BOARD MEMBERS' LIABILITY FOR DAMAGES

BY

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I. COMPANY BOARD LIABILITY IN SCANDINAVIAN LAW

1. INTRODUCTION. THE INTERRELATIONSHIP BETWEEN THE ASSIGNMENT AND THE LIABILITY OF THE BOARD. THE TWO-TIER SYSTEM

The scope and strictness of liability in performing particular duties is determined by and large by what may reasonably be demanded from a person performing such duties in the light of statutory provisions and good business practices. Liability for board members under Scandinavian law may conveniently be described as a liability for fault. In this Scandinavian law coincides with the laws of most other Western countries.

Liability for fault of a person entrusted with a particular assignment entails liability for the wilful or negligent failure to fulfil the duties connected with that assignment. Consequently, the liability of board members of a limited public or private company who are not at the same time executive directors, depends on what the law demands from a board member. A study of the liability of management involves, *inter alia*, an analysis of the consequences in terms of duties and liabilities of the division of the company's management into two separate organs—the executive director(s) and the board such as prescribed in Scandinavian law as well as in the company law of several other countries.

In England and in other common law countries liability for directors is usually discussed as a singular issue, without taking note of the fact that full-time executive directors, on the one hand, and part-time outside directors, on the other, cannot have the same familiarity with and insight into the operation of the company, even though they are members of the same board. Also in countries where a two-tier system is adopted, the liability of executive director(s) and board members is usually treated as one common problem. The bipartition of a company's management is particularly distinct and consequent in German law.[1] Nevertheless the provision of the German Companies Act (Aktiengesetz or AktG) on liability for members of the "Aufsichtsrat" is a simple reference to the provisions on the liability of the "Vorstand".[2] Likewise the Nordic Companies Acts make board members and executive directors, as well as promotors, inspectors and auditors subject to the same liability rule,

[1] In Germany no one may at the same time be a member of the "Aufsichtsrat" and of the "Vorstand". Cf. sec. 105 of the German Companies Act.
[2] Cf. secs. 116 and 93 of the German Companies Act.

i.e. fault liability. The necessary differentiation is obtained by the flexibility of fault liability when applied to the varying duties connected with the various assignments and positions. Clearly the objective element of the rule of fault (the unlawfulness) varies according to the persons and situations involved. Nor is the subjective element of the rule (wilful or negligent conduct) constant. The Companies Act states that shareholders are liable only for wilful or grossly negligent conduct, cf. no. 3.6 below. As demonstrated in the following analysis, especially nos. 4 and 7, also the liability of board members displays considerable variations from the traditional liability for fault.

Most major Danish companies maintain a clear distinction between the board and the executive directors. A complete prohibition against double roles, however, is only prescribed in Denmark for banks.[3] As for other limited public companies, secs. 51 and 56 of the Companies Act merely prescribe that a majority of the board and the chairman of the board may not at the same time be executive directors of the company. Without any compelling reason the provisions of the Companies Act have been repeated in the Private Companies Act (secs. 31(4) and 38(1)). The Companies Acts of the other Nordic countries merely prescribe that the chairman of the board must not be an executive director. The Danish Companies Act does not preclude a board chairman from acting as a "working chairman", even though this role may involve participation in meetings of the executive directors and, to some extent, in their work in general.

A board member who also participates in day-to-day management of the company has the same liability as other persons performing corresponding duties within the daily management. Should the board entrust one of its members to act as a "commissioner" or as "working chairman", or should a board member even without a formal authorization actually perform also the duties of an executive director, he becomes liable as such. An actual performance which goes beyond the formal position and the designation of the position results in a corresponding expansion of the scope of liability.

The Danish courts have in line herewith held a factual director responsible, particularly in cases regarding failure to pay income tax withheld from employees. A person who, for all practical purposes, acts as an executive director is not exempted from liability for withheld taxes not being paid to the Internal Revenue Service, merely because he is registered with the Limited Companies Registry as a board member, or because he is not formally appointed as an executive director but e.g. as office manager, secretary, or the like, or because there has not even been any designation of his position.

Under the Withholding Tax Act (sec. 69) a person who does not fulfil his obligation to withhold tax becomes liable for the missing amount, "unless he proves that he is not guilty of any negligence in adhering to the provisions" of the

[3] Cf. sec. 17 of the Bank and Savings Associations Act.

Withholding Tax Act. The reversal of the burden of proof prescribed in this provision has not resulted in a particularly strict course in practice. A person whose position or assignment does not include the running of day-to-day business is normally not liable under sec. 69.

2. THE DUTIES AS A MEMBER OF THE BOARD AND AS AN EXECUTIVE DIRECTOR UNDER THE TWO-TIER MANAGEMENT SYSTEM

2.1. A study of the Danish legislation on limited companies and of the *travaux préparatoires*, starting with the first Danish Companies Act of 1917 and continuing through the second Act of 1930 to the third, current Act of 1973, reveals that there has been an evolution in the perception of a supervisory board from being the organ which actually runs the company into an organ whose duties are communications with the shareholders, policy-making and decisions on fundamental issues, including hiring and firing of executive directors.

The duty of an executive director is to guide the day-to-day operations and activities of the company. He must comply with the guidelines adopted by the board. Any transaction which is of an unusual nature or of major significance seen in the light of the situation of the company must be submitted to the board.[4] The directors shall ensure that the company's book-keeping is conducted in compliance with statutory provisions, and that the company's assets are administered in a proper manner (sec. 54(3)).

The duties of the board as described in the Companies Act consist in directing the management of the company's affairs together with the executive directors, arranging for a proper organization of the company's business, and seeing to it that book-keeping and the administration of property is supervised in a manner satisfactory according to the situation of the company (sec. 54(1) and (3)). The description given by the Companies Act of the duties of the board and of executive directors is not very precise. The situation of each and every company varies widely in line with the particular company's size, line of business, organization, and tradition, and the Companies Act aims at giving the individual company a considerable degree of liberty to arrange its affairs as it sees fit. It is not possible—and it is unwise to attempt—within the brief wording of a statutory provision to regulate all aspects of the operation of a business enterprise. Nowadays it is seen as the main duties of the board to appoint the executive director(s) and to work out—in cooperation with the executive director(s)—the fundamental policies of the company. The nature and scope of the duties of a board member resemble more the assignment as a

[4] Cf. sec. 54(2) and the cases reported in 1937 UfR 198 Ø and 1981 UfR 973 H.

board member of an association, or a fund, or as a member of a municipal board, than the assignment as an executive director or another managing position in a business company. The part of a board member's activity on behalf of the company which is immediately ascertainable consists in participation in meetings of the board. Furthermore, a board member must sign the annual accounts, and other fundamental documents regarding the company such as share certificates (sec. 21(3)), lists of subscription (sec. 34), and notifications to the Limited Companies Registry (secs. 155(2) and 156).

2.2. The two-tier system, the value of having in business enterprises "supervisory" boards different and separated from day-to-day top management (the executive director(s)), has in recent years been widely debated in several countries. The supervisory board must be composed of persons who have their main duties elsewhere and its members are, therefore, only able to make a limited contribution to the operations of the company. Is it an advantage to have a board of outsiders placed in the hierarchy between the shareholders and the executive directors? Is such a board in a position to make a significant contribution? What is the natural field for the board—supervision of management or policy-making?

The typical member of the board of a major Danish company is a person who has a main occupation elsewhere and whose background in terms of professional knowledge and skills falls outside the company's line of business. Usually board members of these companies are not themselves major shareholders of the company and they do not represent major shareholders.

