



Duties of Company Directors

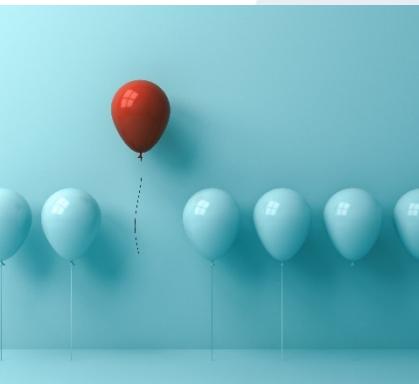
ECLA Round Table



START A circular icon containing a white right-pointing arrow, indicating the start of a process or presentation.



Today's agenda





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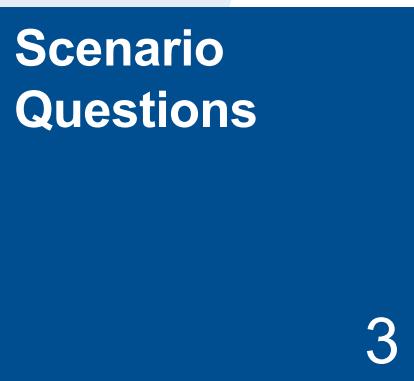
**Overview:
How do
directors
make decisions**

1



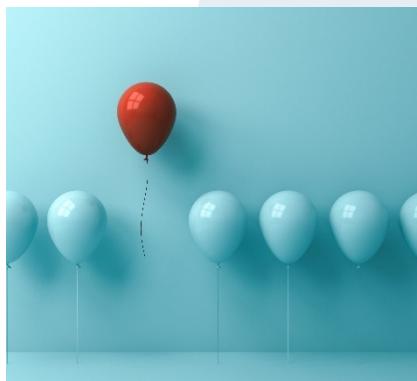
**Duties and
responsibilities
as a company
director**

2



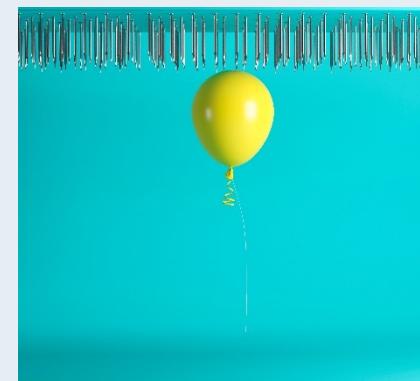
**Scenario
Questions**

3



**Consequences
of breach and
mitigation**

4



**Risks in
financial
difficulty**

5





Introduction

How do directors make decisions?





Directors make decisions collectively (as a board)

- » Constitutional documents set out details on director decision-making:
 - by majority at meetings; or
 - unanimously by written resolution
- » Question: if SPV has two registered directors, how many are required for a majority decision at a board meeting?
- » Nominee directors should also regard to internal governance policies for decisions that require shareholder consent





Directors' duties apply to decision to delegate (whether to committees or employees)

- » Directors must have regard to their duties at all times and must not fetter their discretion
- » Permissible to delegate authority to others:
 - Directors must have a reasonable belief in the delegate's ability to perform
 - Directors remain ultimately responsible
 - Delegation not abdication



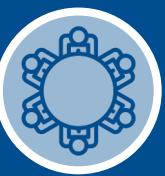


How do directors make decisions?

Directors make decisions solely or jointly with other directors – no need to form a management board

- » Generally, just one managing director ("Geschäftsführer") is sufficient.
- » If there is more than one, the individual director can be authorised to act solely or only together with another director.
- » Prohibition of self-dealing (§181 GmbH); director may be released by resolution
- » no distinction between executive directors and non-executive directors. In particular, all directors share a joint responsibility for the affairs of the company.
- » The external power of managing directors to represent the company in dealings with third parties ("Vertretungsbefugnis") is generally unlimited: Third parties are protected by the unlimited power of representation
- » The internal authority to conduct the business of the company ("Geschäftsführung") may be limited by the articles of association, management rules, the service agreement and possibly by shareholders' resolutions.





Who is a “director” for these purposes?

Singular Board

A properly appointed director to the board of the Company

1

Legal director

Where there is a defect in appointment or a person held out as director and carries out actions of a director

2

“De facto” director

A person who is not a director but in accordance with whose directions or instructions the directors of a Company are accustomed to act

3

“Shadow” director

Certain duties still apply to former directors

4

Former director



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“Shadow” director

Certain duties still apply to former directors

Former director

Non-executive directors have same obligations as executive directors even if not employees and not involved in day to day management



Advisory/ Supervisory Board

- » Establishing a separate supervisory board may be mandatory under employee co-determination rules if the company has more than 500 employees. In such a case, a part of the supervisory board members is elected by the employees.
- » A voluntary advisory board or supervisory board be provided for in the articles.
- » The role of a supervisory/advisory board and its members is limited to oversight.



