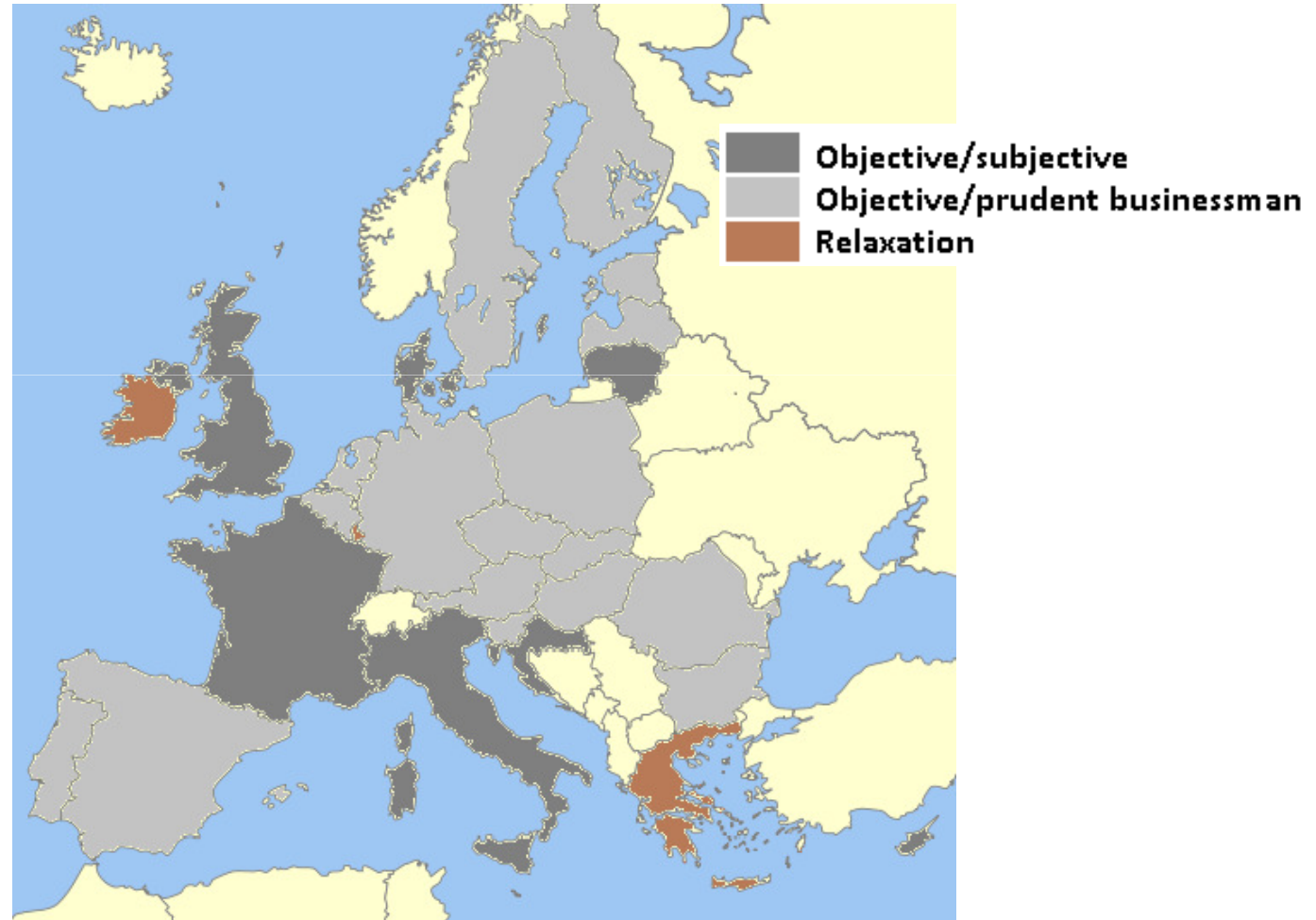
# Important issues

- What is the regulatory approach prevalent in the EU?
- Duty of care:
  - What is the applicable standard of care?
  - Who bears the burden of proving lack of due care?
  - Do directors enjoy a margin of discretion that is not judiciable (business judgment rule)?
- How are related party transactions regulated?
- What are the regulatory strategies in relation to near-insolvency situations?
- Is the derivative action an effective mechanism to protect minority shareholders?
- What are the main cross-border problems in relation to directors' duties?

