

Directors' Liability  
A Worldwide Review  
Third Edition

Edited by  
Alexander Loos



the global voice of  
the legal profession®

International Bar Association Series

 Wolters Kluwer

*Published by:*

Kluwer Law International B.V.  
PO Box 316  
2400 AH Alphen aan den Rijn  
The Netherlands  
Website: [www.wklawbusiness.com](http://www.wklawbusiness.com)

*Sold and distributed in North, Central and South America by:*

Wolters Kluwer Legal & Regulatory U.S.  
7201 McKinney Circle  
Frederick, MD 21704  
United States of America  
Email: [customer.service@wolterskluwer.com](mailto:customer.service@wolterskluwer.com)

*Sold and distributed in all other countries by:*

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United Kingdom  
Email: [kluwerlaw@turpin-distribution.com](mailto:kluwerlaw@turpin-distribution.com)

*Printed on acid-free paper.*

ISBN 978-90-411-5835-2

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Printed in the United Kingdom.

# International Bar Association

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The International Bar Association (IBA), established in 1947, is the world's leading organisation of international legal practitioners, bar associations and law societies. The IBA influences the development of international law reform and shapes the future of the legal profession throughout the world.

It has a membership of over 55,000 individual lawyers and 206 bar associations and law societies spanning all continents. It has considerable expertise in providing assistance to the global legal community as well as being a source of distinguished legal commentators for international news outlets.

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The IBA GEI will become the leading voice and authority on global HR issues by virtue of having a number of the world's leading labour and employment practitioners in its ranks, and the support and resource of the world's largest association of international lawyers.

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## Contributors

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## Summary of Contents

Editor	vii
Contributors	ix
Preface	lxix
List of Abbreviations	lxxi
Argentina <i>Javier M. Petrantonio &amp; Laura Lavia Haidempergher</i>	1
Australia <i>Rory Moriarty</i>	15
Austria <i>Christian Dorda</i>	27
Belarus <i>Dmitry Viltovsky</i>	39
Belgium <i>Philippe Malherbe</i>	51
Bermuda <i>David William Peter Cooke</i>	63
Bolivia <i>Ignacio M. Aguirre U.</i>	73
Brazil <i>Walter Douglas Stuber</i>	85

## Summary of Contents

---

Canada <i>Markus Koehnen &amp; Stephen Brown-Okruhlik</i>	97
Cayman Islands <i>Antony G.D. Duckworth, Alan G. de Saram &amp; Wendy Stenning</i>	109
Chile <i>Pablo Guerrero V.</i>	117
Czech Republic <i>Dagmar Dubecká</i>	127
Denmark <i>Niels Bang</i>	137
Ecuador <i>Javier Robalino-Orellana, Daniel Robalino Orellana, Martín Pallares Sevilla &amp; Estefanía Alarcón</i>	147
Estonia <i>Sven Papp &amp; Kaspar Kolk</i>	157
The European Action Plans of 2003 and 2012 <i>Thorsten M. Volz</i>	169
Finland <i>Riikka Rannikko &amp; Jesse Collin</i>	179
France <i>Jacques Buhart &amp; Nicolas Lafont</i>	189
Germany <i>Alexander Loos</i>	203
Hong Kong <i>Allan Leung &amp; Danny Leung</i>	213
India <i>Som Mandal</i>	227
Indonesia <i>Lia Alizia &amp; Valdano Ruru</i>	239
Ireland <i>Stephen Hegarty &amp; Maeve Moran</i>	251
Israel <i>Ehud Sol &amp; Haim Machluf</i>	263



---

Summary of Contents

Italy <i>Gabriele Fagnano</i>	275
Japan <i>Norio Mitsuuchi</i>	287
Latvia <i>Jānis Gavars, Reinis Sokolovs &amp; Raimonds Slaidiņš</i>	297
Luxembourg <i>Alexander Koch</i>	309
Mexico <i>Daniel Del Rio &amp; Juan José López-de-Silanes</i>	323
Mongolia <i>Chris Melville, Anthony Woolley &amp; Ariungoo Khurelbaatar</i>	335
The Netherlands <i>Willem Calkoen &amp; Martin Grablowitz</i>	345
New Zealand <i>Pip England</i>	355
Nigeria <i>Ayodeji Oyetunde &amp; Lotanna Nwodo</i>	369
The People's Republic of China <i>Liang Xu &amp; Sarah Zhang</i>	379
Poland <i>Tomasz Żak</i>	391
Portugal <i>Miguel de Avillez Pereira &amp; Hugo Teixeira</i>	401
The Russian Federation <i>Doran Doeh &amp; Svetlana Barinova</i>	411
Singapore <i>Stephanie Keen &amp; Matthew Bousfield</i>	421
South Africa <i>Nastascha Harduth, Eric Levenstein, David Gewer &amp; Derek Alexander</i>	433
South Korea <i>Kyung-Taek Jung &amp; Hye-Sung Kim</i>	445
Spain <i>Enric Picanyol &amp; Coro Fernández-Rañada</i>	457

## Summary of Contents

---

Sweden <i>Björn Kristiansson &amp; Per Samuelsson</i>	469
Switzerland <i>Matthew T. Reiter &amp; Lorenz Naef</i>	479
Turkey <i>Serdar Paksoy &amp; assisted by Deniz Özkan</i>	493
Ukraine <i>Timur Bondaryev, Pavlo Khodakovsky &amp; Alesya Pavlynska</i>	505
United Arab Emirates <i>Imtiaz Shah</i>	517
United Kingdom <i>Karla Dudek</i>	529
United States of America <i>Robert Ripin</i>	541
Vietnam <i>Jeff Olson &amp; Minh Nguyen</i>	553
Index	565

# Table of Contents

Editor	vii
Contributors	ix
Preface	lxix
List of Abbreviations	lxxi
Argentina	
<i>Javier M. Petrantonio &amp; Laura Lavia Haidempergher</i>	1
I 'National Basics' and National Legal Theories of Directors' Liabilities	1
[A] Corporations Legal System in Argentina	1
[B] Board's Authority and Structure	2
[1] Rules - Meetings	2
[2] Duties of the Board	2
[3] Composition of the Board	3
[4] Directors' Compensation	3
[C] Directors' Appointment and Conditions	4
[1] Election of Directors	4
[2] Individuals Precluded to Be Appointed as Directors	5
[D] Delegation	5
[E] Removal of Directors	6
II Recent Cases Dealing with Directors' Liabilities	6
[A] Nature of Directorss' Liabilit	6
[B] Directorsshe been Aware of Said Misconducts	6
[C] Cases Related to the Administration of the Company	7
[D] Delegation and Activities in Competition with the Company	7
III Judicial Review (Tightening of Standards?)	7

## Table of Contents

---

	[A] Tightening of Standards?) Interests If They Engaged in a Business	7
	[B] Standard of Diligence	8
	[C] Damages to the Company and Liability: General Conditions	10
	[D] Judicial Procedure	10
IV	Corporate Governance	10
V	Liability Issues	11
	[A] The Responsibility Actions Ruled by the Companies Act	11
	[1] Corporate Liability Action Filed by the Company ('Acción de Responsabilidad Social')	11
	[2] Corporate Liability Action Filed by Any Shareholder	12
	[3] Individual Responsibility Action	12
	[B] Limits (Caps)	13
	[C] Directors' Joint Liability	13
VI	Indemnification	13
VII	Lawyer Directorship	13
Australia		
	<i>Rory Moriarty</i>	15
I	Introduction	15
II	'National Basics' and National Legal Theories of Directors' Liabilities	15
	[A] Two-Tiered or Unitary Company Structure	15
	[B] Chairman and CEO (One or Two People/Checks and Balances)	15
	[C] Board Structures	16
	[D] Elections/Staggering	16
	[E] Delegation	16
	[F] Removal of Directors	17
III	Recent Cases Dealing with Directors' Liability	17
IV	Judicial Review (Tightening of Standards?)	18
V	'Socio-Anthropological Issues'	18
	[A] Is Board Composition Changing in Australia in Light of Recent Developments?	18
	[B] Are the Decision-Making Mechanisms Changing in Australia in Light of Recent Developments?	18
	[C] Board/Management Relationship	19
VI	Corporate Governance	19
	[A] Board Procedures	19
	[B] Structures of Oversight (Mechanisms, Etc.)	20
VII	Liability Issues	20
	[A] Who Can Sue?	20
	[1] The Company and Individual Shareholders	20
	[2] Australian Securities and Investments Commission	21
	[3] Creditors	21
	[B] Who Can Be Sued?	21

## Table of Contents

	[C] On What Basis Can a Director Be Sued?	22
	[D] Thresholds and Limitations/Caps of Liabilities in Australia (Statutory Limitations on Directors' Liability)	22
	[1] Duty of Care and Diligence	22
	[2] Duty to Prevent Insolvent Trading	23
	[E] Joint Liability/Solidarity	23
	[F] Derivative Actions	23
	[G] Class Actions	24
	[H] Bankruptcy and a Directors' Liability Suit	24
	[I] Costs and Fees in Liability Litigation	25
VIII	Indemnification	25
IX	Directors' and Officers' Insurance	25
X	Other Methods of Protection	26
XI	Lawyer Directorship	26
	Austria	
	<i>Christian Dorda</i>	27
I	'National Basics' and National Legal Theories of Directors' Liabilities	27
	[A] Composition and Structure of Boards	27
	[B] Appointment, Election, Delegation and Removal of Directors	28
	[C] General Principles of Directors' Liability	28
	[1] Liability of Directors towards the Company	29
	[2] Liability of Directors towards Third Parties	29
II	Recent Cases Dealing with Directors' Liability	30
III	Judicial Review: Tightening of Standards?	31
IV	Typical Schemes to Avoid Director's Liability	32
	[A] Changing Composition of Boards	32
	[B] Changing Decision-Making Mechanism	32
	[C] Relationship Board/Management	32
V	Corporate Governance	33
VI	Liability Issues	34
	[A] Who Can Sue?	34
	[1] The Company	34
	[2] Shareholders	34
	[3] Third Parties	34
	[B] Who Can Be Sued?	35
	[1] Directors	35
	[2] The Company	35
	[C] Thresholds and Limitations	35
	[D] Joint Liability/Solidarity	35
	[E] Derivative Actions	35
	[F] Class Actions	36
	[G] Relevance of Bankruptcy	36
	[H] Costs and Fees in Liability Litigations	36

## Table of Contents

---

VII	Indemnification	36
VIII	Directors' and Officers' Insurance	36
IX	Other Methods of Protection	37
X	Lawyer Directorship	37
Belarus		
	<i>Dmitry Viltovsky</i>	39
I	National Legal Framework and Theoretic Aspects of Directors' Liability	40
	[A] One-Level or Two-Level Company Structure	40
	[B] Chairman of the Board of Directors/Director	40
	[C] Collective Executive Body	41
	[D] Appointment/Election of Directors	41
	[E] Requirements for Appointment of the Director	42
	[F] Delegation of the Director's Powers	42
	[G] Termination of the Director's Activity	42
II	Case Law on the Directors' Liability	42
III	Estimation of the Legal Regulation of the Directors' Liability	43
	[A] Liability before the Shareholders (Owners) of the Company	43
	[B] Disciplinary Responsibility	43
	[C] Liability for Damages	44
	[D] Administrative Responsibility	44
	[E] Criminal Responsibility	45
IV	Standard Behavior Models to Avoid the Directors' Liability	45
V	Corporate Governance	45
VI	Liability Issues	46
	[A] Who Can Be a Plaintiff?	46
	[1] Company	46
	[2] Shareholders	46
	[3] Crisis Manager	47
	[4] Creditors and Third Parties	47
	[5] Government	47
	[B] Who Can Be a Defendant?	47
	[C] Factual Director	48
	[D] Limitation and Excess of Liability	48
	[E] Joint and Several Liability	48
	[F] Derivative Suits	48
	[G] Collective/Class Action Suits	48
	[H] Suits Against the Director within the Bankruptcy	49
VII	Compensation of Damages by the Company That Are Inflicted by the Director to a Third Person	49
VIII	Director's Insurance	49
IX	A Lawyer as the Director	49
X	Predictions on Future Legislation Development	49