The trend in our time is not towards a unified management consisting of full-time directors only. The belief in the value of a two-tier management system seems to be growing. The Scandinavian Companies Acts are all based on the two-tier system. The 5th EEC draft directive on the structure of limited companies and on the rights and duties of their organs is based upon the two-tier system.[5] Also in the United States the importance and advantages of major companies having a number of independent outside directors have been emphasized in the discussion on social responsibility or accountability in recent years. The two-tier system is prescribed by the German Companies Act (AktG) and in several German-inspired Acts in other countries. Under French law, companies have the possibility to choose a two-tier management.[6]

The term supervisory board (a translation from the German "Aufsichtsrat") is not a good indication of the functions that a board can and should have in an optimal two-tier organization.[7] The board should work on company

[5] EC-document COM(83)185, final, 1983.08.12.
[6] Cf. art. 118 of the 1966 Loi sur les Sociétés Commerciales.
[7] It should be noted that the word *Aufsichtsrat*, or the equivalents in their respective languages, is not used in Scandinavia, Switzerland or the Netherlands. "Governing board" would here be a

policies and general planning. The board should help the executive directors by giving them opportunities to discuss the problems of the company in complete confidence with a group of people representing different professional expertise and experiences and having a positive attitude to the company. The board should open the door for a broader societal view and evaluation of the company and bring in inspiration and knowledge from the outside world. Unwise, unacceptable, as well as illegal practices should be stopped by the board. In difficult situations the board acting alone can enforce its will. Were there no board, but only the general meeting, an executive director—or directors—would be supreme within the company and with that, as for major companies, would exercise a very substantial influence upon society. Political power operates through a constitutional legal system of checks and balances. The two-tier system provides the checks and balances of company law. The chairman of the board and the chief executive should present a dual leadership. The importance of a two-tier organization should not be underestimated.

An independent board can and should ensure that major companies do business in a way which is useful and acceptable, also when assessed from a general social point of view. In the long run accepting corporate social responsibility is in the best interest of all, including the company itself. It is for the board to ensure the legality as well as the propriety of the company's business.[8]

The emphasis in earlier days was more in accordance with the term supervisory board. Supervising the book-keeping and checking the annual accounts as well as the presence of the assets were said to be among the main duties of the board. Nowadays boards may normally rely upon the auditor's official report on the annual accounts and on his supplementary confidential messages to the board regarding entries in the audit report (secs. 88–92 of the Companies Act), cf. no. 8.1 below as far as book-keeping, the existence of assets and the correctness and general legality of the annual accounts are concerned.

3. SCANDINAVIAN LEGISLATION ON BOARD MEMBERS' LIABILITY

3.1. *The Current Companies Acts*

The Companies Acts of the Nordic countries were all adopted during the 1970s, based on proposals drafted by cooperating law commissions in the

more apt translation. — The functions of the "Verwaltungsrat" in Switzerland has recently been described as "Oberleitung", cf. a Company Law Revision Report of February 23, 1983 (a summary is to be found in *Schweizerische Aktiengesellschaft* 1983, pp. 117–23).

[8] The ties between function and structure are discussed, *inter alia*, by G. Teubner in *Zeitschrift für Unternehmens- und Gesellschaftsrecht* 1983, pp. 34–56.

various countries. The Acts all contain a chapter regulating the liability of promoters, shareholders, board members, executive directors, auditors and inspectors. The statutory texts are similar, but not identical.

In this context it should be noted that private limited companies such as the German GmbH and the French SARL are known only in Denmark and were introduced in 1973 in connection with Denmark's joining the EC. The idea of introducing a particular legal framework for minor and closed companies has not won support in the other Nordic countries. The provisions of the Danish Act on Private Companies on liability are identical word for word with those of the Danish Companies Act.

Nordic cooperation on harmonization in the field of company law started in 1964. At that time a Danish law commission had finished its work on a draft proposal for a new company Act (Law Revision Report no. 362/1964). The version based on the Nordic cooperative efforts was published in 1969 (Law Revision Report no. 540/1969). The current Danish Act came into force on January 1, 1974.

3.2. *Fault Liability in Statutory Form*

The liability for board members, promoters, etc., enacted in the Nordic Acts is based on fault (*culpa, Schuld, faute*). Fault as a legal concept is generally defined as wilful or negligent improper conduct. Fault is seen as a general basis for liability in Danish law, and the statutory provisions proposed in the 1964 and the 1969 Law Revision Reports prescribing a fault liability for the board and managers of a company were seen merely as codifications of current law in this area. The Companies Act Commission hoped that giving the statute form to fault liability in the Companies Act would have a useful pedagogic and preventive effect.

Unfortunately, the codification of fault liability in the Companies Act has not provided any clarification regarding board liability. Not only is the concept of fault as flexible and vague as it has ever been when applied in the field of company law, but the codification of fault liability in sec. 140 of the Danish Act has introduced different liability rules for damage inflicted upon the company and for damage caused to third parties, a distinction adopted from the prior Swedish statutes. This distinction is incompatible with the Danish tradition of seeing the rule of fault as a general rule of liability. The distinction was deleted in the Norwegian Companies Act (sec. 15-1), and it ought to have been deleted in the Danish Act also. The background to, and the relevance of, the distinction in sec. 140 between damage to the company and to third parties is dealt with below in nos. 3.4 and 3.5.

The types of damage caused by managerial faults and errors committed by the directors of a company consist usually in general financial damage and only rarely in personal injury or damage to goods. However, the concept of fault has a clearer meaning within the original scope of *lex Aquilia* (*damnum corpore corpori datum*) than it has in other areas. Also in modern legal systems an important distinction exists between liability for infringements of the human body and the integrity of goods, on the one hand, and liability for infringements of another nature, on the other hand. It is still meaningful to look to the customary behaviour and opinions of a *bonus pater* as a starting point when dealing with liability for personal injury and damage to goods occurring in everyday life, whereas a *bonus pater*—or even a person with some kind of expertise—is unable to draw a clear line between proper and improper conduct when it comes to situations of a special and complicated nature. The idea that the courts may determine liability under the rule of fault by means of a balancing of damage and utility constituted the main substance of the early doctrine of Nordic jurisprudence on wrongfulness/illegality and is also found elsewhere, e.g. in Restatement Torts 2d, art. 291, on the balancing of risk and utility. That this idea is of practical value only in relation to personal injury and damage to goods, was spelled out in various writings by those outstanding jurists, *Ussing* of Denmark and *Karlgren* of Sweden. According to them, it is not possible in advance to exclude any kind of risk and of utility from the balancing of interests. Indications of the relative weight of risks can only be vague. It would seem, however, that in fixing the limit of a board's liability the risk of physical damage to a third party must be given greater weight than his credit risk, which again carries greater weight than a business risk for the company itself. Nonetheless, *Ussing*, just as other Danish legal writers, saw the rule of fault as a general rule of liability, i.e. a rule of general applicability.[9]

The basis for a general rule of fault lies in sympathy for the demand that honest and proper behaviour be exercised. The rule is necessarily vague because of the difficulties of substance and language involved in expressing more precise and graduated liability rules in the lapidary style of a statutory text, which would cover in an adequate way the differing conditions in various companies as well as different factual situations. An attempt has, however, been made to limit the liability of shareholders to cases of wilful and grossly negligent actions only (sec. 142). However, in the view of the present author, this is hardly a successful innovation and is unlikely to make an impact on case law.

[9] Cf. Ussing in *Erstatningsret*, 1937, pp. 26 and 34 ff., and in *Retstridighed*, 1949, pp. 23 ff. and 46 ff., Karlgren in *SvJT* 1938, pp. 361 ff. There seems to be accordance between the notion of a general duty of care as suggested in the debate around the already famous English decision *Junior Books Ltd.* v. *Veitchi & Co. Ltd.* (1982) 3 W.L.R. 477 and the general principle of fault liability under Danish law.

Ussing did not outline any general criteria besides the general concept of fault on the basis of which one could delimit liability for infringements of a non-physical nature but evolved special rules for a number of typical cases. The background to such special rules is, however, akin to the substance of the rule of fault in its central area, being based on similar general patterns of reasoning, such as a balancing of opposing interests and an assessment of equity, a cost benefit analysis. Non-physical infringements encompass damage of a very varied nature, and assessing equity and balancing interests often include elements other than the immediate risk and utility. In spite of this there is no distinct difference between the substance and function of the rule of fault when applied to personal injury and damage to goods and general liability rules applied to damage of a different nature.[10] The application of rules akin to the rule of fault on infringements of a non-physical nature does, however, lead to varying results, results which are sometimes more realistically described by means of a sophisticated vocabulary rather than by a mere reference to the standard concept of fault. In some cases it is, e.g., more appropriate to speak of liability for disloyal or dishonest conduct or liability for conduct violating what is considered to be good business practice in the field, whereas the legal position in other cases, *inter alia* cases involving personal injury and damage to goods, can more usefully be described by means of the traditional concept of fault. In no. 6 below an attempt is made to clarify and elaborate the rule on board liability by dividing the general rule of fault into three rules with a more limited scope and more precise contents.