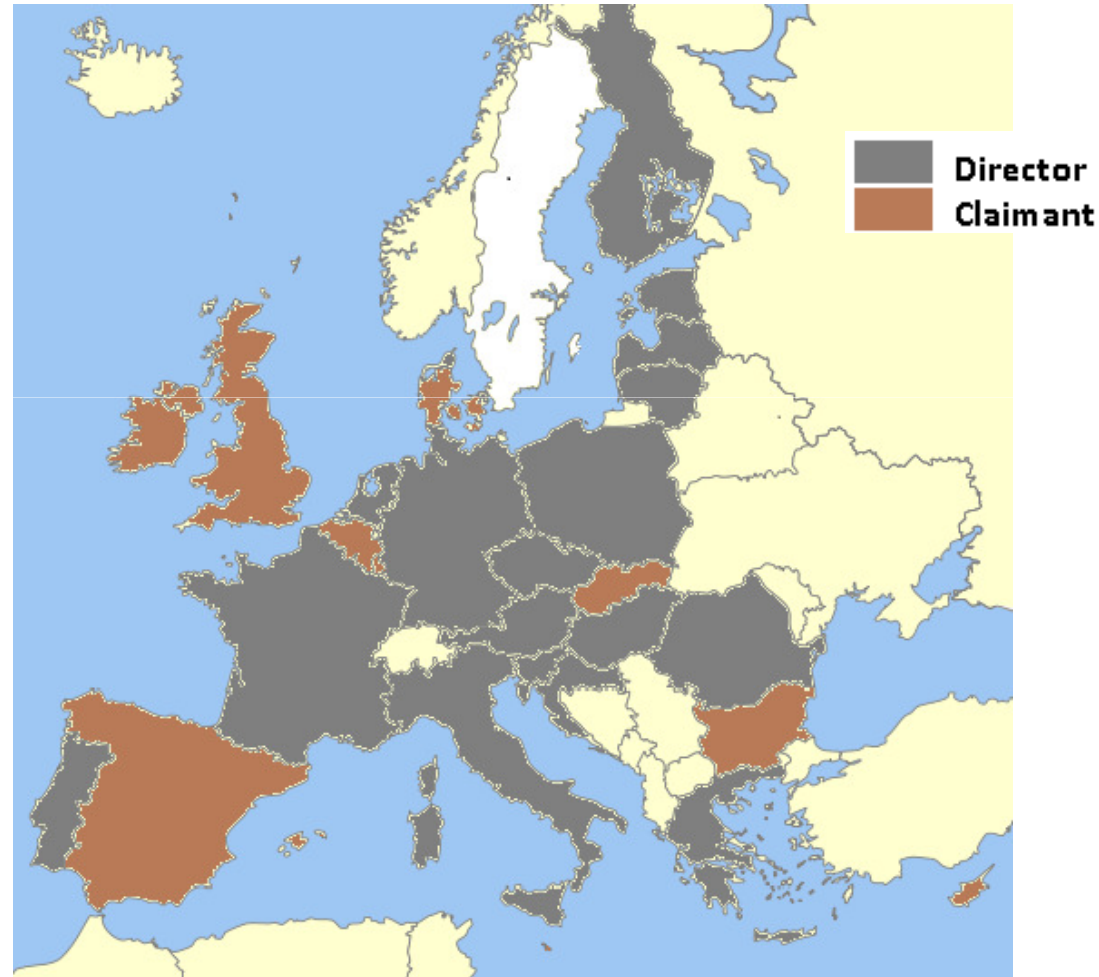
# Regulatory approach



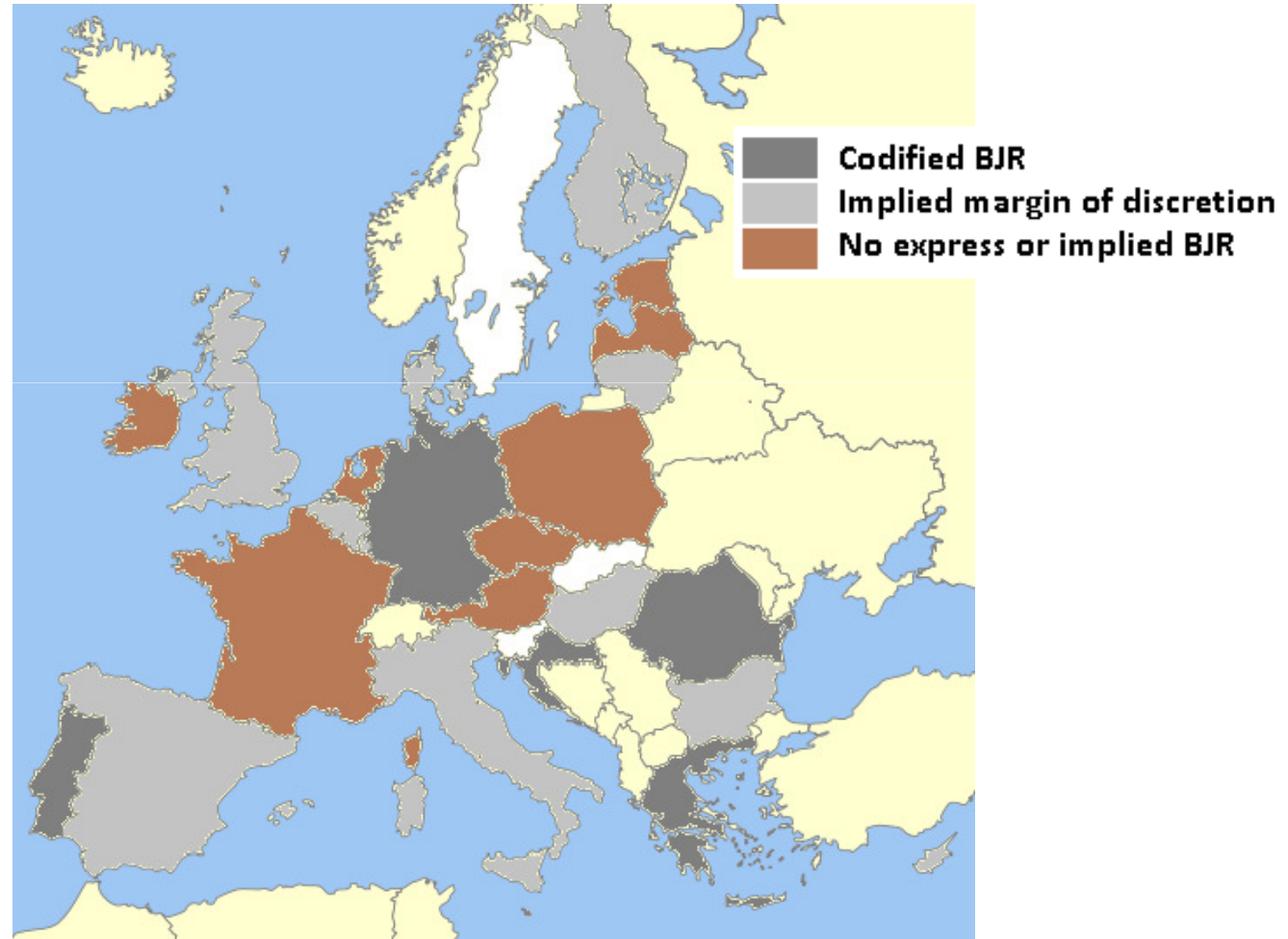
# Standard of care



# Burden of proof

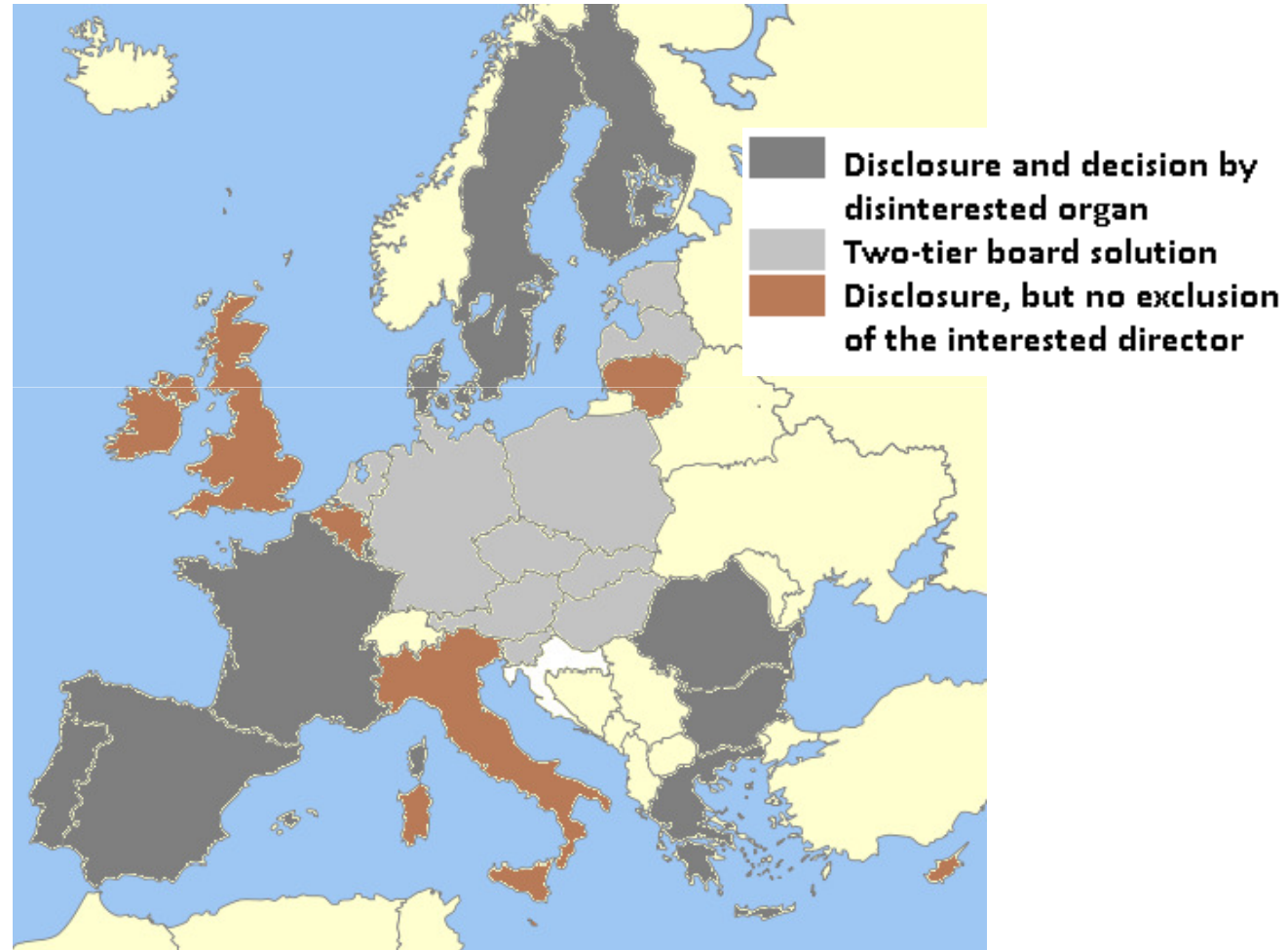


# The problem of risk aversion





# Related party transactions



# An example for functional substitutes

- Spanish Corporate Enterprises Act, s. 367: If the law requires a company to be wound up (e.g., because losses have reduced the company's equity to an amount lower than one half of the capital) and the directors fail to convene the general meeting to decide on the winding up within two months, they are jointly and severally liable for corporate obligations incurred since the legal ground for the winding-up was satisfied.
- Directors are liable according to Art. 172 Spanish Insolvency Act for insufficiency of assets if insolvency proceedings are qualified as 'culpable'. Insolvency proceedings are culpable if intentional or grossly negligent acts of *de iure* or *de facto* directors caused or aggravated the state of insolvency. As a consequence, the court may order the guilty directors to cover the deficit in the company's assets completely or partially.