General duties





- » Act within powers
- » Promote the success of the company
- » Exercise independent judgement
- » Avoid (situational) conflicts
- » Not accept benefits from third parties
- » Declare interest in proposed transactions

1

2

3



Fiduciary Duties (UK)



Exercise reasonable care, skill
& diligence

1

2

3



Non-fiduciary duties
(UK)



May be applied by statute such
as preparation and publication/
filing of accounts

1

2

3



Other specific duties
(UK)



Fiduciary duties (Germany)

- » duty of adherence to the company's articles and by-laws, service agreement and instructions of the shareholder(s)
- » duty to act in the best interests of the company (not necessarily identical to the shareholders' interests)



Non-fiduciary duties (Germany)

- » duty of care – employ diligence of an "orderly businessman" when making decisions on behalf of the company and shareholders
- » conflicts of interest – non-compete obligation while holding office as director



Other specific duties (Germany)

- » prepare, content, circulate and file company's annual report and accounts
- » prepare for and convene the annual shareholders' meeting
- » comply with statutory requirement to maintain accounts and uphold the principles of capital maintenance (i.e. not to pay back to the shareholders the stated share capital)
- » reporting/information obligations vis-à-vis the shareholders
- » ensure all statutory filings with the commercial, trade and transparency registers are made
- » ensure that the company meets its obligations under public law – in particular tax and social security laws



Promoting the success of the company

- » Consider, in good faith, what is most likely to promote the success of the company for the benefit of its shareholders as a whole
 - success = what shareholders collectively want – normally, long-term increase in value
 - good faith a subjective test but applies to all decisions not merely formal
- » Consider other “stakeholder” factors
 - long-term consequences;
 - employees interests;
 - relationships with third parties (suppliers, customers);
 - impact on environment and community;
 - reputation;
 - act fairly between shareholders
- » Licence not to pursue only profit





Question

A large company manufactures goods in its home country. Senior management draw up a plan to move production to a lower wage-cost country abroad. This will save the company a substantial sum, even after taking into account redundancy payments to the current factory workers.

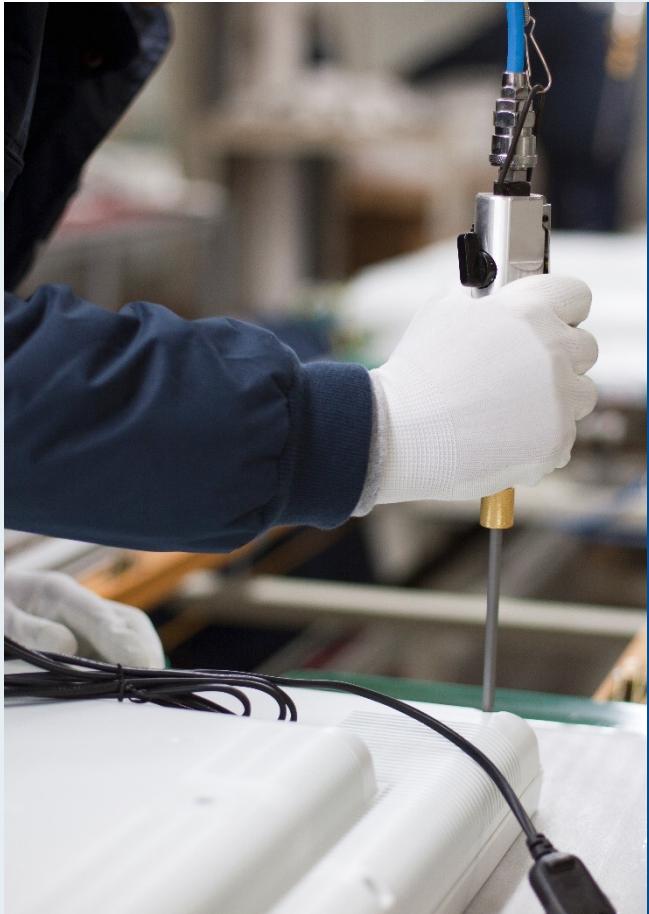
The manufacturing plant is in an area of high unemployment and its closure is likely to have a significant impact on the local community.