Belgium		
	<i>Philippe Malherbe</i>	51
I	National Basics and National Legal Theories of Directors' Liability	51
	[A] Two-Tiered or Unitary Company Structure	51
	[B] Chairperson/CEO	52
	[C] Board Structures	52
	[D] Directors' Elections	53
	[E] Directors' Term of Appointment	53
	[F] Delegation	53
	[G] Removal of Directors	54
	[H] Representation of the Company	54
II	Liability Issues	54
	[A] Who Can Be Sued?	54
	[1] Permanent Representatives	55
	[2] Managing Director or Delegate to Daily Management	55
	[3] De Facto Director	55
	[B] Who Can Sue?	55
	[C] Liability Grounds	56
	[1] Criminal Liability	56
	[2] Civil Liability	56
	[a] Contractual Liability	56
	[b] Tort Liability	57
	[c] Bankruptcy Related Liability	57
III	Corporate Governance	58
IV	Recent Cases	58
	[A] Grounds of Liability	59
	[B] Directors' Liability for Tax Debts	59
	[C] Sellers' Liability as Former Directors of the Target	60
	[D] Information Duties	60
	[E] False or Inexact Balance Sheet	60
V	Judicial Review	60
VI	Directors' Liability Insurance	61
VII	Indemnification	61
VIII	Other Methods of Protection	61
	[A] Reporting Faults	61
	[B] Exoneration Clauses	62
IX	Lawyer Directorship	62
Bermuda		
	<i>David William Peter Cooke</i>	63
I	'National Basics' and National Legal Theories of Directors' Liabilities	63
	[A] Role of Chairman and CEO	63
	[B] Board Structures	64

## Table of Contents

---

	[C] Directors' Election	64
	[D] Delegation	65
	[E] Removal of Directors	65
II	Recent Cases Dealing with Directors' Liability	65
III	Judicial Review	65
IV	Typical Approach to Avoid Directors' Liability	66
	[A] Composition of the Board	66
	[1] Are the Decision-Making Mechanisms Changing?	66
	[2] Board/Management Relationship	66
V	Corporate Governance	66
VI	Liability Issues	67
	[A] Who Can Sue?	67
	[B] Who Could Be Sued?	68
	[C] 'De Facto' Directors	68
	[D] Thresholds and Caps on Liability	68
	[E] Joint Liability/Solidarity	69
	[F] Derivative Actions	69
	[1] Class Actions	69
	[2] Relevance of Bankruptcy of Company with Regard to Bringing a Directors' Liability Suit	69
	[3] Costs and Fees in Liability Litigation	70
VII	Indemnification	70
VIII	Directors' and Officers' Insurance	70
IX	Other Methods of Protection	70
X	Lawyer Directorships	70
XI	Forecast on Future Legislation Development	71
Bolivia		
	<i>Ignacio M. Aguirre U.</i>	73
I	National Basics and National Legal Theories of Directors' Liabilities	73
	[A] Introductory Aspects: Corporate Governance Issues	73
	[B] Board of Directors	75
II	Board Members' Liabilities	80
	[A] General Issues	80
	[B] Indemnifications of Directors and Liability Insurance	82
	[C] Recent Cases Dealing with Directors' Liability	83
	[D] Typical Schemes/Behaviour to Avoid Directors' Liability	83
	[E] Forecast on Future Legislation Development	83
Brazil		
	<i>Walter Douglas Stuber</i>	85
I	"National Basics" and National Legal Theories of Directors' Liabilities	85
	[A] Overview	85



Table of Contents

	[B] Limitada	85
	[C] <i>Sociedade Por Ações</i> (“SA”)	87
II	Recent Cases Dealing with Directors’ Liability	89
III	Judicial Review (Tightening of Standards)	89
IV	Typical Schemes/Behavior to Avoid Directors’ Liability	89
V	Corporate Governance	90
VI	Liability Issues	92
	[A] Who Can Sue?	92
	[B] Who Can Be Sued?	92
	[C] “De Facto” Director	93
	[D] Thresholds and Limitations/Caps of Liabilities	93
	[E] Joint Liability/Solidarity	93
	[F] Derivative Actions	94
	[G] Class Actions	94
	[H] Relevance of Bankruptcy of Corporation	94
VII	Indemnification	95
VIII	Directors’ and Officers’ Insurance	95
IX	Other Methods of Protection	95
X	Lawyer Directorship	96
XI	Forecast on Future Legislation Development	96
Canada		
	<i>Markus Koehnen &amp; Stephen Brown-Okruhlik</i>	97
I	‘National Basics’ and National Legal Theories of Directors’ Liabilities	97
	[A] Two-Tier or Unitary Company Structure	97
	[B] Chairman/CEO	97
	[C] Board Structures	98
	[D] Elections/Staggering	98
	[E] Delegation	98
	[F] Removal of Directors	99
II	Recent Cases Dealing with Directors’ Liability	99
III	Judicial Review (Tightening of Standards?)	101
	[A] Judicial Deference to Directors’ Business Decisions	101
	[B] Are Decision-Making Mechanisms Changing in Light of Recent Developments?	102
	[C] Relationship between Board and Management	103
IV	Corporate Governance	103
	[A] Board Procedures	103
	[B] Structures of Oversight	104
V	Liability Issues	104
	[A] Who Can Sue?	104
	[B] Who Can Be Sued?	105
	[C] De Facto Directors	105
	[D] Thresholds and Limitations/Caps of Liabilities	105

## Table of Contents

---

[E]	Joint Liability	106
[F]	Derivative Actions	106
[G]	Class Actions	106
[H]	Relevance of Bankruptcy	107
[I]	Costs and Fees in Liability Litigation	107
VI	Indemnification	107
VII	Directors' and Officers' Insurance	107
VIII	Other Methods of Protection	108
IX	Lawyer Directorship	108
Cayman Islands		
	<i>Antony G.D. Duckworth, Alan G. de Saram &amp; Wendy Stenning</i>	109
I	Introduction	109
II	Board Structure	110
	[A] Appointment of Directors	110
	[B] Delegation	110
	[C] Removal of Directors	110
III	Duties of Directors	111
	[A] General Duties of Directors	111
	[B] Duty of Honesty and Good Faith	111
	[C] Duties of Care and Skill	113
IV	Liability Issues	113
	[A] General Points	113
	[B] What Can Be Recovered?	113
	[C] Costs	114
V	Indemnification of Directors	114
VI	Directors' Reliance on Outside Professionals and Professionally Qualified Directors	114
VII	Winding Up	115
Chile		
	<i>Pablo Guerrero V.</i>	117
I	National Basics' and National Legal Theories of Directors' Liabilities	117
	[A] The Board of Directors	118
	[B] Composition of the Board	118
	[C] Powers of the Board and How They Are Used	118
	[D] Independent Directors and Directors' Committee	120
	[E] Executive Officers	121
II	Duties of Directors	121
	[A] Duty of Care	121
	[B] Duty of Loyalty	122
	[C] Duty of Disclosure	123
III	Directors' Liability	124

Table of Contents

IV	Directors' Insurance	125
V	Actions to Pursue Redress of the Company	125
VI	Conclusion	125
Czech Republic		
	<i>Dagmar Dubecká</i>	127
I	'National Basics' (New Civil Code and New Corporation Acts Effective since 1 January 2014)	127
	[A] Basic Powers of the Statutory Bodies	128
	[1] Board of Directors/Statutory Director	128
	[2] Supervisory Board/Administrative Council	129
	[B] Basic Duties of the Members of the Company's Statutory Bodies	130
	[C] Liability for a Breach of Duties	131
	[1] Civil Liability	131
	[2] Liability in Insolvency	132
	[3] Basic Criminal Law Aspects	133
	[D] Composition of Company Statutory Bodies, Membership and Requirements for the Performance of Office	133
	[1] Composition of Company Statutory Bodies	133
	[2] Election and Removal, Membership Requirements	133
	[3] Parallel Performance of Functions and Ban on Competition	134
	[E] Protection for Members of Company Statutory Bodies	135
Denmark		
	<i>Niels Bang</i>	137
I	The Danish Management System	137
	[A] General	137
	[B] Election of Directors and Managers	137
	[C] The Division of Power	138
II	Directors' Liability	138
	[A] Legal Prerequisites to Liability	138
	[B] Tasks and Duties	139
	[C] Directors in Listed Companies	140
III	Recent Cases Dealing with Directors' Liability	140
	[A] Introduction	140
	[B] Liability for Violation of the Companies Act	141
	[C] Liability for Predecessors' or Successors' Acts	141
	[D] Liability for Violating the Financial Statements Act	142
	[E] Duties in Pursuance of Special Legislation	143
	[F] Operation of a Company in Difficulties	143
IV	Developments in the Liability of Directors	144
V	Limitation of Liability	144
	[A] Introduction	144

## Table of Contents

---

	[B] Agreed Exemption From Liability	144
	[C] Discharge from Liability: Adoption of Accounts	145
	[D] Reduction of Liability	145
VI	Insurance	145
	[A] Common Directors' and Officers' Liability Insurance	145
	[B] Lawyers' Liability Insurance	145
	[C] Effect of Insurance Coverage	146
Ecuador		
	<i>Javier Robalino-Orellana, Daniel Robalino Orellana, Martín Pallares Sevilla &amp; Estefanía Alarcón</i>	147
I	National Basics and National Legal Theories of Director's Liabilities	147
	[A] Two-Tiered or Unitary Company Structure	147
	[B] Chairman/CEO	147
	[C] Board Structures	148
	[D] General Shareholders' Meetings	148
	[E] Director's Elections	149
	[F] Director's Term of Appointment	149
	[G] Removal of Directors	149
II	Typical Behavior to Avoid Director's Liability	149
III	Corporate Governance	150
	[A] Andean Community's Corporate Governance Code	150
	[B] Corporate Governance in the Banking Regulatory System	150
	[C] Ecuadorian Institution of Corporate Governance	151
IV	Liability Issues	152
	[A] "De Facto" Director	152
	[B] Limitations of Liabilities	152
	[C] Responsibility Action	153
	[D] Relevance of Bankruptcy of Corporation	154
V	Indemnification	154
VI	Director's and Officer's Insurance	155
VII	Other Methods of Protection	155
VIII	Lawyer Directorship	155
IX	Forecast on Future Legislation Development	155
Estonia		
	<i>Sven Papp &amp; Kaspar Kolk</i>	157
I	Basic Principles for Directors' Liability	157
	[A] Corporate Governance Structure	158
	[B] Management Structure, Chairman and Delegation	159
	[C] Election and Removal of Directors	159
II	Directors' Duties and Typical Liability Cases	160
	[A] Liability vis-à-vis the Company	161