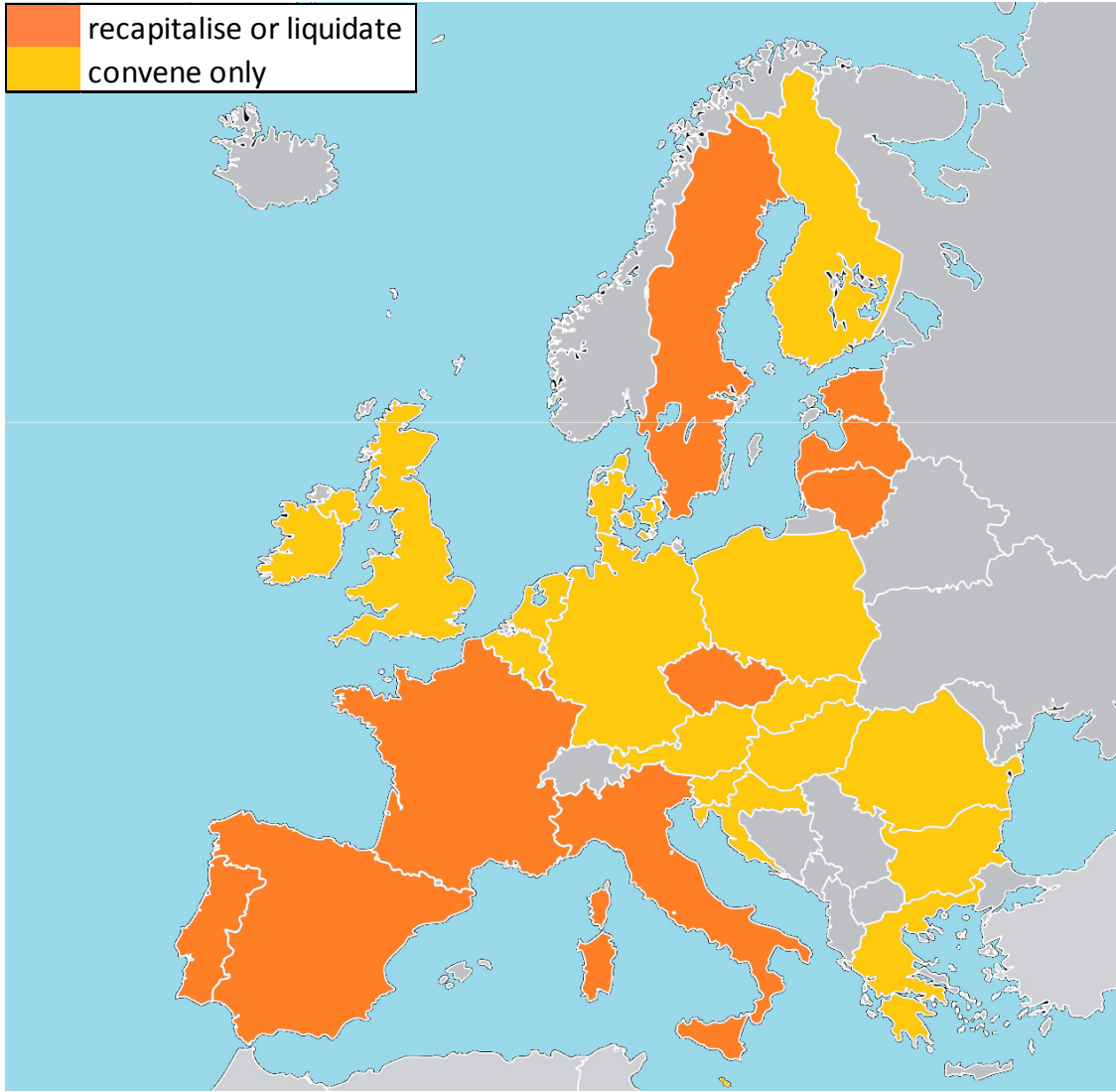
# Duties in the vicinity of insolvency

- Functional approach: What “function” are we focussing on?
  - “Gambling way out of insolvency”
  - Direct consequence of limited liability (option-like financial position of shareholders)
  - Shareholders (and managers) have incentives to pursue overly risky projects
- What we do not deal with:
  - Siphoning-off assets, undervalue sales, unequal treatment of creditors

