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# Things Are Not Always What They Seem: *Understanding Directors' Duties in Europe*

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# Jones Day Panellists



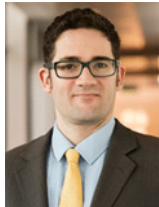
**Vica Irani**

Partner  
M&A Practice Chair (EMEA)  
London  
virani@jonesday.com  
+44.20.7039.5237



**Kay V. Morley**

Partner  
Business Restructuring & Reorganization  
London  
kmorley@jonesday.com  
+44.20.7039.5156



**Gregory J. Barden**

Partner  
Global Disputes  
London  
gbarden@jonesday.com  
+44.20.7039.5130



**Ozan Akyurek**

Partner  
Global Disputes  
Paris  
oakyurek@jonesday.com  
+33.1.56.59.39.39



**Gerjanne te Winkel**

Partner  
Global Disputes  
Amsterdam  
gtewinkel@jonesday.com  
+31.20.305.4219



**Johannes Perlitt**

Of Counsel  
M&A  
Frankfurt  
jperlitt@jonesday.com  
+ 49.69.9726.3939

# Overview

Who is a 'director'?

Who are duties owed to?

Conflicts

Managing a global group

Shareholder liability

Insolvency

Who can bring an action against directors?

Directors and officers (“**D&O**”) insurance

Closing thoughts



## Who is a ‘Director’?

- Directors represent the management of a company, and, collectively as a board, those who are entitled to make decisions and take actions on its behalf.
- Each jurisdiction has its own laws on how directors are appointed in law; it is usually not controversial who the “official” directors of a company are.
- But all major European jurisdictions recognise the concept of a “de facto” director; someone who acts as a director of a company in fact, even though they have not formally been appointed. Directors’ duties will apply to such persons. A similar position usually also applies to “shadow” directors.
- Corporate directorships are not a magic solution to avoid any possibility of liability. Some jurisdictions require natural persons to be on the board (in England you need at least one natural person). In others, the representatives may be jointly and severally liable with the corporate director.
- Steps to preserve the integrity of the board include: (a) documenting authorisations/powers of attorney for both individual directors and third parties in a clear and limited way; (b) ensure appointments are made properly and documented correctly; (c) exclude de facto directors from decision-making (d) senior non-director managers to obtain board approval for decisions (e) independent directors.

## Who Are Duties Owed To?

As a general rule in most jurisdictions, directors owe their duties primarily to the company and its shareholders.

Some jurisdictions have adopted a stakeholders model imposing similar duties to other stakeholders, including employees, customers, suppliers and even the society at large (the Netherlands, France and Italy). It is important for directors to make themselves familiar with local law responsibilities.

ESG factors are shifting the focus from pure profit generation to encompass other considerations. Some jurisdictions have incorporated ESG rules in their regulations or governance codes, such as the Netherlands and Italy, and there are further developments under consideration at the EU level as well.

## Conflicts

- In most European jurisdictions, there is no separate legal concept of a group company in relation to directors' duties - directors owe duties to the company in respect of which they are appointed.
- It is usually possible for a single director to sit on multiple boards; but that invariably comes with a duty to avoid a conflict of interest. These conflicts can be difficult to manage in practice – especially in situations involving financial distress.
- These issues can be mitigated by:
  - Focus on an appropriate board composition and follow local jurisdiction best practice.
  - Boards and, as appropriate, directors themselves should seek independent advice, particularly when dealing with conflicts of interest.

## Managing a Global Group

- Deal with the complexities of having directors on different boards globally, and ensure directors understand the different regimes by:
  - Implementing robust governance systems.
  - Providing strong and clear policies coupled with training and compliance.
  - Seeking advice from local counsel and group legal departments.
- In the event of a claim involving multiple jurisdictions, it is not always obvious which standards apply or which court would have jurisdiction – ultimately it will depend on the specific circumstances and type of action filed. Don't assume!
- Each country's conflict of law and conflict of jurisdiction rules as well as international treaties will determine what applies to a claim.



## Shareholder Liability

- Governance, including in respect of managing subsidiary boards, could increase the risks of the corporate veil being pierced / lifted:
  - In most jurisdictions courts may only look beyond the company's separate personality in limited circumstances. Each company is considered to have separate and distinct legal identities.
  - But it remains a risk, and the way subsidiaries are managed can increase that risk. Proper governance and structures are important.
  - Consider the position in Italy, for example, where shareholders may be liable where they “direct and coordinate” other companies acting in their own or in other parties’ interests.
  - Consider the development of economic torts in England, where a parent company could, under certain circumstances, find itself liable for unlawful interference with contract if it orders a subsidiary/group company to breach it.

## Shareholder Liability

- Mitigate shareholder liability by:
  - Respecting the corporate structure - thoroughly justified resolutions for the particular company concerned and independent, fair opinions.
  - Consideration of the economic interdependence between companies in the same group.
  - Robust corporate governance rules and internal control systems

# Insolvency

- In some jurisdictions – UK, Netherlands, France and Belgium for example – the duties of directors will shift in favour of the creditors of the company.
- Directors will also be subject to additional statutory and fiduciary duties.
- Directors can incur personal liability and be subject to criminal sanction if they fail to act in accordance with their duties.
- Requirement for directors to file for insolvency proceedings within certain time periods.
- It varies! In Germany, for example, the relevant period is within 21 days of a company becoming insolvent. In France, the relevant time period is 45 days. Know the local rules.
- Meeting of shareholders sometimes required if the net asset value falls below certain thresholds.
- Personal liability for unpaid taxes in some jurisdictions.

## Actions Against Directors

- Most European jurisdictions permit:
  - the Company itself to sue directors for breach of duty or law;
  - creditors to sue directors, de facto directors or shadow directors;
  - bankruptcy trustees to sue for any deficit in the bankruptcy estate;
  - third parties to bring claims for misleading statements; and
  - tax authorities, social security administrators and pension funds to sue for unpaid taxes and contributions.
- In the UK, shareholders can bring derivative claims on behalf of the company. In other jurisdictions, shareholders can bring claims directly in certain situations.
- Civil and criminal sanctions for directors.

## Actions Against Directors

- The applicable standards for these claims vary between jurisdictions – usually there is a requirement of breach of duty, negligence or contractual breach. In other instances there is a requirement for fraud, gross error/negligence or wrongful trading.
- Rise in litigation funding, increased regulation and broadening of stakeholders (consider ESG), facilitation of class actions and economic and political instability all combined make for fertile ground for disputes.
- Consider recent German court decision: secondary burden of proof regarding involvement of top management.
- Landscape constantly changing – for example, new German legislation (Corporate Sanctions Act) envisaged with fines of up to 10% of group turnover.
- Consider compliance and ensure internal decision-making is properly documented.

## D&O

- When obtaining D&O policies, review terms carefully to ensure it is as protective as possible. Ensure adequate protection in the event of financial distress (and all relevant insolvency proceedings catered for) and consider D&O protection for resigned directors.
- If you are a director, familiarize yourself with what cover is in place.
- Ensure compliance with policy terms and conditions – note obligation to notify promptly if a potential claim.

## Closing thoughts

- Be aware of your main obligations, and the consequences of failing to comply with them, in each jurisdiction in which you are appointed.
- Respect your role; remember duty owed to the specific company, not a parent.
- Monitor the financial performance of the company and its business.
- Ensure that you adopt decisions based on relevant information and seek expert advice where necessary.
- Be mindful of potential conflicts.
- Consider the impact of group decisions on relevant local subsidiaries.

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