What analysis should the directors go through?





Answer

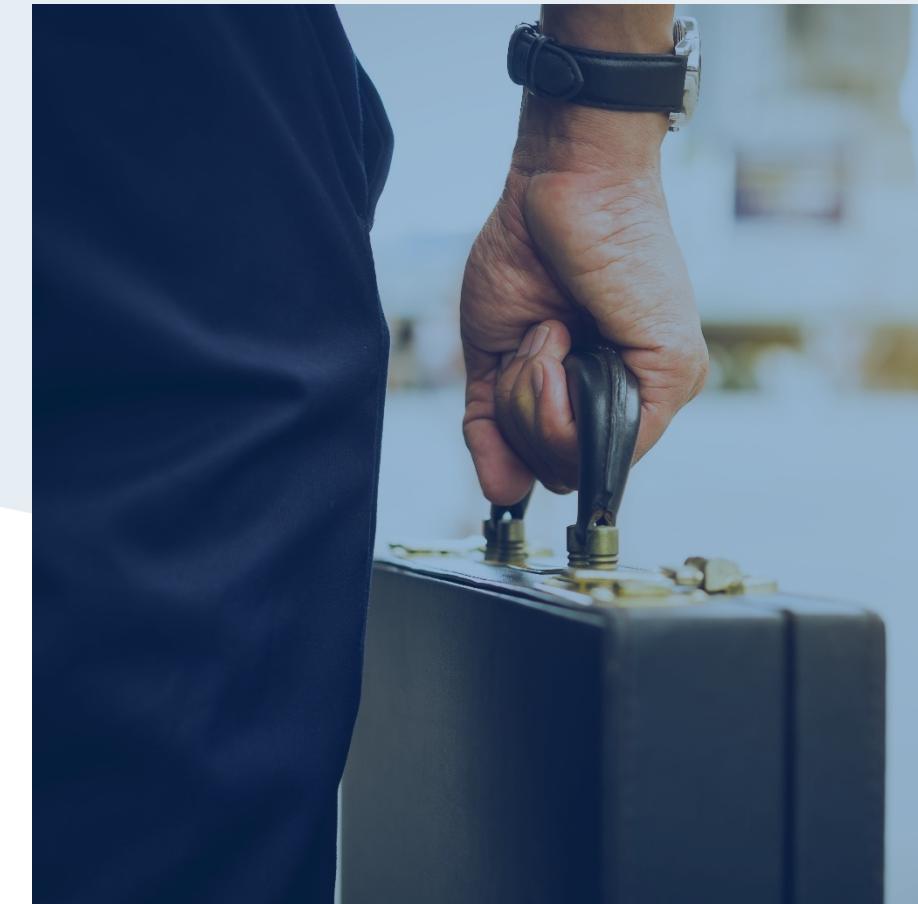


- » Changing supplier may lead to criticism from local employees, unions, politicians, etc.
- » Not changing supplier may lead to criticism from shareholders and creditors.
- » Directors need to reach a decision based on their own judgement, subject to their acting good faith.
- » However, any decision should be made having full regard for all consequences.
- » Decision remains difficult but pursuing a proper review should give some comfort as to the quality of decision-making.



Independent judgement

- » Directors can't fetter own discretion except:
 - as authorised by constitution
 - under an agreement duly entered into by the company
- » Implications:
 - directors can take advice but can't slavishly follow it
 - directors can take a nominating shareholder's views into account but must still exercise independent judgement as to what promotes the success of the company
 - directors cannot agree to vote a particular way (except with a 'fiduciary carve-out')





Question

A company has two shareholders, each of whom appoints a director.

One shareholder instructs its director to vote against the company entering into a particular contract.

However, the director himself thinks it would be best for the company to enter into the contract.

What should the director do?