3.3. *Basic Characteristics of Fault Liability in Nordic Company Law*

As indicated above, the Nordic Companies Acts have subscribed to the idea of the general applicability of fault liability by making fault liability as stated in secs. 140 and 141 of the Danish Companies Act applicable to promoters, board members, executive directors, auditors, and inspectors, persons whose duties are clearly very different. This leaves the courts with a good deal of discretion on account of the flexibility—or vagueness—of that rule. The general applicability of fault liability does, however, entail the following consequences:

(1) Fault liability for the categories enumerated in secs. 140 and 141 depends upon the individual circumstances in the exercise of their duties.
(2) What constitutes fault (improper conduct or negligence) depends upon the demands, posed by the Companies Act and other sources of law, on those exercising their various duties, as well as upon the actual knowledge of the

[10] Cf. Gomard, *Forholdet mellem erstatningsregler i og uden for kontraktsforhold*, Copenhagen 1958, pp. 192 ff.

person in question and his opportunities for acquiring knowledge of the situation of the company and other circumstances relevant to the damage involved.

(3) Liability rests with the individual. It is for the injured party to prove the existence of individual fault. Board members are not liable for the faults of others—e.g. for executive directors and auditors—nor does the liability extend to joint liability or fault liability with a reversed onus of proof. Board members who cannot be presumed to have had any knowledge of the actions of management proper are normally free from liability.

3.4. *Deviations from Fault Liability in the Scandinavian Companies Acts?*

3.4.1. The Basic Problem

It is strange that the Company Law Commission, which only intended to codify the general rule of fault, neither in its 1964 nor in its 1969 Law Revision Report phrased the liability rules in accordance with this intention. In the 1964 draft their applicability was limited without any explanation being given, and in the 1969 draft the substance of the rule of fault was changed. In order to clarify the liability of the board under current law it is necessary to investigate why the fault liability rule in the drafts, as well as in the final Act, is subject to limitations and changes, and whether this has any effect on the current law in the field.

3.4.2. The Liability Rule of the 1964 Law Revision Report

According to the 1964 draft proposal of the Company Law Commission, members of the board, among others, "of a limited company are liable under the general rules of law for any loss which they have inflicted upon, or participated in inflicting upon, the company through actions or omissions contrary to their obligations". Although the Commission, in proposing this phrasing of the liability rule, aimed at nothing but codifying the traditional fault rule within this particular area, the Commission does not explain why it has chosen a wording that refers *only to losses inflicted upon the company* and not to losses inflicted upon third parties, individual shareholders, creditors, and others. It was of course known to the Commission that from time to time also minority shareholders and suppliers have brought actions for damages against board members and obtained redress. The Commission felt a need to emphasize the liability of the board. Such a need, however, appears to be greater in relation to minority shareholders and creditors than in relation to the company as such. The reason why the 1964 Law Revision Report of the Commission put forward the restrictive wording just quoted seems to be that the wording proposed was actually nothing but a copy of provisions on the liability of members of the board found in the then current Bank and Savings Associations Act.

Consequently, it is relevant to investigate the origin of the wording of the liability rule to be found in the Bank and Savings Associations Acts at that time.[11] The liability rule stems from the first Danish Savings Associations Act.[12] It appears from the original draft of this Act that the rule of fault was at that time considered self-evident and that a codification in specific areas, such as e.g. the exercise of the duties as a board member of a Savings Association, was superfluous: "It furthermore goes without saying that board members are subject to liability under the general statutory rules for any loss which they may inflict upon the association wilfully or by violating their obligations."[13] The reason why the rule nonetheless was codified was a desire to emphasize that savers were guaranteed against any loss, should the Savings Association become insolvent owing to inefficient administration. Consequently, it was meaningful for the drafters to mention losses inflicted upon the association. The intention underlying the rule appears to have been underlined also by the Savings Associations Act of October 4, 1919, where the term "the association" was amended to "the association or the savers", but this expansion of the text was due to the 1919 Act containing a joint provision on liability and punishment. The Savings Associations Act of May 11, 1937, has again split up the provisions on liability and on punishment, and the liability rule refers only to loss inflicted upon the Savings Association. Several Danish academics (Sindballe, Eken, and Hartvig Jacobsen) are of the opinion that the liability rule of the Savings Associations Act does not exclude a liability to others.

Also in the view of the present author it is obvious that a statutory rule spelling out a specific form of liability does not restrict the applicability of general rules of liability. It seems, however, strange and unpractical that board members and others must resort to legal writings in order to learn that the liability of the board to others than the company is not limited by the antithetical conclusion which most readers would naturally draw from the Act.

3.4.3. The Liability Rule of the 1969 Law Revision Report and the Companies Act

Apart from a few purely drafting changes the liability rule of the Companies Act adopted is identical with the proposal of the 1969 Law Revision Report. The provisions of sec. 140 distinguish as to whether the injured party is the company or a third party. Board members and directors are liable for any injury which they have wilfully or negligently caused *the company* in performing

[11] The current joint Bank and Savings Associations Act (Act no. 199 of April 2, 1974) contains no rule of liability.

[12] Act no. 64 of May 20, 1880.

[13] Cf. Parliamentary proceedings 1878/79, appendix B, column 513.

their duties, including the valuation of capital assets taken over in connection with the formation of the company or in connection with an increase in its capital. This is tantamount to a general liability of fault. Where the injury has been caused *shareholders, the creditors of the company*, or *any other third party*, the same rule applies "but only where injury has been caused by an infringement of the Companies Act or the company's articles of association". According to the 1969 Law Revision Report this rule is supposed to be "in conformity with the provision of the 1964 draft" (which as mentioned above only dealt with injury inflicted upon the company). Apparently the Commission was not aware that its proposal, in splitting the liability rule into two provisions, following earlier Swedish statutes, and in limiting the liability towards third parties to infringements of the provisions of the Companies Act and of the company's articles of association, deviated from the Danish tradition that the rule of fault has general applicability. The Commission also deviated from its own basic position, namely that the rules of the Companies Act on the liability of board members and executive directors are but a codification of already existing law. In the government's commentaries accompanying the Bill, it is said that the provisions of sec. 140 "do not introduce a special liability rule in this area but merely contain a reference to the general Danish law of liability",[14] and the legislature presumably intended to establish the normal rule of fault as the general liability rule in limited companies, as do also sec. 15-1 of the Norwegian Companies Act and art. 244 of the French loi sur les Sociétés Commerciales. The actual wording, however, of sec. 140 of the Danish Act limiting liability to "infringement of the provisions of the Companies Act or of the company's articles of association", is incompatible with the rule of fault liability. Faults may occur which would entail liability under the general rule of fault but which constitute an infringement neither of the Companies Act nor of the articles of association. Strangely enough, the limitation of liability to the infringements mentioned in sec. 140 could have fitted the rule on liability for damage to the company, because the Companies Act in sec. 54 contains a general clause that the board members and the executive directors, each in their sphere, shall direct the company's affairs in an appropriate manner. Any inappropriate action or omission by the board in performing its duties which inflicts an injury upon the company, may therefore be said to constitute a violation of the Companies Act. One of the conditions of proper management is adherence to current legislation, including sec. 54 of the Companies Act, and any violation thereof will result in liability, provided other liability conditions, causation, etc., are fulfilled. The Companies Act does not contain a corresponding explicit or implied rule to the effect that management is obliged not

[14] Cf. *FT* 1972/73, appendix A, column 4541.

to inflict any injury upon third parties, e.g. by letting the company continue to receive goods and services on a credit basis although unable to pay for them, or by exploiting their special information as insiders when engaging in share transactions. Situations of this nature must be decided on the basis of general fault liability, also after the Act of 1973 has become effective. The liability of management to third parties cannot be limited to situations involving a violation of the Companies Act or the articles of association. During the debate on the equivalent Norwegian Bill, which is identical to the Danish Bill and to the older Swedish statute, attention was drawn to the fact that the wording of the Bills was too narrow. The Norwegian government pointed out that violations of the Companies Act or the articles of association would not always *per se* lead to liability and the government furthermore found it inequitable to introduce a distinction between such violations, on the one hand, and actions entailing liability under general liability rules, on the other hand (thereby referring primarily to the rule of fault). The Norwegian Companies Act as adopted is in conformity with the government's proposal and contains (sec. 15-1) a general rule of fault.