Table of Contents

	[1] Inaccurate Valuation of the Non-monetary Contribution	161
	[2] Causing the Payment of Unlawful Distribution to Shareholder	161
	[3] Payments after Insolvency Has Become Evident	162
	[4] Non-compete	162
	[5] Disclosure of Business Secrets	162
	[B] Liability under Tort Law	162
	[1] Late Filing of a Bankruptcy Petition	162
	[2] Failure to Organize Accounting	163
	[3] Failure to Provide Information to Creditors	163
	[C] Criminal Liability and Liability Arising from Specific Laws	163
III	Liability Issues	164
	[A] Enforcement of Directors' Liability	164
	[1] Who Can Sue?	164
	[a] Company	164
	[b] Bankruptcy Trustee	164
	[c] Creditors (Derivative Action)	165
	[d] Third Persons	165
	[2] Costs of Litigation and Class Actions	165
	[B] Limitations and Joint Liability of Directors	165
	[C] Indemnification and Other Methods of Protection	166
IV	Directors' and Officers' Insurance	166
V	Lawyer Directorships	167
VI	Forecast on Future Legislation Development	167
The European Action Plans of 2003 and 2012		
	<i>Thorsten M. Volz</i>	169
I	Introduction	169
II	The Scope of the European Action Plan	170
III	The Proposed Time Schedule of the European Action Plan	171
IV	The Second European Action Plan of 2012	172
V	Provisions on Directors' Liability within the European Action Plan	172
VI	The Implementation within the European Community	174
VII	The Implementation within Member States' Legislation	174
	[A] Austria	174
	[B] Belgium	175
	[C] Czech Republic	175
	[D] Denmark	175
	[E] Finland	175
	[F] France	175
	[G] Germany	176
	[H] Ireland	176
	[I] Italy	176
	[J] Luxembourg	177
	[K] Netherlands	177

## Table of Contents

---

[L]	Poland	177
[M]	Portugal	177
[N]	Spain	177
[O]	Sweden	178
[P]	Switzerland	178
[Q]	Ukraine	178
[R]	United Kingdom	178
Finland		
	<i>Riikka Rannikko &amp; Jesse Collin</i>	179
I	‘National Basics’ and National Legal Theories of Directors’ Liabilities	179
	[A] Company Organs	180
	[B] Board of Directors	181
	[1] Number of Board Members, Their Election, and Term of Duty	181
	[2] Duties of Board Members under the Companies Act	182
	[3] Finnish Corporate Governance Code and Finnish Panel on Takeovers and Mergers	183
II	Liability of Board Members	183
	[A] Liability under the Companies Act	183
	[B] Damage, Negligence, and Causality	185
	[C] Scope of Liability	185
	[D] Amount of Compensation and Legal Costs	185
III	Division of Liability	186
	[A] Delegation	186
	[B] Adjustment and Allocation of Damages	186
IV	Limitation of Liability	187
France		
	<i>Jacques Buhart &amp; Nicolas Lafont</i>	189
I	“National Basics” and National Legal Theories of Directors’ Liabilities	189
	[A] Two-Tiered or Unitary Company Structure	189
	[B] Chairman and CEO (One or Two People/Checks and Balances)	189
	[1] Unitary Structure	189
	[2] Two-Tiered Structure	190
	[C] Board Structures	190
	[1] Unitary Structure	190
	[2] Two-Tiered Structure	190
	[D] Director’s Elections/Staggering	190
	[1] Unitary Structure	190
	[2] Two-Tiered Structure	191
	[E] Directors’ Term of Appointment	191
	[1] Unitary Structure	191
	[2] Two-Tiered Structure	191

Table of Contents

	[F] Delegation	191
	[G] Removal of Directors	191
	[1] Unitary Structure	191
	[2] Two-Tiered Structure	192
II	Judicial Review (Tightening of Standards?)	192
III	Corporate Governance	192
	[A] Composition of the Board of Directors/Recent Developments	192
	[1] Independent Directors	192
	[2] Parity	193
	[3] Employee Board Member	193
	[4] Vice-Chairman/Senior Director	193
	[B] Are the Decision-Making Mechanisms Changing in France in Light of Recent Developments?	193
	[C] Board/Management Relationship	194
	[1] Unitary Structure	194
	[2] Two-Tiered Structure	194
IV	Corporate Governance	194
	[A] Board Procedure	194
	[B] Structures of Oversight	195
V	Liability Issues	195
	[A] Who Can Sue?	195
	[1] Shareholders	195
	[2] The Company Itself	196
	[3] Third Parties	196
	[B] Who Can Be Sued?	196
	[1] Individual Liability	196
	[a] Civil Liability	196
	[b] Criminal Liability	196
	[2] Collective Liability	197
	[a] Collective Liability of the Board of Directors	197
	[b] Liability of Members of the Supervisory Board	197
	[C] “De Facto” Manager	197
	[D] Thresholds and Limitations/Caps of Liabilities/Caps of Liabilities in France (Statutory Limitations on Directors’ Liability)	198
	[E] Class Actions	198
	[F] Relevance of Bankruptcy of Corporation with Regard to Bringing a Directors’ Liability Suit	198
	[1] Directors’ Liability	198
	[a] Insufficiency of Assets	198
	[b] Personal Bankruptcy	199
	[c] Banqueroute	200
	[2] Liability of Supervisory Board Members	200
	[3] Costs and Fees in Litigations	200
VI	Indemnification	200

## Table of Contents

---

VII	Directors' and Officers' Insurance	200
VIII	Lawyer Directorship	201
	[A] French Lawyers May Not Directly Run a Company	201
	[B] French Lawyers May Be Appointed as Director	201
IX	The "European Action Plan"	201
Germany		
	<i>Alexander Loos</i>	203
I	Basic Principals for Directors' Liability	203
	[A] Single-Body Companies or Two-Tier System	203
	[B] Management Structure and Chairman	204
	[C] Delegation of Management Powers	204
	[D] Removal of Directors	204
II	Typical Liability Cases	205
	[A] Internal Liability towards the Company	205
	[1] Violation of Compliance Rules	205
	[2] Violation of Non-compete	205
	[3] Poaching of Business from the Company	206
	[4] Disbursements from Restricted Equity of the Company	206
	[5] Violation of Arm's-Length Principles	207
	[6] Knowing Disregard of Avoidable Risk	207
	[B] External Directors' Liability	207
	[1] Gross Negligence to Pay Taxes and Public Levies	208
	[2] Illicit Non-payment of Social Security Contributions	208
	[3] Late Filing for Insolvency	208
III	Liability Issues	209
	[A] Enforcement of Director's Liability	209
	[1] Who Can Sue?	209
	[2] Costs of Litigation and Class Actions	210
	[B] Joint Liability of Directors	211
	[C] Indemnification	211
	[D] Time Limitation	211
IV	Directors' and Officers' Insurance	212
V	Lawyer Directorships	212
VI	The European Action Plan	212
Hong Kong		
	<i>Allan Leung &amp; Danny Leung</i>	213
I	Introduction	213
	[A] One-System Body	214
	[B] Board Structure and Duality of Chairman and CEO	214
	[1] Board Structure	214



Table of Contents

	[2] Duality of Chairman and Chief Executive	215
	[C] Delegation	215
	[D] Elections	215
	[E] Removal of Directors	215
II	Liability Issues	216
	[A] Directors' Duties	216
	[1] Fiduciary Duties	216
	[a] Duty to Act in Good Faith in the Best Interests of the Company as a Whole	216
	[b] No Fetters on Discretion	216
	[c] Duty Not to Compete	217
	[d] Duty to Avoid a Conflict of Interest and Not to Make a Secret Profit	217
	[e] Confidentiality	217
	[2] General Duties	218
	[a] Skill, Care, and Diligence	218
	[b] Duty Not to Exceed Powers	218
	[c] Duty to Creditors	218
	[B] Who Can Sue?	218
	[1] Duties Owed to Individual Shareholder	219
	[2] Duties Owed to Creditors	219
	[C] Who Can Be Sued?	219
	[D] Derivative Actions	220
	[1] Common Law Derivative Action	220
	[2] Statutory Derivative Action	220
	[E] Unfair Prejudice	221
	[F] Representative Actions	221
	[G] Insolvency Context	222
	[1] Misfeasance	222
	[2] Fraudulent Trading	222
	[3] Disqualification Order	222
	[H] Costs and Fees in Liability Litigations	223
III	Indemnification	223
IV	Protection Against Wrongs of Directors	223
	[A] Ratification	223
	[B] Directors' and Officers' Liability Insurance	224
V	Corporate Governance	224
	[A] Existing Corporate Governance	224
	[B] Corporate Governance Reform: Difficulties in Hong Kong	224
	[1] Family-Controlled Companies	224
	[2] Quality of INEDs	225
	[C] Going Forward	225

## Table of Contents

---

India		
<i>Som Mandal</i>		227
I	Introduction	227
	[A] Appointment of Directors	227
	[B] Shareholder Rights	228
	[C] Government's Right to Appoint Directors	228
	[D] Removal of Directors	228
	[E] Power of Directors May Be Amended	229
II	Recent Cases and Anthropological Approach to Directors' Liabilities	229
	[A] Financial Scams	230
	[B] Judiciary	231
III	Government's Approach towards Ensuring Greater Corporate Accountability	231
IV	Liability Issues	234
	[A] Officer in Default	235
	[B] Contractual Liabilities	235
	[C] Tortious Liability	235
	[D] Apprehension of Prosecution	236
	[E] Compounding Offences, a Way Out?	236
	[F] Managing Director/Whole-Time Director/Nominee Director/ Professional Director	236
	[G] Object and Scope of Section 633	237
	[H] Directors' Liability Insurance	237
Indonesia		
<i>Lia Alizia &amp; Valdano Ruru</i>		239
I	General Legal Theories on the Board of Directors	239
	[A] Two-Tier System or One-Tier System	239
	[B] Structure of the Boards	240
	[C] Chairman/CEO	240
	[D] Appointment	240
	[E] Authorities	241
	[F] Delegation	242
	[G] Termination	242
II	Liability Issues	243
	[A] Who Can Sue?	243
	[B] Who Can Be Sued?	243
	[C] 'De Facto' Directors	243
	[D] Thresholds and Limitations/Caps on Liabilities	244
	[E] Joint Liability/Solidarity	244
	[F] Derivative Actions	244
	[G] Class Actions	244

Table of Contents

	[H] Relevance of the Bankruptcy of a Corporation	245
III	Corporate Governance	245
IV	Indemnification	245
V	Directors' and Officers' Insurance	246
VI	Lawyer Directorships	246
VII	Criminal and Civil Liabilities of Directors under the Company Law and Company Registration Law	246
	[A] Criminal	246
	[B] Civil	247
VIII	Precautions Directors Should Take to Avoid Liability	247
IX	Recent Cases Dealing with the Liability of Directors	248
	[A] The <i>Videotron</i> Case	248
	[B] The <i>PT MAJU</i> Case	249
X	Future Legislation Forecast	249
	Ireland	
	<i>Stephen Hegarty &amp; Maeve Moran</i>	251
I	National Basics and National Theories of Directors' Liabilities	251
	[A] Two-Tiered or Unitary Company Structure	251
	[B] Chairman/CEO	251
	[C] Board Structure	252
	[D] Directors' Election/Staggering	252
	[E] Directors' Term of Appointment	252
	[F] Delegation	252
	[G] Removal of Directors	253
II	Recent Cases Dealing with Directors' Liability	253
III	Typical Schemes/Behaviour to Avoid Directors' Liability	253
IV	Corporate Governance	254
	[A] UK Code	254
	[B] Directors' Compliance Statements	254
V	Liability Issues	254
	[A] Duties & Obligations Owed by Directors	254
	[1] Compliance with the Act	254
	[2] Fiduciary Duties	255
	[3] Securities Laws	255
	[4] Other Duties/Obligations	256
	[5] Delegation of Duties or Responsibilities	257
	[B] Who Can Sue?	257
	[1] The Company	257
	[2] Members	257
	[3] Employees	258
	[4] Creditors	258
	[5] Other Parties	258