Answer



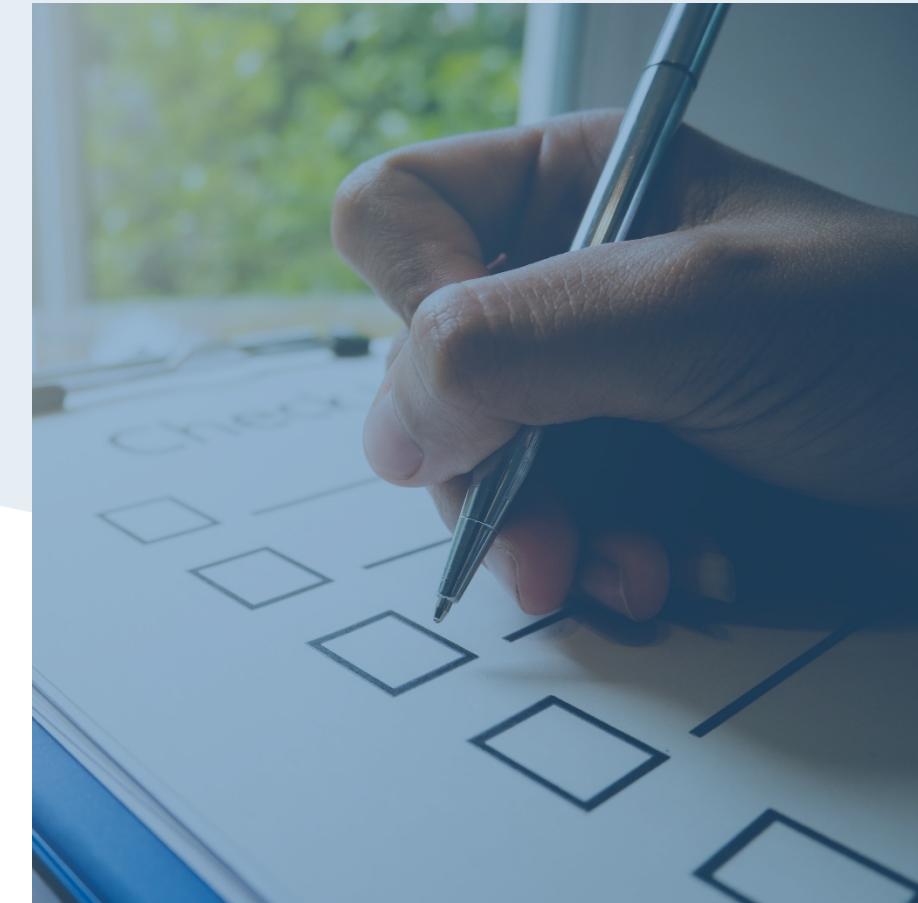
The director must in these circumstances ignore the instruction from the shareholder and vote in favour of the contract if that is the director's true view.

However, the director can (and arguably should) highlight the view of the shareholders so that the other director is also aware of the shareholder's position and can consider the position in light of both shareholders' positions. This is particularly the case where the board decision is then subject to a shareholder approval under the relevant shareholder's agreement.



Care, skill and diligence

- » Reasonable care, skill & diligence
- » Objective standard, but as enhanced by individual experience
- » Division of management/ delegation/ supervision
 - each director must inform themselves of the company's affairs
 - breach for a director to be dominated, bamboozled or manipulated/ totally abdicating responsibility
 - legitimate to trust fellow director whom there is no reason to suspect





Question

A company appoints a qualified accountant as its operations director and an engineer as its finance director.
What level of skill will each have to bring to their roles?