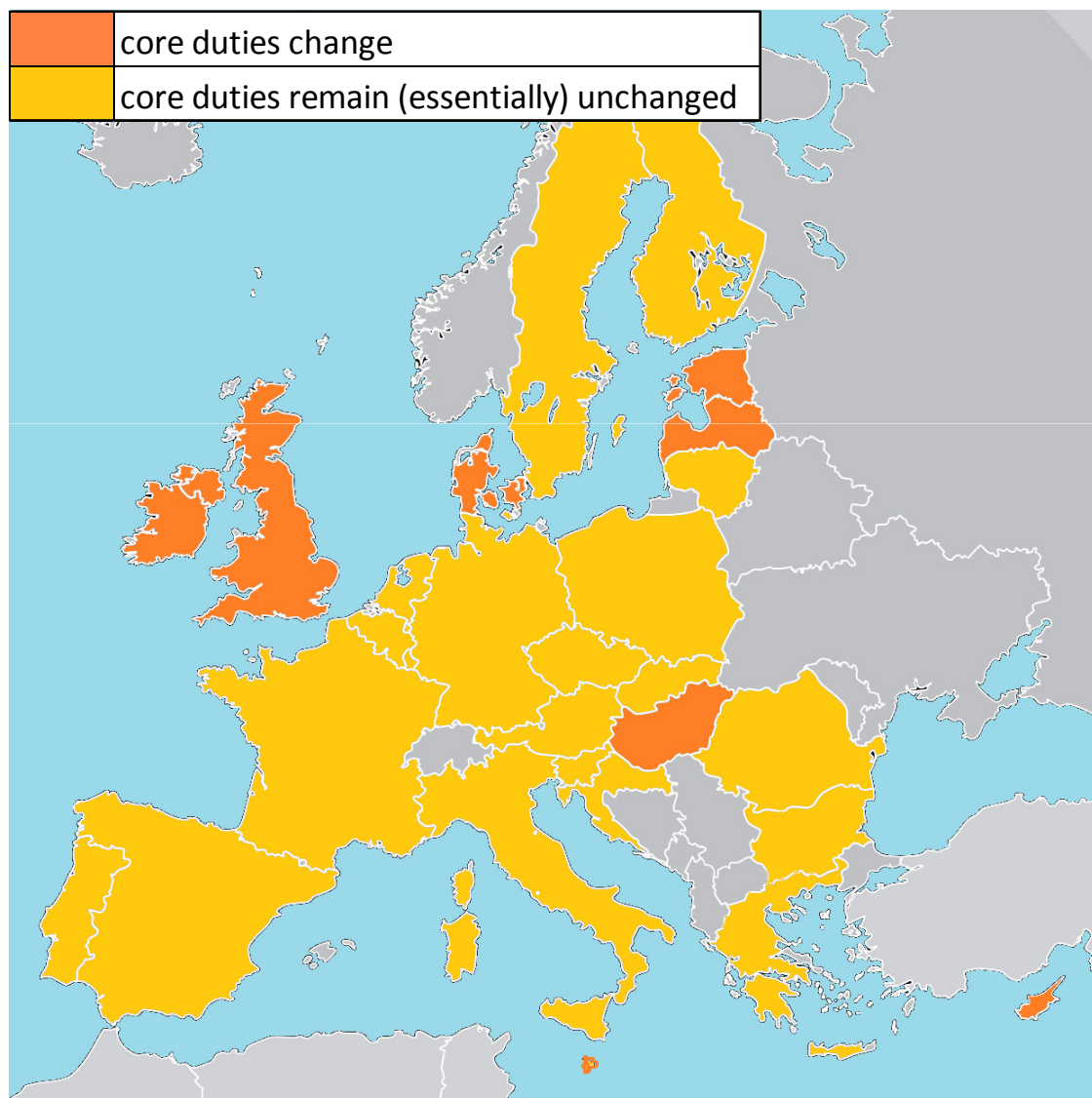
# Legal strategies

- Legal strategies used in EU Member States
  - Wrongful trading rules
    - Company keeps trading
  - Duty to file for insolvency
    - majority of countries
    - Different triggering events
  - Recapitalise or liquidate
  - Change of directors' duties
    - “Intrusion” of creditor interests
    - Dependent on definition in “normal times”..
    - Difficulties in defining relevant point in time
  - Relevance of “interest of the company” and “shareholder value” vs “stakeholder value” approach?
- Functional equivalency
- Required level of risk-aversion
  - Negative net-value projects?
- *Interconnectedness* of company law and insolvency law

# Recapitalise or Liquidate



# Explicit changes in directors' duties *before* reaching insolvency?



# Different triggers for insolvency & pre-insolvency duties

- Preliminary question: When is a company considered “insolvent”?
  - Different approaches across Europe
  - Almost all countries rely on both balance sheet and cash-flow based triggers
  - Most member states allow companies to continue trading for some time after balance sheet insolvency
  - But: Member states differ in their *focus* on balance sheet insolvency (i.e. over-indebtedness)
    - Determining balance sheet insolvency: Going concern vs liquidation values