3.5. *Interpretation and Background of the Limitation of Liability of Sec. 140*

Under Swedish law, liability in tort (i.e. non-contractual liability) for general pecuniary damage as a general rule is limited to damage caused by criminal conduct. Under Danish and Norwegian law, the general rule of fault liability is applicable also to general pecuniary damage. Consequently, a statutory provision which aims at expanding the liability of management to include non-criminal violation of the Companies Act and the articles of association is meaningful in Sweden. It is meaningless in Denmark and Norway. The realization of this fact led to the amendments of the Bill adopted as the Companies Act in Norway, whereas in Denmark the liability rule in sec. 140 was adopted as proposed by the Commission. Nevertheless, in Denmark courts will undoubtedly adhere to the previous law and grant damages on the basis of the rule of fault, be it in relation to companies or in any other relation. In so doing, the courts may *either* invoke the fact that inclusion of the words "infringements of the Companies Act or the articles of association" in sec. 140 of the Danish Act was a mistake of such an obvious nature that courts are justified in correcting it; *or*, as is more likely, the courts may hold that sec. 140 has not changed the general law on fault liability, which remains applicable throughout the field of company law.

3.6. *The Term "Infringement of the Companies Act or the Articles of Association" in Other Provisions of the Act. The Liability of Shareholders: Sec. 142*

The term "infringement of the Companies Act or the articles of association" is found not only in the codification of the rule of fault in sec. 140; it has also been used in certain other provisions of the Companies Act, e.g. secs. 63 and 142. These provisions, too, should, and may, be construed in order to avoid the antithetical conclusion to which this wording invites.

Under sec. 142 a shareholder is liable for losses caused the company, other shareholders, or third parties, only if he *wilfully or grossly negligently violates the Companies Act or the company's articles of association.* The wording of sec. 142 corresponds to secs. 208–210 of the former Swedish Companies Act of 1944 and it was part of the uniform Nordic proposals. Norway, however, adopted a text providing liability under the traditional rule of fault without the limitation to infringements of the Companies Act or the articles of association and without exclusion of ordinary negligence. In favour of the simple and clear Norwegian rule one may argue that the flexibility of the rule of fault affords sufficient opportunities for taking into account the difference in demands to be made upon board members and others performing duties within the company and the position of shareholders. The extent to which a shareholder can influence the company varies considerably in proportion to the number of shares which he holds and his actual participation, if any, in the management of the company. There is no reason to limit liability for a main shareholder who currently takes decisions regarding the operation of the company without being an executive director or a member of the supervisory board, as compared to management's liability under sec. 140. The interpretation of the more equivocal Swedish–Danish provision regarding shareholders (sec. 142) is difficult. As far as Danish law is concerned one must assume that a shareholder is liable for improper conduct or omissions other than those violating the Companies Act and the articles of association if he acts wilfully or grossly negligently. Under Swedish law, shareholders, like members of the board and executive directors outside the scope of sec. 142 (sec. 15(3) in the Swedish Act), can presumably be held liable only for criminal conduct as far as general pecuniary damage is concerned.

3.7. *Invalid Resolutions of General Meetings and of the Board: Sec. 63*

The Companies Act provides in sec. 63 that persons authorized to represent the company must not comply with resolutions passed by the company in general meeting or by other bodies of the company where such resolutions are *invalid as being contrary to the Companies Act or the company's articles of association.*

The words here italicized are peculiar. A resolution of an organ of the company may be invalid for reasons other than that the provisions of the Companies Act or the articles of association have been violated. As is generally acknowledged, fundamental principles of law state that persons in an inferior position are not obliged to obey illegal orders of their superiors, and that the subordinate complying with an illegal order is not, in general, exempt from liability for having carried out the ordered but illegal action. It seems very unlikely that the Commission, in drafting sec. 63, or anybody else, should have intended to subject the scope of these general legal principles to special limitations otherwise unknown within company law.

3.8. *Personal Liability for Breach of the Company's Contract*

The board, management and employees regularly make decisions on behalf of the company regarding the company's entering into, and performance of, contracts with other parties. The company as such is liable for contracts entered into by persons with proper authority being fulfilled in accordance with the provisions of the contracts. Neither board members and management nor the employees are personally liable for any breach of contract in relation to the other party to the contract, regardless of whether the breach involves fault under the law of contracts or some other ground for contractual liability. Naturally this does not mean that the board, the management or the employees are totally exempt from liability. Depending on the circumstances the company may have a right of recourse against them according to the rules discussed earlier on damage inflicted upon the company.

In relation to the injured third party, board members and employees of the company can become directly liable only if they have contributed to a breach of contract through conduct which may be said to constitute a delict in that relationship. Such a special delict exists where the conduct involved is dishonest or exposes the third party to direct physical danger, as e.g. through scamped work in undertaking a quality test of fundamental importance to product safety, or by direct unwarranted interference with the rights of a third party causing him damage.

The assessment of damages in cases where persons acting on behalf of the company are held personally liable for breach of a company contract has not been fully clarified in Danish law. The claim of the other party to the contract against the company will consist in performance in kind and/or damages for breach of contract. The liability of, e.g., management or an auditor may be construed either as joint liability for the claim against the company or as a liability for the loss suffered by the other party to the contract. Should a supplier or a lender suffer a loss because management has induced him to grant a credit to a company on the verge of bankruptcy, those responsible within management may—depending on the circumstances—be held jointly liable for payment of the invoice price of the credit granted with the addition of interest and costs. Should management have misled the other party to the contract through incorrect annual accounts or other financial statements which the auditor improperly has approved without any qualification, the auditor likewise will become responsible to the contracting party for his loss. In a 1982 judgment the Supreme Court held an auditor liable for a disappointed supplier's repurchasing cost and his commercial cost undertaken in vain, whereas the auditor's liability did not include the supplier's profit (1982 UfR 595). Apparently the Supreme Court considered the auditor's liability as a liability in tort and therefore assessed the damages as the value of the goods lost (i.e. the goods delivered) under general rules on damages in the law of tort. Since the profit of the supplier is established through the sale to the company, and since the auditor has been instrumental in bringing the sale about, it would appear more appropriate to impose liability for the full amount of the invoice upon the auditor. In so doing one would also avoid any difficulties stemming from different assessments of the damages in the final distribution of the entire burden of liability among the company and the persons liable.

3.9. *Mitigation of Damages under Sec. 143*

Damages to be paid by a board member, an executive director or an auditor liable under secs. 140–142 may be mitigated if and to the extent a reduction of the amount is found to be reasonable in the light of the degree of guilt, the extent of the damage, and other particular circumstances (sec. 143). In cases not covered by the restrictive wording of secs. 140–142 dealing only with liability towards third parties for infringements of the Companies Act or the articles of association, it would seem appropriate to base a mitigation of damages on an analogy from sec. 143. A general rule on mitigation of damages has been proposed in a 1978 Law Revision Report on parts of the law of tort.[15] Sec. 143, in accordance with that proposal, should be construed so that it is possible to reduce damages as well as to let them lapse completely. In Denmark liability of board members and executive directors is normally not covered through a liability insurance, cf. further no. 6.1 below. The issue whether liability may be modified is therefore particularly important in this field. The special question whether full liability should be upheld for less qualified board members is discussed in no. 12 below.