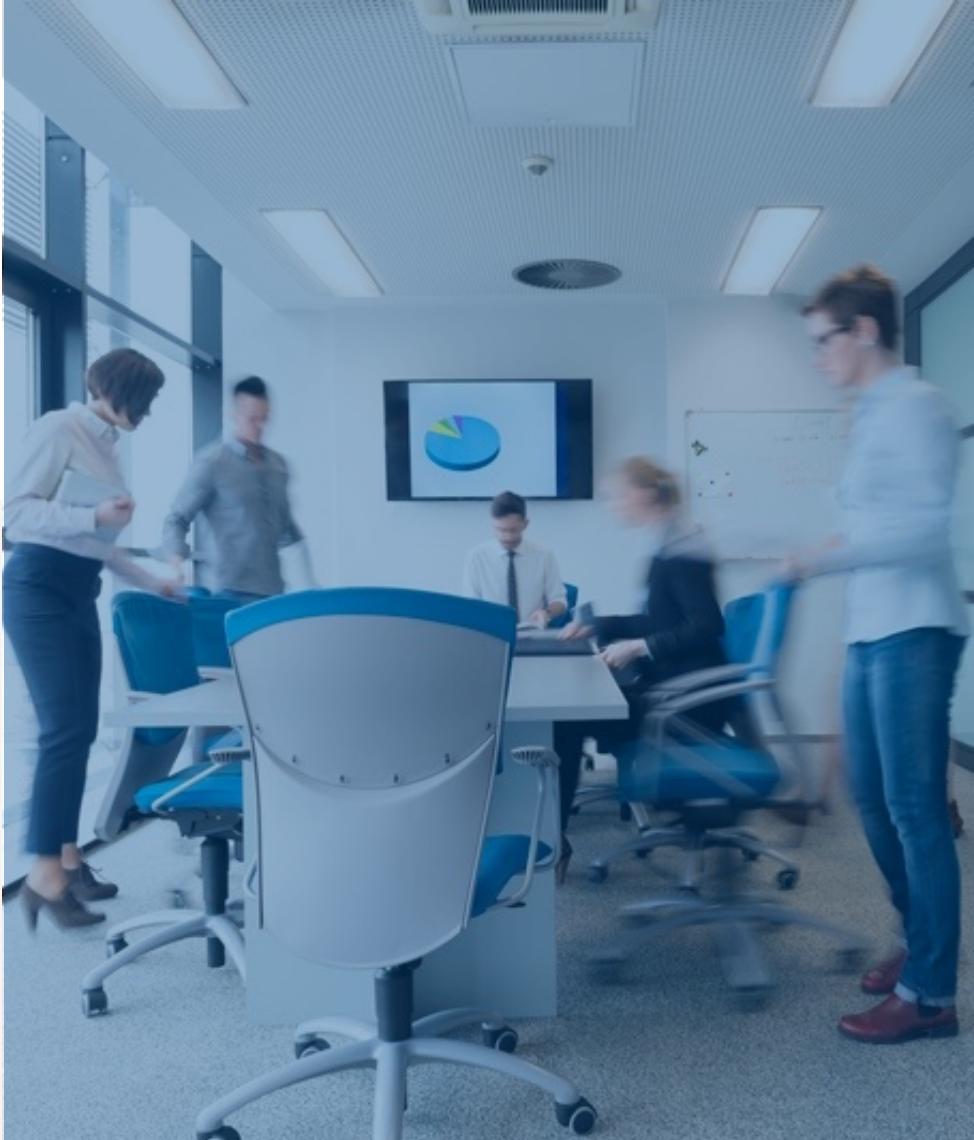


Answer



The accountant/operations director will be expected to exercise the skill of a qualified accountant in all aspects of decision making.

The engineer/finance director will be expected to exercise the skill of a reasonable finance director and will not be excused for any lack of skill because he is qualified as an engineer and not an accountant.



Avoiding conflict

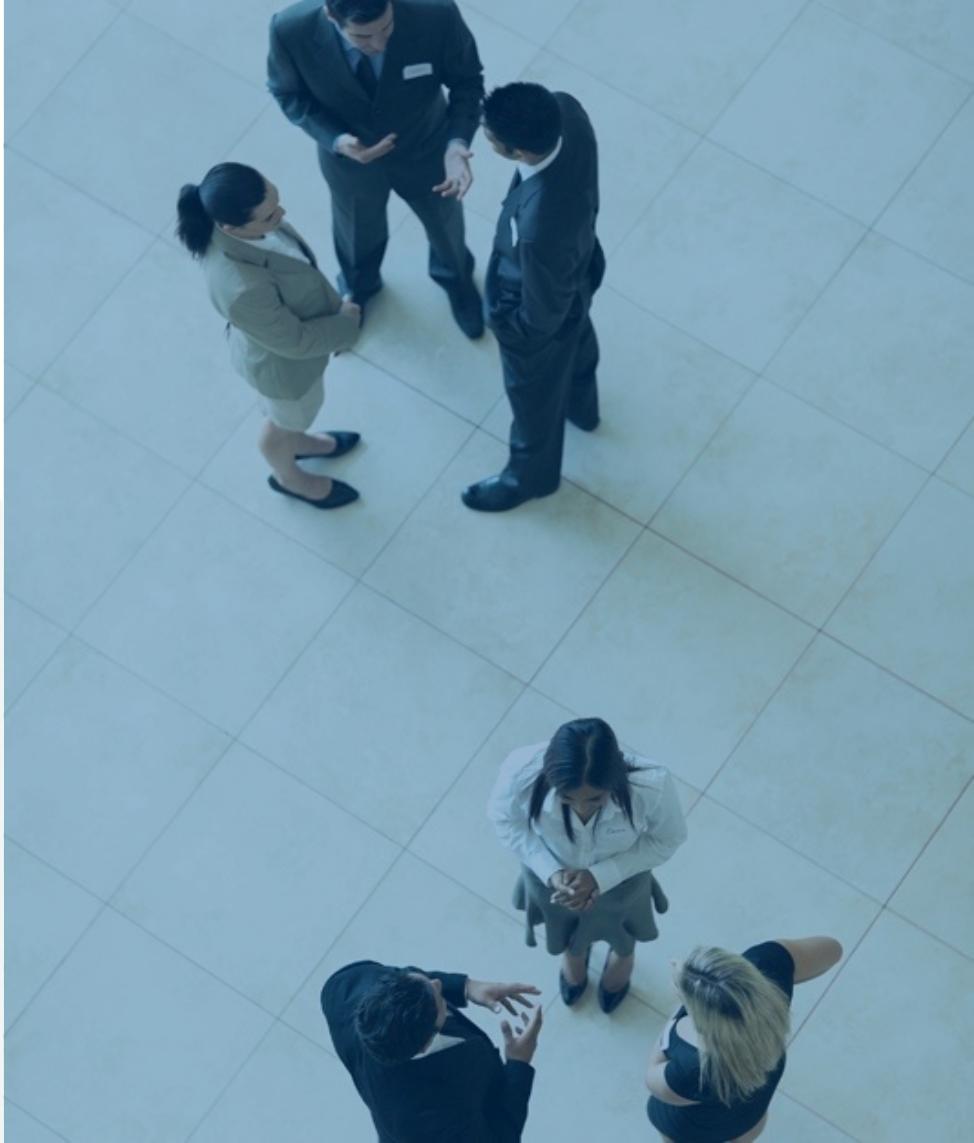
- » Situational conflicts (of interest or duty)
 - avoid a situation where a director has a direct or indirect interest that conflicts or may possibly conflict with the company
 - applies to exploitation of any property, opportunity or information
 - different from specific transaction or arrangement
 - even if company itself could not benefit
 - e.g. role with shareholder, other directorship, interest in competitor
- » Approval procedure may be set out in constitutional documents and/or local law and dictates who can vote / be counted in quorum at board meetings
- » Shareholders may be authorise or ratify (but not always)