## Table of Contents

---

[C]	Who Can Be Sued?	258
[D]	Thresholds and Limitations/Caps on Liabilities	259
[E]	Derivative Actions	259
[F]	Class Actions	260
[G]	Relevance of Bankruptcy of Corporation	260
[H]	Tribunals of Inquiry	261
VI	Indemnification	261
VII	Directors' and Officers' Insurance	261
VIII	Other Methods of Protection	261
IX	Lawyer Directorship	262
X	Forecast on Future Legislation Development	262
Israel		
	<i>Ehud Sol &amp; Haim Machluf</i>	263
I	National Basis: The Israeli Companies Law	263
[A]	History of the Israeli Companies Law	263
[B]	The Board's Principal Role under the Law	263
[C]	The Company's Structure: Organs and Their Powers	264
[1]	The General Meeting	264
[2]	The BOD: Its Authority and Duties	265
[3]	Composition of the BOD	265
[a]	General	265
[b]	External Directors	266
[c]	Independent Directors	266
[d]	Board Committees	267
[i]	Audit Committee	267
[ii]	Compensation Committee	267
[4]	Appointment and Removal of a Director	267
[a]	Appointment of Directors	267
[b]	The Power to Dismiss a Director	267
[5]	The Chief Executive Officer	268
II	Directors' and Officers' Liability	268
[A]	Liability Towards the Company	268
[1]	Duty of Care	268
[2]	Duty of Loyalty	269
[B]	Liability Towards the Shareholders	269
[C]	Liability Towards Third Parties	269
[D]	Criminal Liability	270
[E]	Liability under Specific Laws	270
[1]	Liability under the Securities Law	270
[2]	Presumption Set Out in Various Laws Concerning Directors' and Officers' Liability	271

Table of Contents

III	Claims Against Directors and Officers	271
	[A] Type of Claims	271
	[1] Regular Action by an Individual	271
	[2] Derivative Actions	271
	[3] Class Action	271
	[B] Procedural Aspects of Shareholders' Claims	272
IV	Judicial Review: The Business Judgment Rule and the Entire Fairness Doctrine	272
V	Exemption, Indemnification, and Insurance	273
	[A] General	273
	[B] Exemption	273
	[C] Indemnification	273
	[D] D&O Insurance	274
Italy		
	<i>Gabriele Fagnano</i>	275
I	Corporate Governance Structure and Directors' Liability	275
	[A] Traditional, Single-Body, and Two-Tier System; Structures of Internal Control	275
	[B] Appointment and Removal of Directors	276
	[C] Board Structure and Main Executive Roles	277
	[D] Delegation and Information Flow within the Board of Directors	278
	[E] Directors' Interests in Relation to Company Action	279
II	Directors' Duties and Recent Cases Dealing with Directors' Liability	279
	[A] Directors' Duties	279
	[B] Judicial Approach to Directors' Standard of Care and Diligence and Limits to Judicial Review of Directors' Business Errors: Tightening of Standards	280
III	Liability Issues	282
	[A] Who Can Sue?	282
	[1] Company Action Against Directors and Relevant Indemnification	282
	[2] Action of Company Creditors and Relevant Indemnification	283
	[3] Action of Third Parties and Individual Shareholders, Relevant Indemnification	283
	[B] Who Can Be Sued?	284
	[C] Statute of Limitations and Other Limitations of Liability	284
	[1] Statute of Limitations	284
	[2] Other Limitations	284
	[D] Joint and Several Liabilities	285
	[E] Derivative Actions and Class Actions	285
	[F] Directors' Liability Suit in the Context of Bankruptcy	286

## Table of Contents

---

Japan		
<i>Norio Mitsuuchi</i>		287
I	Introduction	287
II	'National Basics' and National Legal Theories of Director's Liabilities	288
	[A] Basic Structures (To Have a Board or Not, Etc.)	288
	[1] KK without a Board	288
	[2] KK with a Board	288
	[a] KK with a Corporate Auditor or a Board of Corporate Auditors	288
	[b] KK with an Audit and Supervisory Committee	289
	[c] KK with Three Committees	289
	[B] CEO, President, and Other Officers	289
	[C] Structures of Boards and Committees	290
	[D] Elections	290
	[E] Director's Term of Appointment	290
	[F] Delegation	291
	[G] Removal of Directors	291
III	Judicial Review	291
	[A] Relationship between KK and Directors/Corporate Auditors/ Executive Officers	291
	[B] Business Judgment Rule	292
IV	Corporate Governance	292
	[A] Convocation of the Board	292
	[B] Resolutions	292
	[C] Structure of Oversight	292
	[D] Corporate Governance Code	293
V	Liability Issues	293
	[A] Who Can Sue?	293
	[1] Company	293
	[2] Shareholder	293
	[3] Third Party	294
	[B] Who Can Be Sued?	294
	[C] Thresholds and Limitation of Liabilities	294
	[1] Negligence Requirement	294
	[2] Exemption from Liabilities	295
	[3] Partial Exemption from Liabilities	295
	[4] Prior Exemption by Articles of Incorporation and Prior Agreement to Limit Liabilities	295
	[D] Relevance of Bankruptcy of a KK with Regard to Bringing a Directors' Liability Suit	295
	[E] Costs and Fees in Liability Litigations	296
VI	Director's and Officer's Insurance	296
VII	Lawyer Directorship	296

VIII	Conclusion	296
	Latvia	
	<i>Jānis Gavars, Reinis Sokolovs &amp; Raimonds Slaidiņš</i>	297
I	National Basics and National Legal Theories of Directors' Liabilities	297
	[A] Two-Tiered or Unitary Company Structure	297
	[B] Chairman/CEO	298
	[C] Board Structures	298
	[D] Directors' Elections/Staggering	299
	[E] Directors' Term of Appointment	299
	[F] Delegation	299
	[G] Removal of Directors	300
II	Recent Cases Dealing with Directors' Liability	300
	[A] Judgment of 15 January 2014 in Case No. SKC-101/2014 of the Civil Case Department of the Supreme Court of Republic of Latvia	300
	[B] Judgment of 27 May 2014 in Case No. SKC-102/2014 of the Civil Case Department of the Supreme Court of Republic of Latvia	301
	[C] Judgment of 13 June 2014 in Case No. 2014-02-01 of the Constitutional Court of Republic of Latvia 'On the Compliance of Para 4 of Section 17 of Deposit Guarantee Law with the First Sentence of Article 91 of the Constitution of the Republic of Latvia'.	301
III	Judicial Review (For Example, Tightening of Standards?)	301
IV	Typical Schemes/Behaviour to Avoid Directors' Liability	302
	[A] Compliance with the Principle of an Honest and Prudent Manager	303
	[B] Release from Liability by Means of a Decision of the Shareholders' Meeting	303
	[C] Good Faith Compliance with Shareholders' Decisions	303
V	Liability Issues	303
	[A] Who Can Sue?	303
	[1] Private Liability	303
	[2] Public Liability	304
	[B] Who Can Be Sued?	304
	[C] 'De Facto' Director	305
	[D] Thresholds and Limitations/Caps of Liabilities	305
	[E] Joint Liability/Solidarity	305
	[F] Derivative Actions	306
	[G] Class Actions	306
	[H] Relevance of Bankruptcy of Corporation	306
VI	Indemnification	306
VII	Directors' and Officers' Insurance	306
VIII	Other Methods of Protection	307
IX	Lawyer Directorship	307
X	Forecast on Future Legislation Development	307

## Table of Contents

---

Luxembourg	
<i>Alexander Koch</i>	309
I National Basics and National Legal Theories of Directors' Liabilities	309
[A] One-Tier and Two-Tier System	309
[B] Chairperson and CEO	310
[C] Board Structures	311
[D] Directors' Elections and Term of Appointment/Staggering	312
[E] Delegation	312
[F] Removal of Directors	313
II Recent Cases Dealing with Directors' Liability	313
III Judicial Review (For Example, Tightening of Standards?)	313
IV Corporate Governance	314
V Liability Issues	314
[A] Who Can Sue?	315
[1] Liability for Mismanagement (Article 59(1) of the Law)	315
[2] Liability for Breach of the Law or the Articles of Association (Article 59(2) of the Law)	315
[3] Liability in Tort (Articles 1382 and 1383 of the Civil Code)	315
[4] Liability under Criminal Law	316
[B] Who Can Be Sued?	316
[1] Liability for Mismanagement (Article 59(1) of the Law)	316
[2] Liability for Breach of the Law or the Articles of Association (Article 59(2) of the Law)	316
[3] Liability in Tort (Articles 1382 and 1383 of the Civil Code)	316
[4] Liability under Criminal Law	317
[C] De Facto Directors	317
[D] Thresholds and Limitations/Caps of Liabilities	317
[E] Joint Liability/Solidarity	317
[1] Liability for Mismanagement (Article 59(1) of the Law)	317
[2] Liability for Breach of the Law or the Articles of Association (Article 59(2) of the Law)	318
[3] Liability in Tort	318
[4] Liability under Criminal Law	318
[F] Derivative Actions	318
[G] Relevance of Bankruptcy of the Company with Respect to Directors' Liability	319
VI Indemnification	319
VII Directors' and Officers' Insurance	320
VIII Other Methods of Protection	320
[A] Discharge	320
[B] Resignation	320
IX Forecast on Future Legislation Development	321



Table of Contents

---

Mexico		
	<i>Daniel Del Rio &amp; Juan José López-de-Silanes</i>	323
I	Introduction	323
	[A] Investment Promotion Companies (“ <i>Sociedades Anonimas Promotoras de Inversion</i> ”)	323
	[B] Stock Exchange Investment Promotion Companies (“ <i>Sociedades Anonimas Promotoras de Inversion Bursatil</i> ”)	324
	[C] Stock Exchange Companies (“ <i>Sociedades Anonimas Bursatiles</i> ”)	324
II	“National Basics” and National Legal Theories of Directors’ Liabilities	324
	[A] Two-Tier System or One-Tier System	324
	[B] Chairman and CEO (One or Two People/Checks and Balances)	325
	[C] Board Structures	326
	[D] Elections/Staggering	326
	[E] Delegation	326
	[F] Removal of Directors	327
III	Judicial Review (For Example Tightening of Standards?)	327
IV	“Socio-Anthropological Issues”	327
	[A] Is the Composition of the Board of Directors Changing in Mexico in Light of Recent Developments?	327
	[B] Are the Decision-Making Mechanisms Changing in Mexico in Light of Recent Developments?	328
	[C] Board/Management Relationship	328
V	Corporate Governance	328
	[A] Board Procedures	328
	[B] Structures of Oversight	328
VI	Liability Issues	329
	[A] Who Can Sue?	329
	[B] Who Can Be Sued?	330
	[C] Thresholds and Limitations/Caps of Liabilities in Mexico: Statutory Limitations on Directors’ Liability	330
	[D] Joint Liability/Solidarity	330
	[E] Derivative Actions	331
	[F] Class Actions	331
	[G] Relevance of Bankruptcy of Corporation with Regard to Bringing a Directors’ Liability Suit	332
	[H] Costs and Fees in Liability Litigation	332
VII	Indemnification	332
VIII	Directors’ and Officers’ Insurance	332
IX	Other Methods of Protection	333
X	Lawyer Directorship	333
XI	The “European Action Plan”	333

## Table of Contents

---

Mongolia	
<i>Chris Melville, Anthony Woolley &amp; Ariungoo Khurelbaatar</i>	335
I National Basics	335
[A] Three-Tiered Corporate Governance System	336
[B] Chairman/Chief Executive Officer	338
[C] Board Structure	338
[D] Directors' Elections	338
[E] Directors' Term of Appointment	339
[F] Delegation	339
[G] Removal of Directors	339
II Recent Cases Dealing with Directors' Liability	339
III Judicial Overview	339
IV Corporate Governance	340
V Liability Issues	341
[A] Who Can Be Sued?	341
[B] Who Can Sue?	341
[C] 'De Facto' Directors	342
[D] Thresholds and Limitations/Caps of Liabilities	342
[E] Joint and Several Liability	342
[F] Derivative Actions	342
[G] Class Actions	342
[H] Relevance of Bankruptcy of Corporation	342
VI Indemnification	343
VII Directors' and Officers' Insurance	343
VIII Other Methods of Protection	343
IX Lawyer Directorship	344
X Forecast on Future Legislation Development	344
The Netherlands	
<i>Willem Calkoen &amp; Martin Grablowitz</i>	345
I 'National Basics'	345
[A] Two-Tier System or One-Tier System	345
[B] Chairman and CEO	346
[C] Board Structures	346
[D] Elections/Staggering	346
[E] Delegation	347
[F] Removal of Directors	347
II Directors' Liability	347
III 'Socio-Anthropological Issues'	348
[A] Composition of the Board of Directors	348
[B] Decision-Making Mechanism	348
[C] Board/Management Relationship	349
IV Corporate Governance Code	349