[15] The proposed mitigation rule is meant to be of general application: in particular circumstances especially to avoid hardship the victim's claim may be reduced. A similar provision is contained in the Swiss Code on Obligations, art. 43, and has been adopted recently in the other Scandinavian countries. In the Law Revision Report (no. 829/1978 at p. 32) the mitigation rule is described as a "safety valve".

3.10. *Discharge of Liability and the Right to Bring an Action against Board Members*

The chapter of the Nordic Companies Acts on civil liability contains besides the substantive rules (secs. 140–143 of the Danish Act) also rules on discharge of liability and on the right to bring an action for damages against board and management (secs. 144 and 145). These rules concern only the liability to the company. It is for the general meeting to decide whether an action for damages should be brought by the company (sec. 144(1)). The ordinary yearly general meeting *may* pass a resolution on discharge (non-liability) for the board and the executive directors. Under sec. 9(5) of the *Swedish* Companies Act the ordinary general meeting *shall* pass a resolution on whether the members of the board and the executive director(s) are to be granted discharge.[16]

If a resolution of discharge is adopted by a general meeting against the objection of shareholders representing at least 1/10 of the share capital (regardless of the voting power of these minority shares), any shareholder may bring an action for damages claiming the damages to be paid to the company (sec. 144(3)). Such a derivative suit can be brought not only against members of the board and executive directors, but also against shareholders, auditors, etc., by any shareholder.

A shareholder can bring an action for damages as a derivative suit (i.e. claiming that damages be paid to the company) only if the issue of liability has been raised at a general meeting, be it on the basis of a proposal for discharge or to claim damages. This appears clearly from the Norwegian Companies Act, sec. 15-5, and the Danish Act should be construed in line herewith.

Under the *Swedish* Companies Act, an action for damages against management must be brought no later than one year after submission at a general meeting of the annual accounts for the financial year in which the particular decision or action to which the claim refers was taken; (cf. for further details sec. 15(5) (3) and (4)). This rule is natural in Sweden because as already mentioned the question of discharge must always be on the agenda for the annual general meeting in a Swedish company (cf. sec. 9(5) of the Swedish Companies Act). Under the *Danish* Act, shareholders have a time limit of six months to bring an action for damages to be paid to the company. The term is calculated from the adoption of the general meeting resolution on discharge or refusal to bring an action for damages which has opened the way to a derivative suit. If an inspection is involved the term is calculated from the moment the inspection is terminated.[17] There is no time limit under the

[16] Cf. art. 246 of the French Loi sur les Sociétés Commerciales, according to which the general meeting is prohibited from discharging management from liability.

[17] See sec. 145(1), which presumably means the time of holding the general meeting at which the report of the inspectors is submitted (cf. sec. 95(4)).

Companies Act for the company's bringing an action for damages against management. This situation is governed only by the general rules on limitation and the general principle of passivity.

The provisions of sec. 144 of the Companies Act on actions for damages in spite of a resolution on discharge and of sec. 145 regarding time limits for bringing actions apply only to liability to the company but not to liability to individual shareholders, to creditors or other third parties. An individual shareholder or creditor may demand compensation for his loss through damages paid to himself, unless he must be considered to have received full compensation for his loss through damages paid to the company or the company's estate. The possibility of making such claims is not affected by a resolution on discharge, and there are no special time limits within which an action must be brought. This claim also is subject only to the ordinary statutory provisions of limitation and the general principle of passivity. The rule in sec. 144 is of particular importance in cases where the shareholder cannot succeed in a normal liability action because he cannot prove a personal loss.

3.11. *Criminal Liability*

Many violations of the Danish Companies Act are criminal offences. Sec. 161 of the Act makes it a criminal offence to contravene a great number of provisions of the Act, including the general and vague rule in sec. 54 on the functions and competence of the board and the executive directors. The penalty prescribed is a fine. Intentional as well as negligent offences are punishable. It has been found necessary to prescribe fines even where the substantive provision violated is a vague one, because some public intervention has been found essential and no sanction of a civil nature has been found feasible. Possibly as a repercussion of a judgment imposing a fine, settlements out of court may from time to time have been reached regarding the payment of damages.

II. PROBLEMS OF BOARD LIABILITY DISCUSSED AGAINST A SCANDINAVIAN BACKGROUND

4. THE DEMANDS ON AN EFFICIENT BOARD AND THE DELIMITATION OF FAULT LIABILITY

4.1. The provisions regarding the board's liability constitute minimum demands which board members must fulfil to keep clear of legal liability. In order to ensure that the rules on liability do not exercise an undesirable influence upon the way in which board members perform their duty, liability should not be so far-reaching that suitable persons would frequently refrain from accepting board assignments, or that board members would feel compelled to participate in day-to-day management and to exercise extensive but otherwise uncalled–for supervision of the operations of the company. The rules on liability should not become an incentive to board activity which would constitute a duplication of work or back-seat driving. On the other hand, it is equally undesirable that persons lacking the ability or the will to make an actual contribution to the work of the board, perceive the risk in accepting a board position as very small. Little or no liability could foster the idea that serving as a member of a board is a purely formal or ceremonial function.

4.2. It is of great importance to define the demands on an efficient or ideal board. This question is more important than and independent of the scope of liability. Drawing the line between conduct resulting in liability, on the one hand, and a contribution which is modest or amateurish but cannot be regarded as negligible, on the other, is a very different task from setting guidelines for excellent board work. As might be expected, the question of how a good board should work has been debated and analysed much more intensely than the question of liability. One common feature found in the wealth of books, articles and statements on the organization and management of companies is that a board must engage itself in the fundamental problems of the company: its organization, its general policies and strategy, and the choice of persons for the company's top management.

The board should, *inter alia*, debate matters of financing and profitability, product innovation, and marketing. It may also be necessary for the board to take up personnel policy—an area which the board members representing employees have been instrumental in bringing into focus in several boards. It is for the board to intervene should policies and strategies adopted not be adhered to by the executive director, or should these policies turn out to be inappropriate.

The board has a central role to play in the field of corporate social responsibility or accountability. Its members should be aware of society's present demands and those likely in the future and of their importance for the company and its line of business. The board should consider the most appropriate ways for the company to react to these demands. Taking societal interests into account in business decisions has been stressed as a task particularly incumbent upon the special government-appointed board member of banks, savings and loan associations, and credit institutions. The social responsibility of a company should, however, be a priority consideration for all board members of all companies. Exploiting all the opportunities which—for the time being—are legally exploitable is not always the best or wisest long-term policy.

The board should perform its duties in a constant dialogue with the executive directors. Board members and the executive directors should maintain a mutual communication which is as open, professionally engaged and stimulating as possible. The board, which hires and dismisses executive directors (sec. 51(1)), should give the directors satisfactory working conditions. This means that the board must accept the fact that the day-to-day management of the company is exercised by the executive directors under their independent responsibility. The board may intervene in current particular affairs, but should do so only in special circumstances. The board has no obligation to take up individual current matters which are not of an unusual nature (sec. 54(2)), even if this should be advocated by certain board members, company employees, shareholders, customers, or others, and even if a proposal to that effect is presented as a complaint against executive directors. The board is not obliged to serve as a general court of appeals against unpopular decisions by the executive directors and it should not engage in such a role.

This brief survey of the desirable activities of a board provides a basis for taking positions on two issues of importance to board liability. The provisions of sec. 54 of the Companies Act on the duties of the board and of the executive directors, which is a concoction of former rules and new ideas concerning the division of the roles between the two tiers, can and should be construed in accordance with modern views on efficient corporate organization.

(1) The board should include members who have an insight into management and business conditions in general, as well as an understanding of the interrelation between business and society. Expert knowledge regarding the company's particular line of business or other special areas is not in general required. Depending upon the circumstances it may, however, be useful if certain board members possess a certain expertise, e.g. that the board of a business in the chemical industry includes a chemist, or the board of a publishing company a writer. It has to be accepted that not all board members can have the general insight into business life which should be required from those who are occasionally called professional board members. The representation of the employees in the board can only operate successfully if the special contact which these members have with the daily work of the company and their insight into its personnel policy, is accepted by the other members of the board as valuable expertise. All board members, however, should have or should acquire an elementary knowledge of the structural framework and organization of limited companies in general in addition to an insight into the fundamental problems of their particular company.