Worked example of conflicts

A director of company A, has been asked to be a director of Company B

- » Is there a potential in the future that the two companies could compete with each other?
- » Could one company become a customer of the other company in the future?
- » Will the director receive any information as a director of one company that would be useful to the other?
- » Apply the “sniff test”
 - If feels uncertain / questioning at all if there is a conflict, treat it as a conflict and act accordingly (declaring interests, complying with relevant authorisation requirements etc.).



Benefits from third parties

- » No benefits from third parties (no secret profit)
 - incentives that taint judgement
 - doesn't prohibit benefits from group companies or those in service contract
- » Continues post resignation if relates to pre-resignation activity
- » Corporate hospitality, gifts
 - ok if modest value
 - have regard to any corporate hospitality or anti-corruption policy



Question

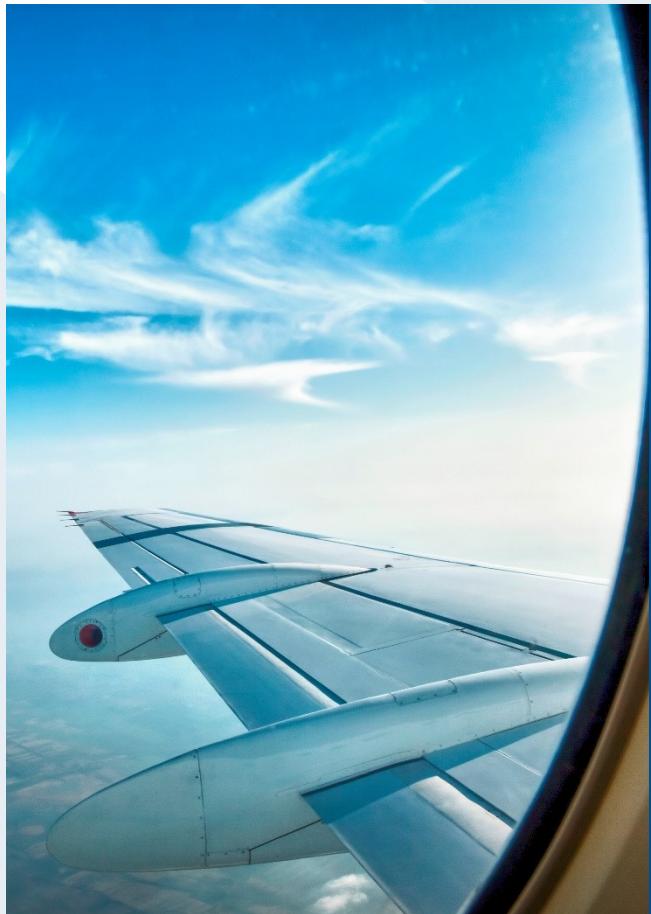
The procurement director is taken by a prospective supplier on an all-expenses-paid holiday – would it be a breach of duty to go?

