

Directors' and Officers' Liability

Comparative Report I


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DIRECTORS' AND OFFICERS' LIABILITY

Comparative Report I


- The company as an exercise in delegation
- Legal nature of directors' and officers' liabilities
- Scope and standard of care
- Variants of the business judgment rule
- Compensation for shareholders arising from breach of duty
- Modification, ratification, exclusion and waiver of claims



DIRECTORS' AND OFFICERS' LIABILITY

The Company as an Exercise in Delegation


- Common problem ('agency costs'), multiple solutions
- Board autonomy vs shareholder control
- Board structure: unitary vs two-tier boards
- Ease of dismissal vs stability of tenure
- Intermingling of functions vs clear division of powers
- Modification of duties vs strict application of legal norms



DIRECTORS' AND OFFICERS' LIABILITY

Divergence

- Systems (mostly common law) with unitary boards in which it is relatively easy for shareholders to dismiss directors tend to recognise greater leeway for 'business judgment' in managerial decisions, and more readily allow directors duties to be modified, limited and waived
- Systems (mostly civil law) with two-tier boards and stable tenure for directors tend to impose stricter duties on directors in relation to managerial decisions, and make it more difficult to modify, limit or waive these duties



DIRECTORS' AND OFFICERS' LIABILITY

Convergence


- Duties are becoming stricter in most systems
- A version of the business judgment rule is becoming more generally recognised



DIRECTORS' AND OFFICERS' LIABILITY

The Nature of Liability

- Contract or tort?
- Fiduciary duties
- General company law



DIRECTORS' AND OFFICERS' LIABILITY

Requirement of Fault

- Duties originating in contract are generally strict while those based on tort require fault of some kind
- In some (mostly civil law) systems where fault is required for a claim in tort or contract, there is a tendency for it to be assumed if there has been a breach of the general company law or of the company's bylaws



Scope and Standard of Care

- Scope of duties
- Standards generally becoming stricter
- 'Objective plus' test
- Business judgment rule
- Non-executive directors
- Joint and several liability



Scope of Duties

- In general: duty to promote the interests of the company
- Common law systems: 'loyalty', 'care'; now also, 'good faith' (US)
- Civil law systems: tendency for duty of management to be made explicit



Standards are Becoming Stricter...

- UK: 'objective plus' standard
- US: objective standard, although mere negligence generally not enough
- Germany, Austria: standard of conscientious or diligent business person or manager (most other civil law systems have something similar)
- Netherlands: need for 'severe blame'



But More Systems are Adopting the Business Judgment Rule

- US: director who acts in good faith and takes necessary steps to inform themselves of business risks will not normally be liable for losses flowing from a managerial decision
- Israel also has a version of the BJR but the UK does not (although this is because it was felt that directors were already sufficiently protected)
- BJR now explicitly recognised in several civil law jurisdictions (Austria, Germany, Switzerland, Turkey, Brazil)



Treatment of Non-Executive Directors

- Most systems have a single objective standard of care which can however be modified to imply specific types of duty for non-executive directors
- Some systems recognise a specific duty for NEDs to take reasonable care in monitoring, where by law or practice they do not have executive responsibilities



Joint and Several Liability

- Although liability is individual in all countries, a 'dissenting director' may still be liable for collective decisions of the board
- Some systems recognise a rebuttable presumption of joint and several liability for board decisions resulting in loss (Spain, Italy, the Netherlands; Brazil for private companies)
- In other systems a director may be liable for failing to monitor what other directors have done (Germany, Austria)
- There is no joint liability for board decisions in the common law systems



DIRECTORS' AND OFFICERS' LIABILITY

Damage to the Shareholders' Interests

- In all systems, duties are owed to the company, not (in general) to the shareholders
- It follows that the normal plaintiff is the company and that the shareholders' loss is 'reflective', 'indirect' or 'secondary'
- Some systems (UK, US, Israel, Brazil) enable the shareholders to sue for the company's loss in a derivative action
- Others (Italy, Spain, the Netherlands, Norway, Switzerland, Turkey) allow the shareholders to sue for their own loss but require causation to be shown and place a bar on double recovery



DIRECTORS' AND OFFICERS' LIABILITY

Modification

- In most civil law systems, modification of the scope or standard of the general duty of care owed by a director is not possible, but the scope of duties of an individual director may sometimes be modified, generally with the consent of the supervisory board or shareholders in general meeting
- In the common law systems, modifications of the core duty are presumptively void, but ex post ratification by the shareholders is normally possible, as is limitation of liability through contract



DIRECTORS' AND OFFICERS' LIABILITY

Authorisation and Ratification

- In systems where shareholders do not owe each other or the company fiduciary duties when voting and where the division of functions between the board and shareholders is blurred in law and/or practice, shareholder authorisation or ratification of unlawful acts of directors is normally possible (the UK is at one end of this spectrum)
- The position is otherwise in most civil law countries and in some common law ones where shareholders may owe fiduciary duties (the US in closed corporations) and where the principle of division of functions is recognised in law (Israel)



DIRECTORS' AND OFFICERS' LIABILITY

Exclusion and Limitation

- In some civil law countries (Austria, the Netherlands, Brazil, Turkey) exclusion and liability of the general duty of care are not possible, but in other civil law systems there is a more flexible approach (Italy, Switzerland, Poland, Spain)
- In the UK, limitation, but not exclusion, of the duty of care is possible where the director in question has D&O insurance and certain other conditions are met
- In the US, limitation is generally possible where provision is made for it in the company bylaws
- It is not normally possible to limit liability for gross negligence or bad faith



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Conclusion to Part I

- Some convergence (stricter standards but more leeway to invoke the business judgment rule)
- Continuing divergence around issues of board autonomy, stability of tenure, shareholder authorisation and ratification, modification of the duty of care, and limitation of liability
- Different approaches may be influenced by legal origin and by industrial structure, but at a fine-grained level of legal analysis it may be hard to discern the influence of these factors, and there is evidence of cross-fertilisation between common law and civil law



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