Table of Contents

V	Liability Issues	350
	[A] Who Can Sue?	350
	[1] The Company	350
	[2] The Shareholder	350
	[3] Trustee in Bankruptcy	350
	[4] Creditors and Third Parties	351
	[5] The Government	351
	[B] Who Can Be Sued?	351
	[C] Thresholds and Limitations/Caps of Liabilities in the Netherlands (Statutory Limitations on Directors' Liability)	351
	[D] Joint Liability/Solidarity	351
	[E] Derivative Actions	352
	[F] Class Actions	352
	[G] Relevance of Bankruptcy of Corporation with Regard to Bringing a Directors' Liability Suit	353
	[H] Costs and Fees in Liability Litigations	353
VI	Indemnification	353
VII	Directors' and Officers' Insurance	354
VIII	Lawyer Directorship	354
IX	Pending Legislation	354
	 New Zealand	
	<i>Pip England</i>	355
I	'National Basics' and National Legal Theories of Directors' Liabilities	355
	[A] Two-Tiered or Unitary Company Structure?	355
	[B] Definition of 'Director'	356
	[C] Separation of Chairperson and CEO	356
	[D] Board Structures	356
	[E] Directors' Elections/Staggering	357
	[F] Directors' Term of Appointment	357
	[G] Delegation	357
	[H] Disclosure of Conflicts of Interest	357
	[I] Removal of Directors	358
II	Recent Cases Dealing with Directors' Liability	358
	[A] Reckless Trading	358
	[B] Directors' Duties	359
	[C] Silent Directors	360
	[D] Directors of Finance Companies	360
III	Judicial Review (Tightening of Standards?)	360
IV	Corporate Governance	361
	[A] Overview of New Zealand Governance	361
	[B] FMA Corporate Governance Handbook	361
	[C] NZX Discussion Document	362
	[D] Use of Board Committees	362

## Table of Contents

---

	[E] Other Oversight Structures	363
V	Liability Issues	363
	[A] Who Can Sue?	363
	[1] The Company	363
	[2] Shareholders	364
	[3] Creditors	364
	[4] Regulatory Bodies	364
	[B] Who Can Be Sued?	365
	[C] Statutory Limitations on Directors' Liability	365
	[D] Joint Liability	365
	[E] Derivative Actions	365
	[F] Class Actions	365
	[G] Relevance of Liquidation	366
	[H] Costs in Liability Litigation	366
VI	Indemnification and Insurance	366
	[A] Indemnity	366
	[B] Insurance	367
VII	Forecast on Future Legislation Development	367
Nigeria		
	<i>Ayodeji Oyetunde &amp; Lotanna Nwodo</i>	369
I	Overview of Nigeria's Corporate Governance Regulation	369
II	National Basics and National Legal Theories of Directors' Liabilities	369
	[A] Unitary Company Structure	369
	[B] Separation of Chairman and CEO	370
	[C] Board Structures	370
	[D] Directors Elections/Staggering and Term of Appointment	371
	[E] Delegation	371
	[F] Removal of Directors	372
III	Liability Issues	373
	[A] Duties of a Director	373
	[B] Who Can Sue?	373
	[C] Who Can Be Sued?	374
	[D] De Facto Director	374
	[E] Thresholds and Limitations/Caps of Liabilities	374
	[F] Joint Liabilities	375
	[G] Derivative Actions	375
	[H] Class Actions	375
	[I] Liabilities of Directors on Winding Up	375
IV	Recent Cases Dealing with Directors' Liability	376
	[A] Joint Responsibility of the Board	376
	[B] Misappropriation of Funds	376
	[C] Duty to Render Accurate Accounts	376
V	Judicial Review	377

Table of Contents

VI	Schemes/Behaviours to Avoid Directors' Liability	377
VII	Indemnification and Liability Insurance	377
VIII	Lawyer Directorship	378
IX	Forecast on Future Legislation Development	378
The People's Republic of China		
<i>Liang Xu &amp; Sarah Zhang</i>		379
I	Introduction	379
	[A] Three-Tiered Corporate Governance Body	379
	[1] Shareholders	380
	[2] Board of Directors or Executive Director	380
	[3] Board of Supervisors	381
	[B] Board Structure and Concurrent Offices	381
	[1] Board Structure	381
	[2] Concurrent Office	381
	[C] Delegation	382
	[D] Elections	382
	[E] Removal of Directors	382
	[F] Qualification of Directors	383
II	Liability Issues	383
	[A] Directors' Duties	383
	[1] Fiduciary Duty	383
	[2] General Duties	384
	[3] Legal Representative	384
	[4] Apparent Authority	385
	[B] Who Can Sue?	385
	[1] Duties Owed to the Company	385
	[2] Duties Owed to Shareholders	385
	[3] Duties Owed to Creditors	386
	[C] Who Can Be Sued?	386
	[D] Derivative Actions by Shareholders	386
	[E] Unfair Prejudice	386
	[1] Compulsory Buy Back	386
	[2] Compulsory Winding Up	387
	[F] Representative Actions	387
	[G] Liquidation Context	387
	[H] Costs and Fees in Liability Litigations	388
III	Indemnification	388
IV	Protection Against Wrongs of Directors	388
	[A] Ratification	388
	[B] Directors' and Officers' Liability Insurance	388
V	Corporate Governance	388

## Table of Contents

---

Poland	
<i>Tomasz Żak</i>	391
I 'National Basics' and National Legal Theories of Directors' Liability	391
[A] Two-Tiered or Unitary Company Structure	391
[B] Chairman and CEO	392
[C] Board Structure	392
[D] Directors' Election/Staggering	392
[E] Directors' Term of Appointment	393
[F] Delegation of Powers	393
[G] Removal and Suspension of Directors	393
II Typical Schemes/Behaviour to Avoid a Directors' Liability	394
III Corporate Governance	394
[A] Management Board	394
[B] Supervisory Board	395
IV Liability Issues	395
[A] Liability Towards the Company	395
[B] Liability Towards Third Parties	396
[C] Derivative and Class Actions	398
[D] Costs	399
[E] Criminal Liability	399
V Indemnification	399
[A] Liability Towards Third Parties	399
[B] Liability Towards the Company	399
VI Directors' and Officers' Insurance	400
VII Lawyer Directorship	400
Portugal	
<i>Miguel de Aveliz Pereira &amp; Hugo Teixeira</i>	401
I National Basics and National Legal Theories of Directors' Liabilities	401
[A] Two-Tiered or Unitary Company Structure	401
[B] Chairman/CEO	402
[C] Board Structures	402
[D] Directors' Elections/Staggering/Term of Appointment	402
[E] Delegation	403
[F] Removal of Directors	403
II Recent Cases Dealing with Directors' Liability	404
III Judicial Review (For Example, Tightening of Standards?)	404
IV Typical Schemes/Behaviour to Avoid Directors' Liability	405
V Corporate Governance	406
VI Liability Issues	406
[A] Who Can Sue?	407
[1] Liability Towards the Company	407
[2] Liability Towards Shareholders (and Other Third Parties)	407

Table of Contents

[3] Liability Towards Creditors of the Company	407
[4] Liability Before Tax Authorities and Social Security	407
[B] Who Can Be Sued?	408
[C] The De Facto Directors	408
[D] Thresholds and Limitations/Caps of Liabilities	408
[E] Joint Liability/Solidarity	408
[F] Derivative Actions	409
[G] Class Actions	409
[H] Relevance of Bankruptcy of Corporation	409
VII Indemnification	409
VIII Directors' and Officers' Insurance	410
IX Other Methods of Protection	410
X Lawyer Directorship	410
XI Forecast on Future Legislation Development	410
The Russian Federation	
<i>Doran Doeh &amp; Svetlana Barinova</i>	411
I "National Basics" and National Legal Theories of Directors' Liabilities	
[A] Two-Tier or Unitary Company Structure	412
[B] Chairman/General Director	412
[C] Board Structures	412
[D] Election of Directors	413
[E] Directors' Term of Appointment	413
[F] Delegation	413
[G] Removal of Directors	414
II Recent Cases Dealing with Directors' Liability	414
III Judicial Review (Tightening of Standards?)	414
IV Typical Schemes/Behavior to Avoid Directors' Liability	415
V Corporate Governance	415
VI Liability Issues	415
[A] Who Can Sue?	416
[B] Who Can Be Sued?	416
[C] "De Facto" Director	417
[D] Thresholds and Limitations/Caps of Liabilities	417
[E] Joint Liability/Solidarity	417
[F] Derivative Actions	417
[G] Class Actions	418
[H] Relevance of Bankruptcy of Corporation with Regard to Bringing a Director's Liability Suit	418
VII Indemnification	418
VIII Directors' and Officers' Insurance	419
IX Lawyer Directorship	420
X Forecast on Future Legislation Development	420

## Table of Contents

---

Singapore		
	<i>Stephanie Keen &amp; Matthew Bousfield</i>	421
I	‘National Basics’ and National Legal Theories of Directors’ Liabilities	421
	[A] Two-Tiered or Unitary Company Structure	422
	[B] Directors’ Duties	422
	[C] Chairman and CEO	423
	[D] Board Structures	423
	[E] Directors’ Elections	424
	[F] Directors’ Term of Appointment	424
	[G] Delegation	425
	[H] Removal of Directors	425
II	Recent Cases Dealing with Directors’ Liability	425
	[A] <i>Lim Weng Kee v. Public Prosecutor</i>	425
	[B] <i>Ho Kang Peng v. Scintronix Corp Ltd</i> (Formerly Known as TTL Holdings Ltd)	426
	[C] <i>Falmac Limited v. Cheng Ji Lai Charlie</i>	426
III	Corporate Governance	426
	[A] Independent Directors	426
	[B] Executive and Non-executive Directors	427
	[C] Oversight Committees	427
IV	Liability Issues	428
	[A] Who Can Sue?	428
	[B] Who Can Be Sued?	428
	[C] De Facto Directors	428
	[D] Thresholds and Limitations on Directors’ Liabilities	429
	[E] Joint/Several Liability	429
	[F] Derivative Actions	429
	[G] Class Actions	430
	[H] Relevance of Bankruptcy of the Corporation	430
V	Indemnification and Insurance	430
VI	Other Methods of Protection	431
VII	Legislation Development	431
South Africa		
	<i>Nastascha Harduth, Eric Levenstein, David Gewer &amp; Derek Alexander</i>	433
I	Introduction	433
II	National Basics and National Legal Theories of Directors’ Liabilities	434
	[A] Board Structures	434
	[B] Chairperson and Chief Executive Officer	434
	[C] Directors’ Election, Staggered Rotation and Terms of Appointment	435
	[D] Delegation and Board Committees	435
	[E] Removal of Directors	436
III	Recent Cases Dealing with Directors’ Liability	437