(2) The demands regarding the qualifications of board members are essential to liability under a rule of fault. A board member is not subjected to liability for errors in day-to-day management or for lack of technical expertise.

4.3. The reference to the general concept of fault in the Companies Act does not in itself constitute a clear delimitation of the obligations of the board and the zeal with which these obligations should be performed. The rule of fault points to traditional conduct and the opinion of reasonable citizens as a yardstick for what is permissible in the sense that it does not entail liability. A comparison with what is now generally expected from a sensible board member leads only in rather obvious cases to acceptable solutions.[18] In situations closer to the borderline between liability and freedom from liability, a comparison with a *bonus pater* does not normally provide any useful guidance in deciding whether a board member should be held liable or not. It is not possible to give a precise definition of a *bonus socius*, and, more important, not all performances on the board which are less than "satisfactory" entail liability. There is a considerable gap between a valuable contribution and a contribution which just barely escapes liability. The gap is so wide that the rule of fault cannot be said to be fully adhered to.

As the standards for satisfactory work in the board and the ambit of liability are not congruent, an independent analysis of the liability which is incumbent upon board members under current law is necessary. In the debate on what tasks an informed and conscientious company board should undertake and how intensive and qualified a contribution the members of the board should make, the delimitation of liability is relevant only as background information that points out a much too modest minimum.

5. A SURVEY OF DANISH EXPERIENCE REGARDING THE LIABILITY OF BOARD MEMBERS

5.1. Danish law reports do not contain many cases on board liability, and the number of unreported cases is also believed to be small. It does happen that boards recognize liability voluntarily without an action being brought, or with the result that an action brought is withdrawn before judgment. This, however, is a rare phenomenon. In the other Nordic countries cases and judgments regarding board liability are likewise rare. The commentaries on the German Companies Act indicate that in this area Germany, too, can point to only a few reported judgments. The number of cases in the United States—particularly

[18] Cf., e.g., the 1955 and 1962 Supreme Court decisions (1955 UfR 1004 H and 1962 UfR 452 H) discussed in nos. 9.2 and 11 below, respectively.

the number of derivative suits—seems to be much higher, even when the numbers are adjusted to take into account the size of that country.

There are several probable reasons why liability is not invoked more often against board members. It has been mentioned already *that* legal liability in only a small number of cases constitutes a suitable and equitable sanction against a board whose contribution has been inappropriate or insufficient, and *that* liability for negligent performance has been imposed on a board member only in cases where the member has been dishonest, has acted in an obviously unreasonable way, or has violated one of the board obligations explicitly defined by legislation. There may be additional reasons, e.g. *that* injured parties sometimes refrain from bringing an action because they feel a collegiate loyalty with the unfortunate responsible board member or because they wish to maintain valuable cooperation, *that* establishing the personal liability of a board member has no importance if that member is impecunious or if the losses suffered are excessive, *that* the liability—contrary to that of auditors and advocates—is not normally insured or covered in any other way, *that* one cannot always prove that damage has occurred as a consequence of a misdeed by the board, *that* the harm done cannot always be eliminated through a public trial and payment of damages, or *that* a criminal action is brought and the question whether the conduct of the board was appropriate or not is decided by the court under that case (cf. no. 3.11 above).

5.2. The liability actions which have actually been brought in Denmark against members of the board of limited companies—or of cooperative societies—have dealt mainly with

- loss stemming from embezzlement or fraud against the company committed by executive directors or employees in situations where the crime has been made possible, or facilitated, because the board has not exercised any control, even though—in most cases—certain factors indicated disorder in the company;
- loss stemming from the board having engaged in transactions for its own benefit or for the benefit of a group of shareholders, thereby violating the rights of the shareholders in general or the rights of the other shareholders (cf. secs. 63 and 80 of the Companies Act);
- loss stemming from transactions violating specific provisions of the Companies Act or of the articles approved by or known to the board, as, e.g., a decision to engage in an activity outside the purpose of the company (*ultra vires*) or to grant or tolerate loans to a shareholder in violation of sec. 115 of the Companies Act;
- loss suffered by customers, suppliers or creditors because the company with

the connivance of the board has received payment, supplies on credit, or loans in spite of serious economic difficulties or even an imminent bankruptcy, or loss suffered by creditors because the board has deliberately postponed suspension of payments in situations where payments should be suspended because of the company's insolvency and growing losses;

- loss stemming from purchase of shares at an unrealistic price or from the granting of credit or the continuation of credit through relying upon misleading annual accounts;
- loss inflicted upon creditors by incorrectly stating in the memorandum of association, or in a notification to the (public) Registry of Limited Companies, that the share capital has been paid up;
- loss inflicted upon the creditors through the collapse of a company which with only a modest amount of capital has optimistically embarked upon extensive projects. It should be added, however, that the courts in these cases have refused to grant creditors compensation for their loss by making the board personally liable.

Only a few of the cases reported, or unreported but publicly known, deal with *shareholders* claiming compensation from board members for infringement of their rights as shareholders or minority shareholders. The great majority of cases involve claims from creditors, either from individual creditors or from the company's insolvent estate in situations where the company has gone bankrupt or is being liquidated in some other way as an insolvent company. In no Danish case has a company or an individual shareholder claimed compensation from a board or from individual board members because, due to faulty leadership, the company has not done as well as it could and ought to have done, the company having, e.g., missed profitable business or operated with too heavy overheads. Nor has it occurred that the board of a company upon which fines or confiscation have been imposed for violations of public regulations has been faced with claims for compensation from individual shareholders or from the company as such for the loss suffered by the company. This reticence cannot be due to the generally accepted rule that a business assessment leading to infelicitous results does not *eo ipso* involve liability ("the business judgment rule"). This rule does not cover cases where profits are lost because of tangible faults.[19]

5.3. Judgments regarding the liability of executive directors are rare, rarer even than judgments regarding the liability of board members. This may be so

[19] A 1941 decision by the Admiralty and Commercial Court (1941 SHT 169) is out of step with other reported cases. The court held the board of a seed company liable because the company had engaged in catastrophic speculative shortselling without the board covering when prices began to rise.

because the liability of an executive director is obvious where the director himself has committed or ordered an illegal action involving damage, and because liability is irrelevant if the tortfeasor has no funds. The issue of liability of an executive director may, however, also arise in relation to a lack of supervision or insight into the business, or unjustified business transactions. These situations are not much at variance with the identical issues in relation to the board's liability, although the more intensive engagement in the business of an executive director does have a substantial bearing upon what conduct is to be considered as negligent.

6. THE UNITARY GENERAL RULE ON BOARD LIABILITY OF THE COMPANIES ACT MAY BE SPLIT INTO THREE SPECIAL RULES

The case law surveyed in no. 5 indicates that board liability is not a strict professional liability. The liability is milder and the reasons for this leniency seem to be *that* proper performance of the functions of a company board cannot in general be assessed on the basis of a strict rule of fault; *that* the assignment as a board member is normally a side-line activity taking only a limited amount of time; and *that* the direct contact with the company normally consists in participating in a limited number of meetings. This negative conclusion on board liability can be elaborated by reversing the issue and raising the question of under which circumstances board members should be—and have by the courts actually been—held liable. The preliminary conclusion that the liability of board members is a mild or lenient one in comparison with professional liability, can be supplemented (1) by a positive indication of the situations in which even a mild assessment will lead to the imposition of liability, and (2) by an indication of certain areas where the assessment is not a mild one. The fault liability as codified by the Companies Acts is as flexible as the fault liability in areas not covered by statute. This flexibility allows the courts to assess different types of board activities with different degrees of strictness.