Once a year the sales director receives a food hamper valued at €50 from a major customer – would it be a breach of duty to accept?





Answer



Depends on company policy but likely that acceptance of the holiday would be a breach of duty and the director would have to pay to the company the value of the holiday. May be tax implications for the company if the director is seen as receiving a benefit by virtue of employment.

The hamper gift would probably not be a breach as it could not be thought to influence the director.

What if the hamper is given once a week?

What if the hamper is given once a quarter?



Consequences of breach and mitigation





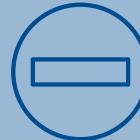
Consequences of breach (UK)



Company claim

- » Negligence claim for breach of duty:
 - Director to account for damages to Company
 - Injunction to prevent an action
 - Set aside the transaction
- » Termination of employment contract / non-executive appointment

1





Consequence of breach (UK)



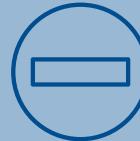
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- » Shareholder claim (on behalf of the Company)
- » Unfair Prejudice claims





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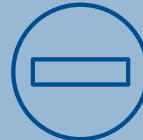
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Disqualification

Repeated breaches might be grounds for a director's disqualification order





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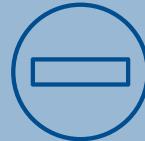
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Reputational risks

Reputational damage for the company as well as the directors themselves





Relief from liability? (UK)

Any provision that purports to exempt/ indemnify a director (to any extent) from liability for negligence, default, breach of duty or breach of trust is void in the UK





Relief from liability? (UK)

Some limited relief from liability:

- » by members (authorisations/ ratifications/ releases)
- » by court (if acted honestly and reasonably)
- » special indemnities
- » company may fund defence costs but need to be repaid if found to have breached duties - depends on company's willingness to pay





Relief from liability? (UK)

D&O insurance

- » Personal and will cover defence costs if successful
- » Does not cover fraud, illegality, dishonesty or breach of duty





Consequences of breaches (Germany)

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3



Liability vis-à-vis company for negligent or intentional breaches of his/her duties for damages.

- » No liability, if the actions have been (validly) approved or ratified by the shareholders ("**Entlastung**"), precluding the company from claiming damages in relation to such breach.



Consequences of breaches (Germany)

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3



Liability to Third Parties (e.g. creditors, insolvency administrator) if the obligation to file for insolvency in time is not complied with (for payments made by the company after insolvency or over-indebtedness are established).



Consequences of breaches (Germany)

1

2

3



Criminal sanctions in case of fraud, misconduct or gross negligence as to managing director's obligations, e.g. under tax and social security or insolvency laws



Relief from liability? (Germany)

Doubtful under German law whether the managing director's liability to the company can be validly limited in advance by any kind of general agreement.





Relief from liability? (Germany)

The company may waive specific claims against a managing director and regularly resolves to approve the managing director's management ("Entlastung") after the close of each business year.

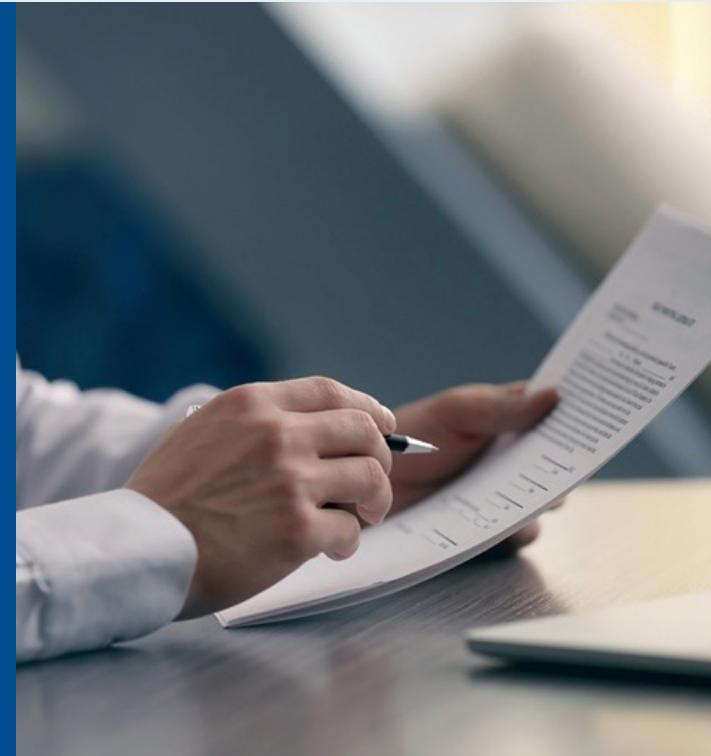
Operates as a waiver of any claims which were identifiable at the time of the resolution.