Table of Contents

IV	Socio-Anthropological Issues	438
V	Behaviour to Avoid Director's Liability	439
VI	Liability Issues	440
	[A] Who Can Sue and Who Can Be Sued	440
	[B] The 'De Facto' Director	440
	[C] Joint Liability	441
	[D] Derivative Actions	441
	[E] Insolvency and Financial Distress	441
VII	Indemnification, Directors' and Officers' Insurance, Other Methods of Protection	441
VIII	Lawyer Directorship	442
IX	Forecast on Future Legislation Development	442
	South Korea	
	<i>Kyung-Taek Jung &amp; Hye-Sung Kim</i>	445
I	National Basics and Legal Theories of Directors Liabilities	445
	[A] Two-Tiered or Unitary Company Structure	445
	[B] Representative Director/Executive Officer	445
	[C] Board Structures	446
	[D] Director's Elections/Staggering	446
	[E] Director's Term of Appointment	447
	[F] Delegation	447
	[G] Removal of Directors	447
	[H] Duties of Directors	447
	[1] Duty of Care	447
	[2] Duty of Loyalty	447
	[3] Duty of Confidentiality	448
	[4] Duty of Non-compete with the Company	448
	[5] Duty Against Usurpation of Business Opportunity of the Company	448
	[6] Duties as to Transactions between Directors and the Company (i.e., Self-Dealing)	448
	[7] Duty to Report to Audit Committee	449
II	Recent Cases Dealing with Directors' Liability	449
III	Judicial Review	450
IV	Typical Schemes/Behavior to Avoid Directors' Liability	450
V	Corporate Governance	451
	[A] General Principles of Corporate Governance in Korea	451
	[B] Recent Developments in the Law, Codes and Rules of Corporate Governance	451
	[C] The Law Enforcement Agency in Charge of Enforcing Corporate Governance in Korea	452
VI	Liabilities Issues	452
	[A] Who Can Sue & Who Can Be Sued?	452

## Table of Contents

---

[B]	De Facto Director	453
[C]	Thresholds and Limitations/Caps of Liabilities	453
[D]	Joint Liability/Solidarity	453
[E]	Shareholders' Derivative Actions	453
[F]	Class Actions	454
[G]	Relevance of Bankruptcy of Corporation	454
VII	Indemnification of Directors' Liability	454
VIII	Directors' and Officers' Insurance	454
IX	Lawyer Directorship	455
X	Forecast on Future Legislation Development	455
Spain		
	<i>Enric Picanyol &amp; Coro Fernández-Rañada</i>	457
I	'National Basics' and Legal Theories on Directors' Liabilities	457
[A]	Two-Tier versus 'One-System' Body	457
[B]	Chairman/CEO	458
[C]	Board Structure	458
[D]	Elections/Staggering	458
[E]	Delegation	459
[F]	Removal of Directors	459
II	Recent Cases Dealing with Directors' Liabilities	459
[A]	General Rules	459
[B]	Liability for Corporate Debt	459
III	Judicial Review	460
IV	Socio-Anthropological Issues	461
V	Corporate Governance	461
VI	Liability Issues	462
[A]	Who Can Sue?	462
[1]	Corporate Action	462
[2]	Individual Action	462
[B]	Who Can Be Sued?	463
[1]	Directors	463
[2]	Corporate Entities as Directors	463
[3]	De Facto Directors	463
[4]	Liquidators	463
[5]	Persons Holding Powers of Attorney	463
[C]	Thresholds and Limitations	464
[1]	Time-Barring Term	464
[2]	Negligence	464
[D]	Joint Liability/Solidarity	464
[E]	Derivative Actions	465
[F]	Class Actions	465
[G]	Directors' Liability in the Event of Insolvency	465
VII	Indemnification	466

Table of Contents

VIII	Directors' and Officers' Insurance	467
IX	Lawyer Directorship	467
Sweden		
	<i>Björn Kristiansson &amp; Per Samuelsson</i>	469
I	'National Basics' and National Legal Theories of Directors' Liabilities	469
	[A] Forms of Association and Legal Context	469
	[B] Company Structure and Representation	470
	[C] Board Structure	470
	[D] Directors' Election and the Nomination Committee	471
	[E] Directors' Term of Appointment and Removal of Directors	471
II	Recent Cases Dealing with Directors' Liability	472
III	Judicial Review	472
IV	Corporate Governance	473
	[A] Legal Framework	473
	[B] Directors' Duties Towards the Company	473
	[C] Directors' Duties Towards Majority and Minority Shareholders	474
	[D] Directors' Duties in Case of Bankruptcy	475
V	Liability Issues	475
	[A] Who Can Be Sued?	475
	[B] Who Can Sue?	476
	[1] The Company	476
	[2] Shareholders: Derivative Actions	476
	[3] Creditors and Other Third Parties	476
	[C] 'De Facto' Directors' Liability	477
	[D] Limitations	477
	[E] Class Actions	477
VI	Indemnification and Directors' Insurance	477
VII	Other Methods of Protection	478
VIII	Lawyer Directorship	478
IX	Forecast on Future Legislation Development	478
Switzerland		
	<i>Matthew T. Reiter &amp; Lorenz Naef</i>	479
I	Directors' Liability in Switzerland: The Basic Legal Regime	479
	[A] Introduction	479
	[B] Flexible One-Tier System	480
	[C] Board Structures, Chairman and CEO	480
	[D] Election and Removal of Directors, Nationality and Domicile Requirements	481
	[E] Delegation	481
II	Recent Cases Dealing with Directors' Liability	482
	[A] Claims of the Company in Good Standing	483

## Table of Contents

---

	[B] Late Filing for Insolvency	484
	[C] Liability for the Issuance of Prospectuses	484
III	Standards of Judicial Review	485
IV	Corporate Governance	485
V	Liability Issues	485
	[A] Grounds for Liability and Prerequisites in General	485
	[B] Who Can Sue?	486
	[C] Derivative Actions in Particular	487
	[D] Who Can Be Sued?	488
	[E] No Thresholds and Limitations on Directors' Liability	488
	[F] Joint and Several Liability	489
	[G] Class Actions	489
	[H] Costs and Fees in Liability Litigations	489
VI	Indemnification	490
VII	Directors' and Officers' Insurance	490
VIII	Other Methods of Protection for Directors on the Board of a Swiss Corporation	491
Turkey		
	<i>Serdar Paksoy &amp; assisted by Deniz Özkan</i>	493
I	Introduction	493
II	Who Can Be Elected as Director?	493
	[A] Becoming a Director	493
	[B] Qualifications of Directors	494
III	Composition of the Board	494
IV	Fiduciary Duties of Directors	495
V	Liabilities of Directors	496
	[A] Situations in Which Directors Are Held Liable	496
	[1] Incorrect Payments of the Shareholders for Their Capital Contributions	496
	[2] Unlawful Documents and Statements of the Company	497
	[3] Non-existing or Unduly Kept Corporate Books and Company Records	497
	[4] Shareholders Resolutions That Are Not Implemented without a Just Cause	497
	[5] Directors' Deliberate or Negligent Failure to Perform Other Duties Delegated by the TCC or the Articles of Association	498
	[6] Failure to Appoint Capable Executives	498
	[B] Liability of Legal Entity Directors and Their Representatives	498
	[C] Differentiated Joint Liability Principle	498
	[D] Who Can Sue the Directors?	499
	[1] Company	499
	[2] Shareholders	499
	[3] Third-Party Claims	499

Table of Contents

[E]	Directors' Liability Insurance	500
[F]	Liability of Directors under the CML	500
[G]	Liabilities of Directors Arising Out of Extraordinary Transactions	500
	[1] Capital Increases	500
	[2] Issuing Bonds	501
	[3] Liability in Case of Bankruptcy	501
[H]	Liability of Directors under the Tax Laws	501
[I]	Liability of Directors under Social Security Law	502
[J]	Liability of Directors under the Banking Law	502
[K]	Liability of Directors under Criminal Law	502
VI	Defences of Directors	502
VII	Ceasing to Be a Director	502
Ukraine		
	<i>Timur Bondaryev, Pavlo Khodakovsky &amp; Alesya Pavlynska</i>	505
I	'National Basics' and National Legal Theories of Directors' Liabilities	505
	[A] Two-Tiered or Unitary Company Structure	505
	[B] Chairman/CEO Executive Body	506
	[C] Board Structures	506
	[D] Directors' Elections	507
	[E] Directors' Term of Appointment	507
	[F] Delegation of Authorities (Powers)	507
	[G] Removal of Directors (Dismissal, Recalling and Suspension)	508
II	Recent Cases Dealing with Directors' Liability	508
III	Judicial Review	509
IV	Typical Schemes/Behaviour to Avoid Directors' Liability	509
V	Corporate Governance	510
VI	Liability Issues	510
	[A] Who Can Sue?	511
	[B] Who Can Be Sued?	511
	[C] 'De Facto' Director	512
	[D] Thresholds and Limitations/Caps of Liabilities (Limits of Directors' Liability)	512
	[E] Joint Liability/Solidarity	513
	[F] Derivative Actions	513
	[G] Class Actions	513
	[H] Relevance of Bankruptcy of Corporation	513
VII	Indemnification	514
VIII	Directors' and Officers' Insurance	514
IX	Other Methods of Protection	514
X	Lawyer Directorship	514
XI	Forecast on Future Legislation Development	515

## Table of Contents

---

United Arab Emirates	
<i>Imtiaz Shah</i>	517
I UAE Legal Regime	517
[A] Introduction	517
[B] Free Zones	517
[C] Permitted Corporate Vehicles	518
II 'National Basics' and National Legal Theories of Directors' Liabilities	519
[A] Company Structure	519
[B] Chairman/CEO	519
[C] Board Structures	520
[D] Directors' Elections	520
[E] Directors' Term of Appointment	521
[F] Delegation	521
[G] Removal of Directors	521
III Corporate Governance	521
[A] Decision 518	522
IV Liability Issues	523
[A] General Concept	523
[1] General Liabilities: Onshore Companies	523
[2] Criminal/Other Liabilities: Onshore	524
[3] General Liabilities: DIFC Companies	524
V Who Can Sue?	525
VI 'De Facto' Director	525
VII Threshold and Limitations/Caps of Liabilities	526
VIII Relevance of Bankruptcy of Corporation	526
IX Indemnification	526
X D&O Insurance	526
XI Forecast on Future Legislation Development	527
United Kingdom	
<i>Karla Dudek</i>	529
I 'National Basics' and National Legal Theories of Directors' Liabilities	529
[A] Two-Tiered or Unitary Company Structure	529
[B] Chairman and CEO	530
[C] Board Structures	530
[D] Directors' Elections/Staggering	531
[E] Directors' Term of Appointment	531
[F] Delegation	531
[G] Removal of Directors	532
II Recent Cases Dealing with Directors' Liability	532
III Judicial Review	533
IV Typical Schemes/Behaviour to Avoid Directors' Liability	534
V Corporate Governance	534

Table of Contents

	[A] Board Procedures	534
	[B] Structure of Oversight	535
VI	Liability Issues	535
	[A] Who Can Sue?	535
	[B] Who Can Be Sued?	536
	[C] ‘De Facto’ Director	536
	[D] Thresholds and Limitations/Caps of Liabilities	537
	[E] Joint Liability/Solidarity	537
	[F] Derivative Actions	537
	[G] Class Actions	538
	[H] Relevance of Bankruptcy of the Corporation	538
VII	Indemnification	539
VIII	Directors’ and Officers’ Insurance	539
IX	Other Methods of Protection	539
X	Lawyer Directorship	540
XI	Forecast on Future Legislation Development	540
	United States of America	
	<i>Robert Ripin</i>	541
I	National Framework for US Corporate Boards	541
	[A] Regulatory Structure	541
	[B] Board Composition	541
	[1] Board and Corporate Structure	541
	[2] Number of Directors	542
	[3] Age and Nationality Restrictions	542
	[4] Independence	542
	[C] Multiple Roles	542
	[D] Board Procedures	542
	[E] Board Elections	543
	[1] Classified Boards	543
	[2] Cumulative Voting	543
	[3] Staggered Board	543
	[4] Weighted Voting	543
	[F] Delegation	543
	[G] Removal of Directors	544
II	Standards Applicable to Directors	544
	[A] General Duties	544
	[B] State Statute, Securities Exchange, and Common Law Duties	544
	[1] Duty of Care	544
	[2] Duty of Loyalty	545
	[3] Business Judgment Rule	545
III	Cases Dealing with Directors’ Liabilities	545
	[A] Quadrant/Gheewalla	545
	[B] Krasner	545