# Timing and “risk-aversion”

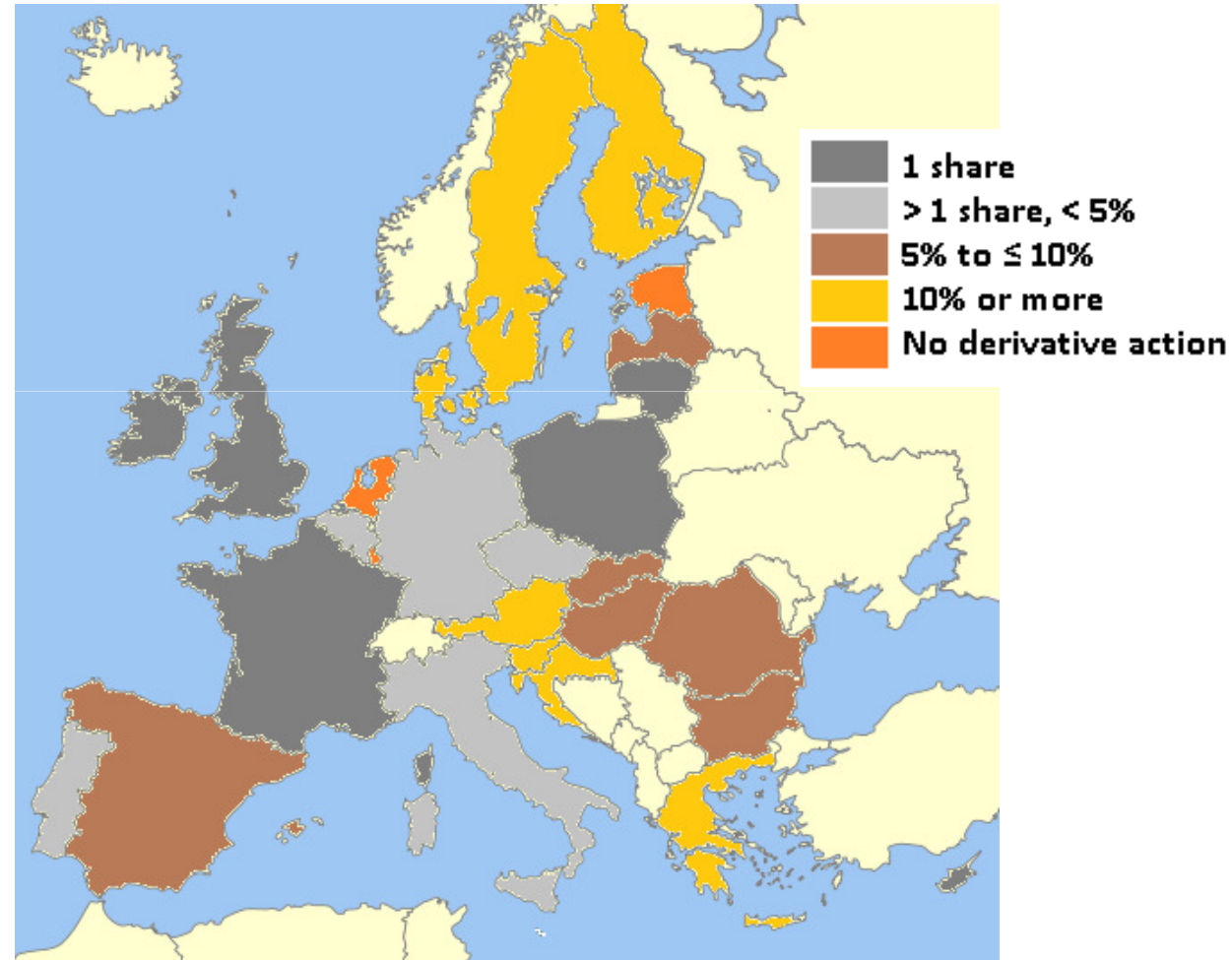
- Trigger for “near insolvency” framework
  - When should the directors change their behaviour / stop trading / file for insolvency?
    - Company is insolvent already
    - Insolvency unavoidable (*e.g. “no reasonable prospect”*)
    - Insolvency sufficiently likely

Legal systems can differ in their levels of “risk-aversion”

- Structure also affect managers’ ability to enter into positive net-value projects
- Potentially gives rise to forum shopping