Relief from liability? (Germany)

The managing director's potential liability towards third parties is not subject to limitation or waiver by the company.

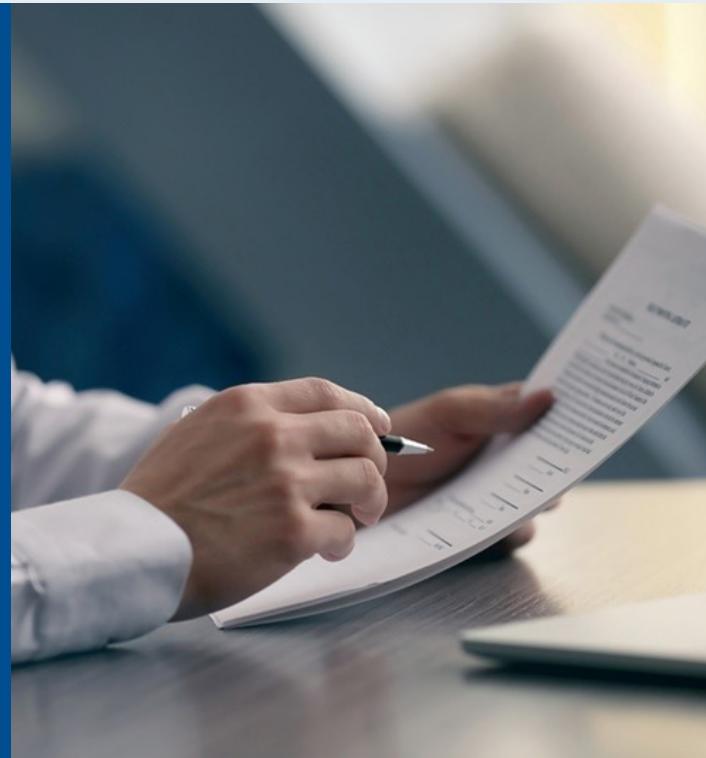




Relief from liability? (Germany)



D&O insurance possible





Other considerations to bear in mind

- » Listed bonds (at parent or subsidiary level)
 - Listed bonds make the issuing company/ group subject to the market abuse regime (MAR) disclosure rules
- » Listing Rules
 - Does something at the company-level trigger an announcement obligation on the part of a listed parent (e.g. a significant write-off on carrying value)?
 - Compliance with other listing rules of the relevant market
- » Consistency of reporting by shareholders (financial, ESG etc)
- » ESG and other policies (particularly where the company is a subsidiary of a parent)
- » FDI, national security, competition and anti-trust
 - JV arrangements and admission of new members/partners may trigger filing obligations (not just M&A)





Risks in financial difficulty





Financial Difficulty

Where there is a risk of insolvency

- » Duties continue but primary duty is to creditors as opposed to the Company/ members
- » “Sliding scale”
- » Wrongful trading may become relevant – if directors knew or should have known there was no realistic prospect of avoiding insolvency





Financial Difficulty

When is there a risk of insolvency

- » Cash Flow Test
- » Balance Sheet Test
- » Can the Company pay its debts as they fall due?
- » 12 month projection
- » Accurate, up-to-date information, on cashflow
- » Taking account of contingent and prospective liabilities
- » Taking into account realistic prospect of shareholder support





Financial Difficulty

If a Company is facing issues in relation to solvency, take advice throughout the process





Key points



The same tests apply to **all types of company**: investment and special purpose vehicles are not subject to different legal rules but how they apply in practice might be different





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Duties are entity specific: need to consider each company separately



Beware of any potential or real conflicts between different companies in a group



Wrongful trading – is there a personal risk for directors if a company continues to trade when he/she knew, or ought to have known, that there was “**no reasonable prospect**” of avoiding insolvent liquidation/administration



Contacts



Alasdair Steele

Partner | Corporate

T +44 20 7524 6422

M +44 7717 292951

E alasdair.steele@cms-cmno.com



Heike Wagner

Partner | Corporate/M&A

T +49 69 71701 319

M +49 171 3408033

E heike.wagner@cms-hs.com



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