1. Introduction

- D&O liability heavily debated because of trade-off:
  - Potential to solve the P-A problem
  - May lead to undesirable risk aversion
- L&E contributes to the debate
- Benefits of Law and Economics
  - Helps to understand incentives
  - Helps to ask the right question
  - Also in a comparison
  - Identity trade-offs

But lit and law-making strongly US influenced
Nothing wrong:
- Business judgment rule
- Disclosure

2. Contractual D&O Liability: Creditor Protection

- Starting point: limited shareholder liability
- Coase: the nature of the firm
- Creates positive externalities
- Possibility of diversification (portfolio theory)
- Creditor protection
  - Informed contracting (Coase 1960) for voluntary creditors
  - But potential contract failures
  - Involuntary creditors?

2. Contractual D&O Liability: Creditor Protection

- Contracting liabilities
  - Limited liability only problem with
    uninformed creditors or
    fraud/misrepresentation
  - Extending D&O liabilities (by contract)
    problematic

3. Owner Protection

- Owner protection doubtful (if for escaping liability) but:
  - Managers of other people’s money
  - Misuse of limited liability could lead to veil piercing
- Inside liability
- Potential moral hazard as a result of dispersed ownership
- Various monitoring devices available (eg non-executive directors/supervisory directors)
- Market for corporate control
4. Liability for Damage to the Corporation and Shareholders

4.1 Fiduciary duty (no stealing)
- No-conflicts rule: liability suit probable
- Conflict approval: by the principal
  - Law should provide constraints
  - Eg delegation to independent (supervisory) director

4. Liability for Damage to Third Parties

4.2 Duty of care (no shirking)
- Business judgment rule:
  - Reaction to rational risk-aversion
  - Informed decision-making
  - Monitoring duties

5. Waivers and Indemnities
- Leading to under-deterrence? Not necessarily
- Ex ante waiver: US yes, EU no
- Real effects often limited and overestimated
- Mandatory liability undesirable
- Balanced approach
- Therefore waivers (ex post) accepted in most jurisdictions

6. Liability for Damage to Third Parties

6.1 Third party liability
- Breach of duty towards creditor
- Useful if agent easier to deter than principal
- But potentially averse effects

6.2 Financial disclosure
- Directors’ liability for misrepresentation in prospectus
- To cure information asymmetry

6. Liability for Damage to Third Parties

6.3 Insolvency
- Not necessarily proof of misbehaviour
- But problem of incentives in a last-period situation
- There contracting fails

7. Concluding
- D&O liability represents many challenges
- Overstressing of liabilities dangerous
- Balanced approach needed
- Breaches of fiduciary duty likely to lead to successful liability suits
- Breaches of duty of care less (understandable)
- But many challenges remain eg:
  - Drawing line between loyalty and care
  - Balancing liabilities towards third parties
  - And many more…