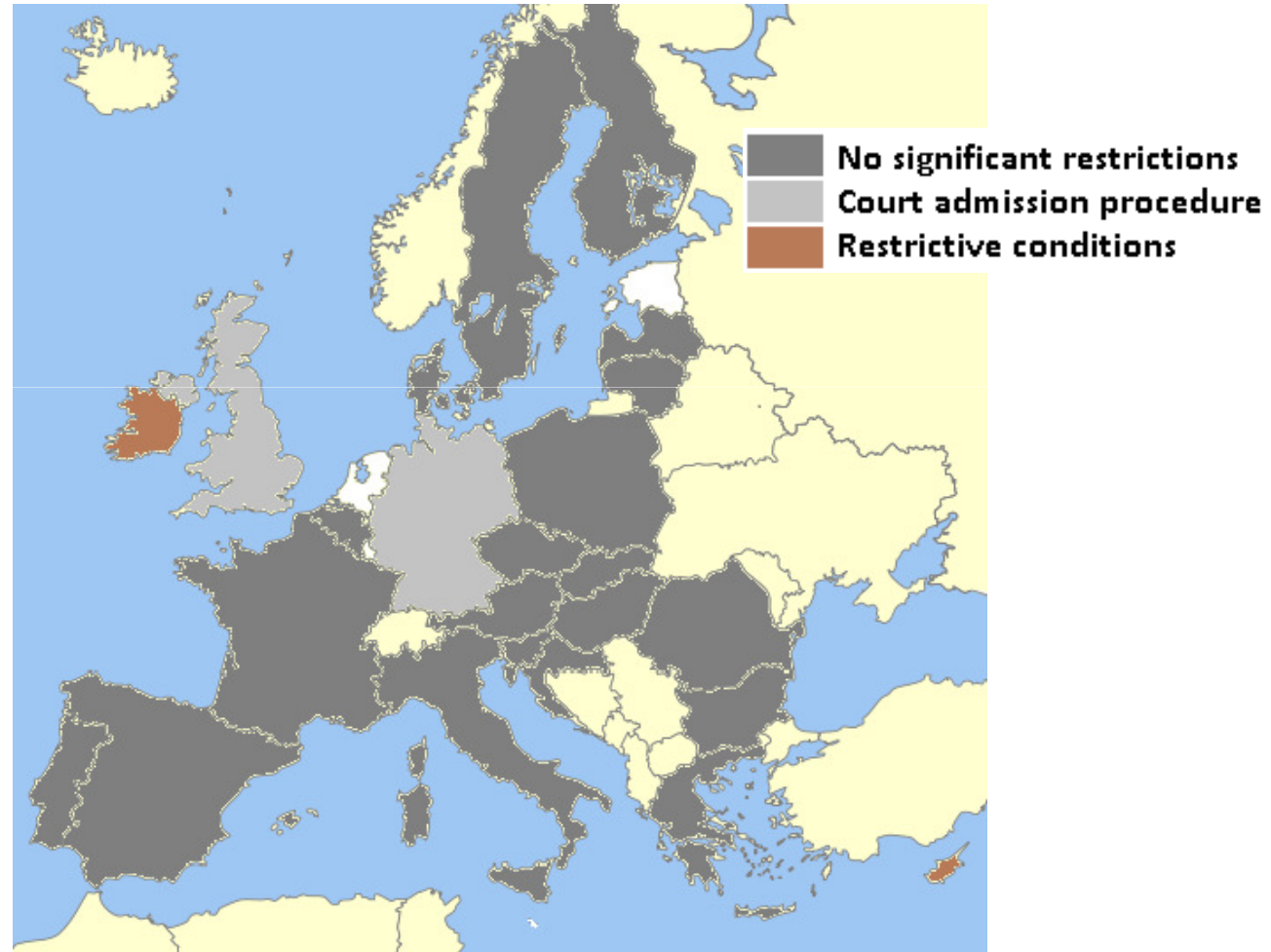
# Derivative action: standing



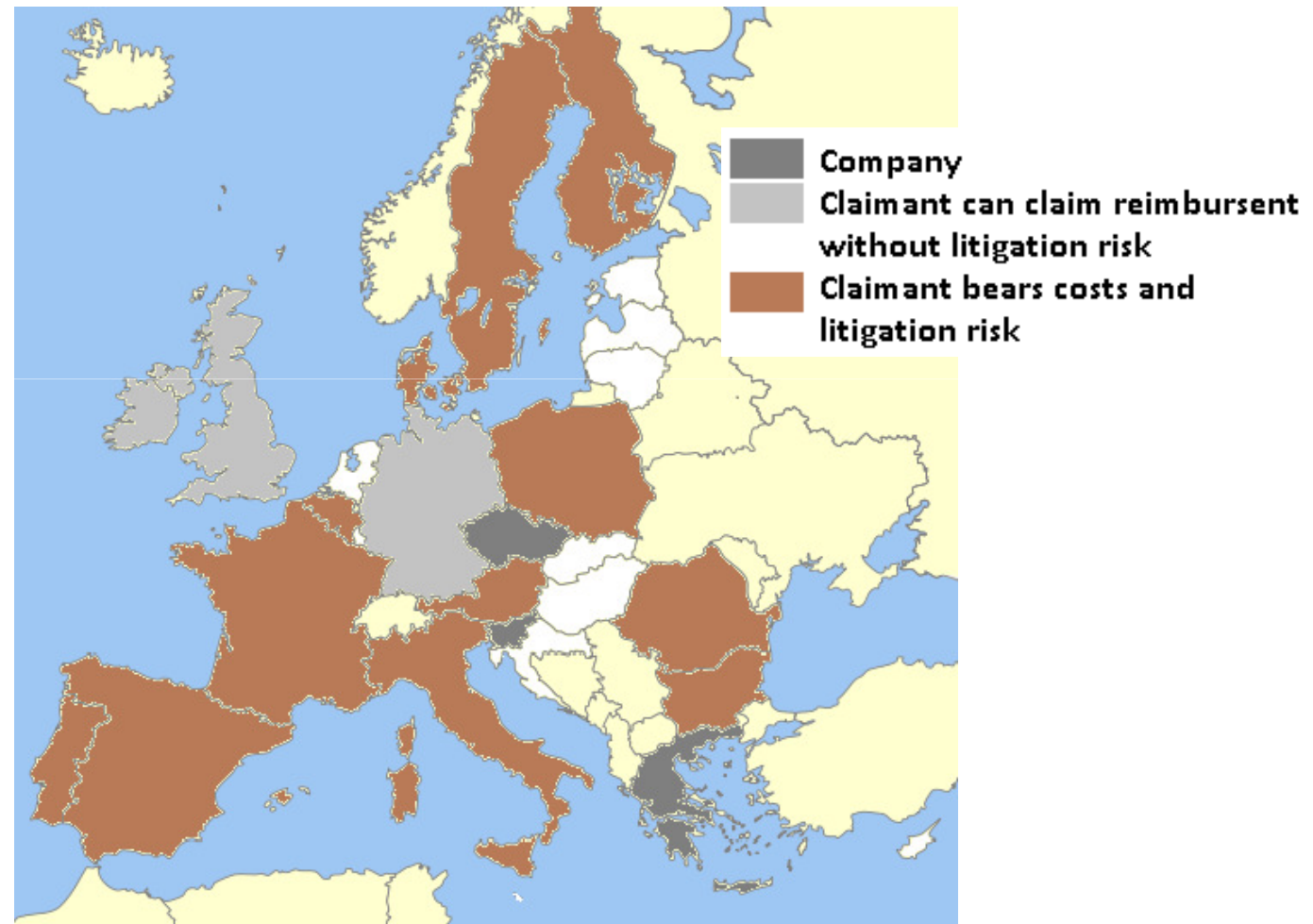
## Another example for functional substitutes