On the basis, *inter alia*, of the survey of the case law in no. 5 above, the two positive questions raised may be answered in schematic fashion to the effect (1) *that* the milder assessment results in board members becoming liable if they (a) have acted dishonestly, cf. for further details nos. 7.1, 7.2 and 10 below, or (b) have not made the contribution which is required as a minimum obligation of a board member, cf. no. 11 below, and (2) *that* the assessment of liability under the rule of fault is not a particularly mild one where the board (c) has not fulfilled certain specifically defined duties of the board, cf. no. 8 below.

Under the traditional rule of fault, a person becomes liable if his conduct is less conscientious and diligent than that of a *bonus pater familias*. The liability for negligence is the same for everybody regardless of individual differences in willingness and ability to comply with this standard. In no. 12 below the question is discussed whether liability under modern law is or should be imposed upon every board member with identical strictness regardless of the extent of his insight into business. In this connection the importance of the rule of mitigation of damages in sec. 143 of the Companies Act is discussed.

7. LIABILITY FOR DISHONEST CONDUCT

7.1. *A General Rule on Liability for Dishonest Conduct*

The old 1866 Danish Criminal code provided that "anybody who has committed a criminal offence is liable to pay damages to the injured party" (sec. 300). This provision might in accordance with Swedish law have been taken as an indication that liability for general financial damage presupposes criminal conduct. The aim of sec. 300, however, was not to establish that any tortfeasor (as a minimum) is liable for all economic damage inflicted if the damaging act (or omission) is criminal under the Criminal Code. The provision only served as an introduction for the following provisions in secs. 301–303 on compensation for non-pecuniary (moral) personal injury. The 1930 Criminal Code reform substituted sec. 300 of the 1866 Criminal Code for sec. 15 of the Criminal Code Promulgation Act on compensation for non-pecuniary damage. Claims for damage of a moral or ideal nature are still limited to personal injury.

There has not existed, and there does not exist in current Danish legislation, any explicit provision to the effect that victims can always claim damages if the damage has been inflicted through an infringement of a serious criminal or gross nature. It does seem, however, that the courts should and actually do recognize a general standard on liability for dishonest conduct as a minimum. A person acting in a way which is dishonest or contrary to honest behaviour cannot nevertheless count on escaping liability. A standard on minimum liability is of practical significance, as a supplement to the rule of fault, in cases where this rule is particularly vague because the damage caused does not consist in physical personal injury or damage to goods, cf. no. 3.2 above.

A general rule of liability for damage caused by dishonest conduct is a natural counterpart to the original Unfair Contracts Clause in sec. 33 of the Contracts Act (1917) which prescribes that a promise is invalid if invoking it would be contrary to generally accepted standards of honesty. The new general clauses in sec. 1 of the Marketing Act (1974) and sec. 36 of the Contracts Act

(1975), among others, now provide an additional basis for such a liability rule. In view of these recent legislative developments, conduct (materially) at variance with established business practices should perhaps also entail liability.

The amendment to sec. 15 of the Criminal Code Promulgation Act introduced in 1972, under which not only "criminal" but any "wrongful" infringement of another person results in liability for any damage inflicted, including pain and suffering or other moral damage, corroborates the existence of a dishonesty rule. The 1972 legislative amendment should not be seen as the introduction of complete liability for fault, even *culpa levis*, in the area of moral damage. That would be going too far.

7.2. *Board Liability under the Dishonesty Rule*

Board members become liable under the dishonesty rule advocated in no. 7.1, if they have caused damage to the company, or to others, by a dishonest action or omission in performing their duties.

> The existence of a liability rule the substance of which is identical with or corresponds to the rule of sec. 33 of the Contracts Act on the invalidity of an unfair contract, may have been in the thoughts of the Supreme Court in a case from 1954 (1954 UfR 224 H). The Court found in favour of the board chairman of a shipyard against whom an action for damages had been brought by a shipowner claiming reimbursement of the keel instalment paid on a ship under construction at the shipyard. The claim for damages was rejected regardless of the fact that the chairman shortly before the shipyard went bankrupt had urged the shipowner to expedite payment of the instalment. The Court said that the chairman had not "engaged in any conduct which under general principles of law or under sec. 33 of the Contracts Act could involve an obligation" for him personally to reimburse the shipowner's loss. A later 1974 Supreme Court decision (1974 UfR 1005) dealt with a company constructing standard houses. The board believed the company to have overcome its liquidity problems, *inter alia* by converting debt to share capital, and appealed to the regular suppliers to continue granting the company normal credit when delivering building materials. Shortly thereafter the company had to close down due to insolvency. By a vote of 4 to 3 the Supreme Court held that, particularly in the light of various statements from the company auditor, the board had not "committed actions of such gravity as to make the individual members of the board personally liable".

A principle of liability for a person who has acted dishonestly or contrary to good business practices is in harmony with the case law on personal liability for credit granted to a company immediately prior to its bankruptcy. A board member is liable only if he should have understood that the company's bankruptcy was unavoidable and imminent so that creditors would necessarily suffer a loss from granting credit to the company, cf. further no. 10 below. It also seems appropriate that liability be imposed upon board members who approve or are aware of a transaction which clearly can be set aside in an *actio Pauliana*, for the amount of which the creditors have been deprived. This liability should be a joint liability together with the party who has been favoured by the transaction, cf. sec. 76 of the Bankruptcy Act. This problem does not seem to have been raised before the courts.[20]

The members of the board of a limited company also become liable if they engage in transactions which intend to give the board as such, some of its members, certain shareholders or other parties an unreasonable advantage at the expense of other shareholders, the company or its creditors. Several provisions in the Companies Act forbid such activities.[21]

The dividing line between dishonesty and incompetence or bad luck is clear. The board does not become liable for having approved business transactions which are unwise or turn out to involve a loss. Liability is not a suitable means for educating honest but unsuccessful businessmen.

8. SPECIFICALLY DEFINED DUTIES OF THE BOARD

Besides its main functions as a policy-maker and a brain trust, a board has certain duties of a more specific and tangible nature. The board's liability for performing these duties is not exhausted through a rule on liability for dishonest conduct as described above.

8.1. *The Annual Accounts and Auditing*

The board is obliged to report to the shareholders on the activities of the company at least once a year by submitting to an annual ordinary general meeting a report and draft annual accounts within half a year after the expiration of the financial year (sec. 69 of the Companies Act and sec. 2 of the Annual Accounts Act—an Act implementing the 4th EC Company Law directive). The board must verify that the annual accounts and supplementary financial information in the report have been audited by the company's

[20] French and Belgian law go further in the direction of making "les dirigeants" of a bankrupt company personally responsible. This "Konkursdurchgriff" has met with criticism in the EC negotiations on a bankruptcy convention, cf. references by J. Thieme in *RabelsZ* 1981, p. 472, note 64.

[21] Cf. in this connection, e.g., sec. 17 of the Companies Act on the principle of equal rights of shares; sec. 58 on the disqualification of board members, *inter alia* in matters "concerning agreements between the company and a third party or any legal action against a third party, if he (i.e. the board member) has a substantial interest therein that may be at variance with that of the company"; and finally secs. 63 and 80, which forbid the board and the general meeting to dispose in a manner which is "obviously aimed at securing for certain shareholders or others an undue advantage at the expense of other shareholders or of the company".

auditor(s) (secs. 89–92).[22] Special rules are given in a 1983 Executive Order regarding the Copenhagen Stock Exchange which obliges the board of a listed company to notify the Stock Exchange Commission immediately of the result of a financial year and of the proposed appropriation of the profit or treatment of the loss, as well as of other decisions of major relevance to the quotation of the shares. The boards of listed companies are furthermore subject to a directive of February 15, 1982 (82/121/EEC; implemented by Executive Order no. 526 of November 10, 1983), to the effect that such companies shall semi-annually publish a report giving information regarding the business.