## Table of Contents

---

	[C] WorldCom/Enron/Emerging Communications	546
	[D] Disney/Van Gorkom	546
	[E] Observations/Recommendations	547
IV	Corporate Governance	548
	[A] Regulation	548
	[B] Board Composition/Independence	548
	[1] Independence of Majority of Board Members	548
	[2] Application to Foreign Private Issuers	549
	[3] Corporate Governance Guidelines/Code of Ethics	549
	[C] State Law Requirements (Delaware)	549
V	Liability Issues	549
	[A] Who Can Sue?	549
	[1] Shareholder Derivative Lawsuits	549
	[2] Creditors' Rights	550
	[3] Regulator Actions	550
	[B] Grounds for Liability	550
	[1] Criminal and Civil Liability	550
	[2] Securities Law	550
	[3] Antitrust	551
	[4] Theft and Fraud	551
	[5] Other	551
	[C] Thresholds and Limitations/Caps of Liabilities	551
	[D] Shareholder Liability	551
VI	Indemnification	551
VII	Insurance	552
	Vietnam	
	<i>Jeff Olson &amp; Minh Nguyen</i>	553
I	“National Basics” and National Legal Theories of Directors’ Liabilities	553
	[A] Legal Framework and the Enterprise Law	553
	[B] Company Forms under the Enterprise Law and Two-Tiered or Unitary Company Structure	554
	[1] Limited Liability Company	554
	[2] Joint Stock Company	555
	[C] Definition of “Director”	556
	[D] Chairman/CEO (General Director)	556
	[E] Board Structures	557
	[F] Directors’ Elections/Staggering and Directors’ Term of Appointment	557
	[G] Delegation	558
	[H] Removal of Directors	558
II	Recent Cases Dealing with Directors’ Liability	559
III	Judicial Review	559
IV	Typical Schemes/Behavior to Avoid Directors’ Liability	560
V	Corporate Governance	560



## Table of Contents

---

VI	Liability Issues	560
	[A] Who Can Sue?	561
	[B] Who Can Be Sued?	561
	[C] “De Facto” Director	561
	[D] Thresholds and Limitations/Caps of Liabilities	562
	[E] Joint Liability/Solidarity	562
	[F] Derivative Actions	562
	[G] Class Actions	562
	[H] Significance of Bankruptcy of Corporation	563
VII	Indemnification	563
VIII	D&O Insurance	563
IX	Other Methods of Protection	563
X	Lawyer Directorship	563
XI	Forecast on Future Legislation Development	563
	Index	565



# Latvia

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## **I NATIONAL BASICS AND NATIONAL LEGAL THEORIES OF DIRECTORS' LIABILITIES**

### **[A] Two-Tiered or Unitary Company Structure**

The Latvian legal system follows the two-tiered company structure theory characterized by: (1) a board of directors which performs the executive function for the company; and (2) a supervisory board which performs the supervisory function (hereinafter, if jointly – Directors). There are two types of companies in Latvia: (1) Sabiedrība ar ierobežotu atbildību (hereinafter – SIA) which is a limited liability company; and (2) Akciju sabiedrība (hereinafter – AS) which is a joint stock company. A board of directors is mandatory for both types of companies (SIA and AS) while a supervisory board is mandatory only for AS and the shareholders of SIA may choose whether a supervisory board would be necessary for their company by including such a provision in the articles of association of the company.

At the same time, according to the Commercial Law, the meeting of shareholders can also be considered an administrative institution of a Company which has the power to decide on specific matters (as well as, in specific conditions – to decide on matters which are within the competence of the Directors).

Commercial activities in Latvia (including Director's liability) are regulated by the Commercial law, by Civil Law and other laws, as well as by the norms of international law that are legally binding in Latvia. The provisions of the Civil Law are applied to commercial activities only insofar as the Commercial Law or other laws that regulate commercial activities do not specify otherwise.

## **[B] Chairman/CEO**

If the board of directors consists of more than one member, a chairman of the board of directors is elected from among the members, who is responsible for organizing the activities of the board. If a SIA has established a supervisory board, the articles of association may provide that the chairman of the board of directors is appointed by the supervisory board, whereas with regard to an AS, the law provides that the chairman of the board of directors is appointed by the supervisory board. With regard to both types of company, the articles of association of the company may provide that the vote of the chairman prevails in case of a tied vote in the meeting of board of directors. The chairman of the board of directors is responsible of signing several procedural and corporate documents such as minutes of the meetings of the board of directors, compartments of the shareholders register of the company in case of share alienation etc.

Similarly, with regard to both – SIA and AS, a chairman and at least one deputy chairman of the supervisory board must be elected by the members of the supervisory board. The deputy chairman of the supervisory board performs the duties of the chairman only if the chairman is absent (due to illness, business trip, vacation and the like), or has assigned such a task to the deputy chairman. The chairman of the supervisory board convenes supervisory board meetings, but in his or her absence or by a specific assignment – it is the task of the deputy chairman. It may be provided in the articles of association of the company that the vote of the chairman shall prevail in the event of tied vote in supervisory board meetings.

Companies may introduce CEO level managers as employees who will be engaged in the management of a company's business activities. Such staff members will be employed on the basis of an employment agreement, a work-performance agreement or a respective power of attorney but not on the basis of the Commercial law. In practice, CEOs will also often be the members of the company's board of directors.

## **[C] Board Structures**

With regard to all types of company, the board of directors may consist of one or more members who are natural persons with the capacity to act. Members of the board of directors may not be supervisory board members, the auditor of the company and members of the supervisory board of the dominant undertaking in a group of companies. Greater restrictions on members of the board of directors may be specified in the articles of association.

Also, with regard to both company types, the supervisory board shall also consist of natural persons with the capacity to act. The minimum number of supervisory members is three, but if the stock of the company is publically traded, then the supervisory board shall consist of a minimum of five members. The maximum number of supervisory board members is twenty. The following persons may not be members of the supervisory board: (1) members of the board of directors, the auditor, procura

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holder or a commercial representative of the company; (2) members of the board of directors of any dependent company of the company or any person with the right to represent the dependent company. The articles of association may provide stricter restrictions that apply to supervisory board members.

#### **[D] Directors' Elections/Staggering**

Members of the board of directors of an AS are elected by the supervisory board of the company, while in a SIA the members of the board of directors are elected by the general meeting of shareholders even if the company has formed a supervisory board. A consent from the relevant person is required in order to elect him/her as a member of the board of directors.

With regard to both company types, members of the supervisory board are elected by simple majority of votes of the present shareholders in the shareholders meeting, if although the articles of association may provide that a larger number of votes is necessary for such election.

#### **[E] Directors' Term of Appointment**

A member of the board of directors (of SIA and/or AS) is elected for an indefinite period of time, if not otherwise specified in the articles of association.

The supervisory board (of SIA and/or AS) cannot be elected for a period which is longer than five years. The articles of association may provide for a shorter term.

#### **[F] Delegation**

In everyday business activities, it is common for members of the board of directors to delegate their tasks to employees of the company. The delegation of such tasks does not exclude the liability of the members of the board of directors as such but the culpability of members of the board will be reviewed in each respective case.

Companies may issue two types of authorizations for third parties to act on behalf of the company – a procura and/or an ordinary commercial power of attorney.

A procura is a commercial power of attorney which is registered with the commercial register and grants the procura holder the right to conclude transactions and to perform other legal activities associated with commercial activities on behalf of the company, including all procedural activities in the course of legal proceedings (bringing an action, settlement, appeal of a court judgment and the like).

If the company does not issue a procura (and register it within the commercial register), but authorizes a person to conduct commercial activities in its name, to conclude specific types of transactions related to the commercial activities performed by the company or also to conclude separate transactions related to the commercial activities performed by the company this may be accomplished by means of an ordinary commercial power of attorney. Such a power of attorney may relate to all

lawful activities related to the performance of such commercial activities or the conclusion of such transactions. An ordinary commercial power of attorney cannot be registered with the commercial register.

### **[G] Removal of Directors**

A member of the board of directors in a SIA may be recalled anytime by a decision of the shareholders. If the company has a supervisory board, it may suspend any member of the board of directors from his or her position until the meeting of shareholders but for period which is not longer than two months. The articles of association may provide that a member of the board of directors may be recalled only if there is an important reason. Such reasons shall be considered to be gross violations of authority, failure to perform or to appropriately perform his or her duties, an inability to manage the company, or causing harm to the interests of the company, as well as loss of confidence from the shareholders. With regard to an AS, the members of the board of directors may be recalled only if there is an important reason. Members of the board of directors may leave their position, by submitting a notification thereof to the company anytime.

With regard to both – SIA and AS, members of the supervisory board may be recalled from their office at any time by a decision of a meeting of the shareholders. Similarly to the board of directors, a member of the supervisory board may relinquish his or her office at any time, by submitting a notice to the company. If a supervisory board member leaves or is recalled from the board before the expiration of the supervisory board's term, then the election of a new supervisory board member requires a new election of the entire supervisory board.

The fact that a person relinquishes their position as a company Director does not automatically terminate an employment and/or work-performance agreement, if such has been concluded between him/her and the company. The agreement that is the basis for the Director holding the respective position must be terminated separately from any employment agreement, after the decision regarding the removal of Director has been made.

## **II RECENT CASES DEALING WITH DIRECTORS' LIABILITY**

### **[A] Judgment of 15 January 2014 in Case No. SKC-101/2014 of the Civil Case Department of the Supreme Court of Republic of Latvia<sup>1</sup>**

In this case the Supreme Court indicated that the Article 169 of the Commercial Law of the Republic of Latvia provides for the liability of the members of the board of directors for losses suffered by the company. The Supreme Court ruled that the rebuttal of this principle is the task for the members of the board of directors in each respective case. At the same time, before a board member has the obligation to prove that he has acted

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1. Judgment of 15 January 2014 in case No. SKC-101/2014 of the Civil Case department of the Supreme Court of Republic of Latvia, para. 8, (AT, 2014).

as an honest and prudent manager, the plaintiff has the obligation to prove the existence of losses according to the contest principle enshrined in the Civil Procedure Law of Republic of Latvia.

**[B] Judgment of 27 May 2014 in Case No. SKC-102/2014 of the Civil Case Department of the Supreme Court of Republic of Latvia<sup>2</sup>**

In this case, the Supreme Court reviewed the understanding of the term ‘honest and prudent manager’. The Supreme Court noted that this term is a general clause which must be determined in the context of each specific case depending on the facts of the matter. In this case the Court ruled that the chairman of the board of directors cannot be exempt from liability for loss expected to be suffered by the Company in the future by means of a decision of the shareholders meeting as this would be contrary to the objective of the provisions of law providing the possibility of shareholders to release the members of the board from their liability for loss already caused to the company.

**[C] Judgment of 13 June 2014 in Case No. 2014-02-01 of the Constitutional Court of Republic of Latvia ‘On the Compliance of Para 4 of Section 17 of Deposit Guarantee Law with the First Sentence of Article 91 of the Constitution of the Republic of Latvia’.<sup>3</sup>**

The Constitutional Court reviewed (*inter alia*) the aspects of the Article 169 of Commercial law providing for the liability of Directors. The Constitutional Court determined that the term ‘honest and prudent manager’ incorporates objective obligations such as being loyal to the company, avoiding the adoption of a decision in case of a conflict of interest, to act according to law, articles of association and the decisions of shareholders meetings as well as the obligation to adopt economically reasonable decisions. According to the Constitutional Court, as essential criteria to determine that one acted as an honest and prudent manager is the conformity of his/hers conduct with the purpose of the economic activity of the company.