- Netherlands: shareholders holding at least 10% of the capital or a nominal value of EUR 250,000 can request the Enterprise Chamber of the Civil Court of Appeal of Amsterdam to conduct an enquiry into the policy and conduct of the business of the company. The court may order the suspension of directors, appointment of supervisory directors with special powers, suspension of resolutions of the management board or suspension of voting rights.
- Great practical relevance

# Derivative action: conditions



# Derivative action: cost rules

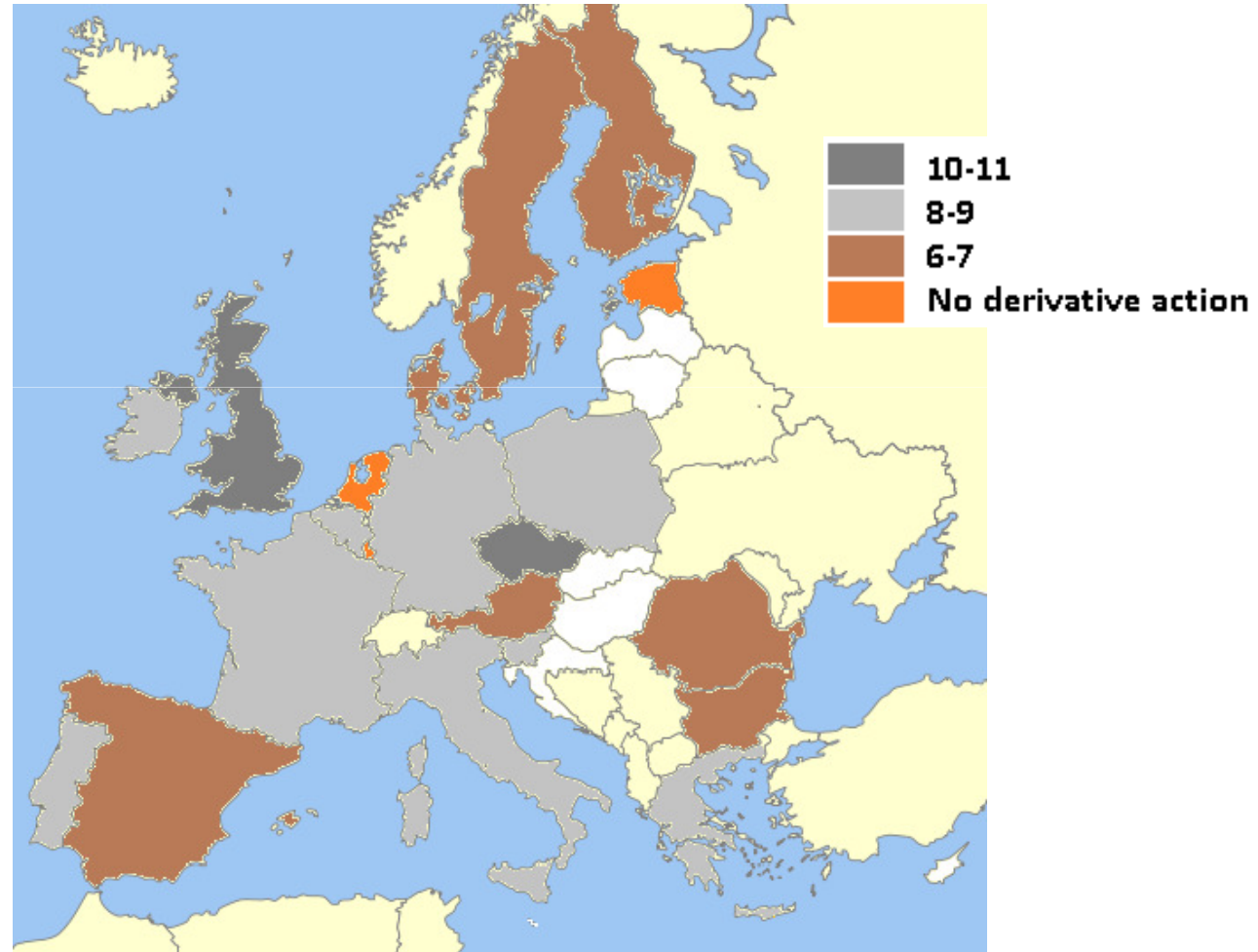


# Ease of enforcement

- Proxy for the ease with which minority shareholders can enforce breaches of directors' duties when the competent organ does not act:

	Standing	Conditions	Cost rules
4 points	1 share: FR, IE, PL, UK	No further conditions: AT, BE, BG, CZ, DK, FI, FR, EL, IT, PL, PT, RO, SI, ES, SE	Company pays all costs: CZ, EL, 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 some conditions without bearing the litigation risk: DE, IE, UK
2 points	5% ≤ 10%: BG, RO, 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: IE	The claimant pays and bears the litigation risk: AT, BE, BG, DK, FI, FR, IT, PL, PT, RO, ES, SE

# Ease of enforcement



# Cross border issues

- The classification problem..
- Functional substitutes and PIL rules
  - Potentially gives rise to regulatory arbitrage / over-deterrence
  - Core duties subject to incorporation state
- Particularly relevant in relation to duties in the vicinity of insolvency
- Majority of countries classify wrongful trading/duty-to-file rules as part of national insolvency law
  - COMI vs incorporation state
  - BUT: Problems remain due to connection between duty to file / wrongful trading and core duties
  - Other functional substitutes

# Classification of duty to file / wrongful trading