### **III JUDICIAL REVIEW (FOR EXAMPLE, TIGHTENING OF STANDARDS?)**

Several amendments have lately been made in Latvian laws regulating the liability of Directors including imposing personal liability for delaying the time for filing documents with the commercial register, non-performance of company’s tax obligations and delayed filing for insolvency in case the company has not settled its debts for more than two months.

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2. Judgment of 27 May 2014 in case No. SKC-102/2014 of the Civil Case department of the Supreme Court of Republic of Latvia, para. 10, (AT, 2014).

3. On the Compliance of para. 4 of s. 17 of the Deposit Guarantee Law with the first sentence of Art. 91 of the Constitution of the Republic of Latvia, 117 (5177), LV, para. 14.2.2., (ST, 2014).

As of 1 January 2013, the Register of Enterprises has the authority to review administrative violation matters involving the non-submission of documents with the commercial register. According to the Administrative Violation Code of Latvia, the Register of Enterprises may send a warning for this violation or impose a penalty of EUR 70 to EUR 430.

As of 1 January 2015, the State Revenue Service (tax authority) of Republic of Latvia can bring a personal recovery claim against members of the board of directors for the non-performance of tax obligations of a company. Liability will apply to those persons who were board members when the tax debt arose, whether they continue to perform the tasks of the members of the board or not. This specific type of tax liability of board members arises if all of the following criteria are met:

- The unpaid tax amount exceeds fifty minimum salaries (currently – EUR 18,000).
- The company has been notified about the enforcement of the tax debt.
- The company has disposed of all assets to a party related to a board member (e.g., spouse, controlled companies, etc.) after the tax debt is discovered.
- Recovery of the tax debt from the company is impossible.
- The company has failed to apply for insolvency proceedings.

It is important to note that on 29 December 2015, the Constitutional Court of Republic of Latvia has initiated a case regarding the above-mentioned law that provides for the liability of members of the board of directors for the non-performance of company's tax obligations.<sup>4</sup>

A similar personal liability clause can be applied as of 1 January 2015 regarding the insolvency obligations of the members of the board of directors. If the documents reflecting accounting information are not transferred from the company to the insolvency administrator (or if a substantial part of the accountancy information is missing) the members of the board of directors can be held personally liable for all of the company's debts. Such a claim against members of the board of directors may be brought either by the insolvency administrator or the creditors of the insolvent company.

#### **IV TYPICAL SCHEMES/BEHAVIOUR TO AVOID DIRECTORS' LIABILITY**

The Commercial Law does not allow for the possibility to limit the liability of Directors in the articles of association of the company. However, there are certain actions that can be taken to protect Directors from such liability.

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4. Decision of the Constitutional Court of Republic of Latvia of 29 December 2015 regarding the initiation of a case 'On the compliance of Section 60, 61 and 62 of the law "On Taxes and Fees" with the first sentence of Article 91, Article 92 and Article 105 of the Constitution of the Republic of Latvia'.



**[A] Compliance with the Principle of an Honest and Prudent Manager**

In order to prove that a Director is not liable for loss caused to the company, the Director must prove that he has acted as an honest and prudent manager. This means avoiding even ordinary negligence. However, in any case – an accidental loss (caused by an accidental event or force majeure) is not required to be compensated by anyone. Acting in accordance with the duties of an honest and prudent manager would be, e.g., voting against and non-execution of a decision which has caused losses to the company etc.<sup>5</sup>

**[B] Release from Liability by Means of a Decision of the Shareholders' Meeting**

The general meeting of shareholders has the right to release Directors from their civil liability after a loss has been detected. It is the prerogative of the general meeting of shareholders to decide to release a Director from liability. Similarly, a settlement can be made with Directors if decided by the shareholders' meeting.

**[C] Good Faith Compliance with Shareholders' Decisions**

Directors cannot be held liable if they act in good faith according to a lawful decision of the shareholders' meeting. For this exemption to be valid, the decision of the shareholders' meeting must have been adopted according to the provisions of law and articles of association.

**V LIABILITY ISSUES****[A] Who Can Sue?**

Directors can be civilly (private liability), administratively and/or even criminally liable (public liability).

**[1] Private Liability**

In case of civil liability which is within the scope of private law, Directors can be held liable as against the company, the shareholders, or any third party for the loss caused to that person. That means that each of the subjects mentioned has standing to make a civil claim against members of the board of directors.

In order to make such a claim against a Director the claimant must prove unlawful action or failure to act by a Director, loss in a specific amount and causality between the unlawful action (failure to act) and the loss.

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5. Aigars Strupišs. *Komercikuma komentāri III*. 150, (A. Strupiša juridiskais birojs, 2003).

With regard to both company types, in situations when the company is making a claim against the board of directors, the company is represented by the supervisory board. On the contrary – if the company is making a claim against the supervisory board, the company is represented by the board of directors.

If the company (SIA) has not formed a supervisory board, a special representative may be elected by a decision of the shareholders meeting to initiate the claim against a member of the board of directors. The shareholders' meeting may also authorize a special representative to represent the company in cases against the supervisory board.

If the shareholders' meeting does not resolve on electing the special representative, the claim will be brought by the shareholders of the company. Generally, it is the prerogative of the shareholders meeting to adopt a decision regarding a claim against a member of the board of directors by a simple majority of the votes. But this does not deprive the rights of minority shareholders – shareholders representing at least one-twentieth of the company's share capital or at least EUR 71,100 of the share capital may request that a claim be brought by the company. Such request by minority shareholders shall be submitted to the institution of the company which has the right to bring the claim (board of directors, supervisory board or the shareholders' meeting), but if the respective institution does not bring the claim within one month, the minority shareholders may bring the claim to court without the intermediation of such institution.

Additionally, it is possible that a creditor may bring a claim in its own name but for the benefit of the company. In cases where a creditor cannot obtain satisfaction of his claim from the company, this creditor may bring a claim against Directors if they have caused loss to the company and haven't compensated such loss. The creditor must prove that it is not possible to satisfy his claim from the company.

## **[2] Public Liability**

The Directors may be held liable according to the Administrative Violations Code (for less serious infringements) or Criminal Law (for serious infringements) on various grounds. The Administrative Violations Code provides for the administrative liability of Directors for breaches such as: (1) failure to comply with accounting regulations; (2) non-submission of insolvency application; (3) the performance of commercial activities without proper registration or without a special permit, etc. More serious sanctions are provided by the Criminal law for breaches such as: (1) causing the company to become insolvent; (2) causing substantial harm to the company or another person's rights and interests; (3) violation of employment regulations, etc.

## **[B] Who Can Be Sued?**

The Commercial Law provides that the company may initiate claims against the founders, Directors, or auditor of the company. Additionally, a claim can also be brought against the person who has exercised influence in bad faith over members of

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the board of directors or supervisory board, a procura holder or a holder of a simple commercial proxy as a result of which the company has suffered losses.

#### **[C] ‘De Facto’ Director**

Latvian law does not specifically provide for the concept of ‘de facto’ Directors of companies but there are a few similar concepts. The role of a ‘de facto’ Director could be exercised by managing employees of the company who are not the registered members of the board of directors or the supervisory board but have a wide area of competence in the company. The company may also authorize third parties to perform specific operations on behalf of the company by means of a general power of attorney, or register a procura for a person who will have all rights to represent the company.

The Commercial Law also provides for a specific type of liability for a person who has exercised influence in bad faith over Directors, a procura holder or a person who has been authorized with a simple commercial power of attorney (by persuading him/her to act against the interests of the company or its shareholders) as a result of which the company has suffered loss. Such liability shall not apply if the influence was exerted: (1) by the use of one’s voting rights at a meeting of shareholders; or (2) by the lawful use of one’s decisive influence in accordance with the Groups of Companies Law.

#### **[D] Thresholds and Limitations/Caps of Liabilities**

The shareholders meeting is competent to release the Directors from liability on behalf of the company. The law states that Directors cannot be released from liability before such liability becomes known (e.g., under a contract). According to law, the shareholders’ meeting may take such a decision only in respect to particular actions which result in company losses, disclosed during the meeting of shareholders. Even in the event the shareholders meeting releases a Director from liability this does not deprive the minority shareholders of the right to bring an action against the respective Director. Provisions of a contract between the Directors and the company may not deprive the third parties (creditors) of the right to bring an action against them.

#### **[E] Joint Liability/Solidarity**

The general principle provided by the Commercial law is that the Directors are jointly liable for losses that they have caused the company. At the same time, as mentioned before, Directors are not held liable if they prove that they have acted, as an honest and prudent manager, therefore individual liability is also possible towards the company and any third parties.

#### **[F] Derivative Actions**

When losses have been suffered by the company a claim must be brought in the company's name by its legal representatives. But this does not deprive the rights of the minority shareholders. The minority shareholders representing at least one-twentieth of the company's share capital or at least EUR 71,100 of the share capital may demand that a claim be brought by the company. Such a request by a minority shareholders must be submitted to the company's institution which has the right to bring an action (board of directors or supervisory board), but if this institution does not bring the action in a court within one month, the minority shareholders may bring an action in court without the intermediation of this institution.

#### **[G] Class Actions**

A claim for recovery of losses is a civil claim and therefore this claim can be filed by each person whose civil rights or interests which are protected by law are infringed. Generally, class actions are only recognized by Latvian law in specific cases regarding employment disputes and consumer protection disputes.

#### **[H] Relevance of Bankruptcy of Corporation**

If the company's business activities meet the insolvency criteria it is the duty of the board of directors to file for an insolvency procedure. The Directors of the company may be held criminally liable for causing the insolvency of the company.

If the documents reflecting accounting information are not transferred from the company to the insolvency administrator (or if a substantial part of the accountancy information is missing) the members of the board of directors may be held personally liable for all of the company's debts.

### **VI INDEMNIFICATION**

If found to be liable, the Directors will be required to compensate losses inflicted on the company.

Directors among themselves may conclude agreements dividing specific areas of responsibility; therefore in their contractual relationship some of the jointly liable Directors may be entitled to indemnification.

### **VII DIRECTORS' AND OFFICERS' INSURANCE**

Directors' and Officers' insurance is available to limit the civil liability of the Directors. Directors at the major national enterprises commonly insure their liability in Latvia. Insurance terms usually depend on the financial performance of the company and other factors evaluated by the insurer on a case-to-case basis. Most often these

insurance policies are governed by English law. Most commonly the policy covers the risk of 'ordinary and gross negligence', whereas 'malicious intent' is not covered.

#### **VIII OTHER METHODS OF PROTECTION**

See sections IV and VI above.

#### **IX LAWYER DIRECTORSHIP**

Generally there are no restrictions for lawyers to become members of the board of directors and members of the supervisory board in Latvian companies. At the same time, the Latvian Council of Sworn Advocates has indicated that acting as a member of the board of directors or supervisory board can be harmful for the professional independence of sworn advocates (Latvian – zvērīnāti advokāti) therefore sworn attorneys who combine their sworn advocate profession with a position of a member of the board of directors or supervisory board has the obligation to inform the Latvian Council of Sword Advocates.

#### **X FORECAST ON FUTURE LEGISLATION DEVELOPMENT**

Legislation regulating the liability of Directors is being constantly amended. Many of the issues indicated in the so-called European Action Plan regulating the liability of the Directors have already been introduced in Latvian law. Currently, there is no public information about any planned amendments regarding the liability of the Directors.

At the same time, the government is constantly working to fully introduce the recommendations of OECD regarding the development of good corporate governance principles.