The board may during the year report to shareholders at extraordinary general meetings, but the Companies Act does not oblige a board to do so unless a request for such a meeting is submitted by shareholders representing 10 % or more of the share capital, cf. sec. 70. The board of a company which has lost one half of its share capital shall outline the financial condition of the company and, if necessary, submit proposals on steps to be taken at a general meeting to be held within six months of the loss having occurred, cf. sec. 69(a) (implementing art. 17 of the 2nd EEC directive). Neither the said section of the Companies Act nor any other of its provisions indicate directly how closely the board must follow the activities of the company, cf. further no. 11 below. It seems that sec. 69(a) is being contravened, at least in cases where the board of a listed company which has not complied with the obligation to submit a semi-annual report, would have realized that one half of the share capital had been lost if it had requested and examined a draft semi-annual report.

The board shall, according to sec. 54(3) of the Companies Act, "ensure that the book-keeping and the administration of the property are controlled in a manner which is satisfactory according to the company's position". Boards may normally exercise their supervision of book-keeping and assets on the basis of the work of the auditor(s). The duties of the auditor are outlined in secs. 88–94. The board members are not obliged, either personally or through special representatives, to undertake any internal auditing or investigations. It is appropriate and advisable for the board to have personal contact with the auditor(s), e.g. by having the auditor(s) participate in the annual meeting of the board at which the annual accounts are debated and approved, but this is not mandatory under the Companies Act. The board shall, however, examine not only the draft annual report and accounts, and the auditor's report on the accounts, but also all entries in the auditor's report including any more

[22] No statutory provision, however, requires the board to ensure that the annual accounts approved by the general meeting are filed with the Registry of Companies (sec. 62 of the Annual Accounts Act and sec. 60(2) of the Companies Act), or—more important—must verify the contents of the company's income tax return or that this document is submitted to the Internal Revenue Service (the Companies Taxation Act, secs. 27–29).

detailed surveys of the year's auditing, cf. no. 2.2 above. The Companies Act ensures that board members make themselves familiar with the results of the auditor's work by demanding that the annual accounts and all entries into the auditor's report shall be signed by all board members, cf. sec. 2(2) of the Annual Accounts Act and sec. 92 of the Companies Act. The members of the board must confirm with their signatures that they have gone over the annual accounts as well as the statements of the auditor and that the board has made such amendments to the annual accounts and taken such other steps as may be necessary in relation to errors and illegal situations which have been pointed out by the auditor or which are clearly recognized.

A failure to include in the annual accounts such items and notes as are specifically required by the Annual Accounts Act (which implements the 4th EEC Directive) or a failure to report facts which are relevant to an assessment of the assets and liabilities of the company, its financial position, the operating result of the financial year in question, or important events which have occurred after the expiration of the year, may result in liability if members of the board ought to have been aware of the omission and its relevance to readers of the accounts.[23] The same rule applies to incorrect or misleading information.

Auditors have attempted to underline the board's duty to submit annual accounts which comply with the demands of the Annual Accounts Act by requiring from the board a "declaration of completeness". After the proper use of such declarations had been actively discussed for some time, the Committee of Auditing Practice, established under the auspices of the Association of Chartered Accountants, adopted a Guideline (no. 4) on management's statements on the accounts. Under these guidelines an auditor shall, immediately prior to drafting and signing his report on the accounts, request a written statement from the management containing information which is not readily accessible within the company. Such a statement is normally given by the executive director of the company and/or by employees in leading positions but only rarely by the board or some of its individual members. The person making the statement does so on the basis of what he believes to be true. The auditor ought to enter such statements received from the management in the auditor's report, but doing so has not (yet) become a firmly established practice.

The auditor(s) of a company serve(s) from time to time also as an economic adviser to the company, e.g. on tax questions or on budget procedures. The auditor(s) cannot disregard knowledge obtained in such other capacities when

[23] Cf. secs. 46(3) and 56 of the Annual Accounts Act and a 1978 Supreme Court judgment (1978 UfR 653 H) on failure to disclose a cross guarantee for a group company.

writing his (their) report on the annual report. The function of and therefore the obligations of an auditor are fundamentally different from those of other consultants.

8.2. *Notification to the Registry of Companies*

Disclosure and publicity are fundamental prerequisites to the basic provision (sec. 1(2)) of the Companies Act, which states that shareholders are not personally liable for the obligations of the company. Publicity is achieved by recording limited companies in the Registry of Companies. The Registry is open to the public (sec. 158). Notifications to the Registry of Companies regarding the formation of a limited company and, subsequently, regarding amendments to the articles of association or any other fact to be recorded by the Registry shall be signed by all members of the board, cf. secs. 155(2) and 156(2). The board is only liable for fault, but no board members can claim to be unaware of notifications filed with Registry and, depending on the specific circumstances, board members may be fined as well as held liable for damages if they are aware, or should have realized, that a notification contains incorrect information, cf. sec. 155(3) (4). This was held in two High Court decisions which also found that lawyers assisting the company may become jointly liable (1962 UfR 429 Ø and 1968 UfR 515 V). Under sec. 160 of the Companies Act the wilful or negligent violation of a number of the provisions of the Act, *inter alia* the ones on notifications to the Registry of Companies, is a criminal offence, and sec. 296 of the Criminal Code prescribes an even more severe criminal liability for providing incorrect or misleading information (among other things) in notifications regarding limited companies, where this is done either wilfully or as a result of gross negligence.

8.3. *Complying with the Provisions of the Companies Act and the Articles of Association*

Members of the board of a limited company who from debates in board meetings or from other sources have learned or should have understood that the company is committing illegal or improper acts, become personally liable for such acts. The board does not have a general duty to scrutinize the legality and the appropriateness of the company's business. But within a limited sphere, i.e. that of compliance with the Companies Act and the articles of association, the board has a special, independent duty and a corresponding liability for the legality of the business. This independent duty may provide some explanation of the otherwise unfortunate rule of sec. 140 to the effect that liability in relation to parties other than the company should be limited to infringements of provisions of the Companies Act and the articles of association, cf. no. 3.5 above. As illustrations of activities which violate the Companies Act and which result in board members incurring liability to such parties, the following examples may be mentioned: a decision to engage in an activity falling outside the purpose of the company (*ultra vires*), cf. 1966 UfR 31 H; a decision to pay dividends although the company does not possess means out of which dividends may be paid (cf. secs. 109 and 113); a decision—explicit or implicit— to grant or tolerate loans to shareholders in violation of sec. 115 of the Companies Act.

As for the thoroughness with which the board should investigate the appropriateness and legality of proposals submitted and of the company's business as a whole, the Companies Act only provides what guidance can be deduced from the general rules on the duties and liability of the board in secs. 54 and 140. The latter section declares the board liable also for negligence. A board would behave negligently and become liable if it were to approve a proposal which is either clearly illegal or improper or which is of such an unusual nature that the board should demand more detailed information on the substance and consequences of the proposal. In a 1962 Supreme Court case (1962 UfR 452 H) board members were held liable for having approved and signed without any reservation major mortgages on the company's real estate, thereby enabling executive directors to embezzle the proceeds. Sec. 54 provides that transactions of an unusual nature or of great importance for the company shall be submitted to the board. This implies that the board must undertake an independent assessment. It suffices, however, that the board limits its consideration to the main substance of the transactions. In the words of the decision just quoted, the board need not "have a full insight into all details of complex transactions".

9. THE BOARD'S LIABILITY FOR THE COMPANY'S ILLEGAL ACTS

9.1. *The Burden of Liability for a Passive and an Active Board Is Different*

The board of a limited company may meet as often as it desires, and the board may discuss whatever issues it sees fit with the executive director(s). The board may decide to investigate, either on its own or through a consultant, any matter regarding the company. The possibility therefore exists that the board may detect any error regarding the company's organization or activity which is discernible. However, the board of a limited company is obviously not obliged to exercise as far-reaching a supervisory activity as that and under normal circumstances it ought not to do so. The extent of the board's liability must be adapted to its normal and desirable function. Should the board, in carrying out its traditional tasks or in some other way, become aware that something is wrong in the company, it is obliged to intervene. That this fundamental view is in accordance with case law is demonstrated, *inter alia*, by a 1961 Supreme Court case and a 1966 Admiralty and Commercial Court case regarding a board's personal liability for recklessly seeking credit. The 1961 case (1961 UfR 151 H) dealt with the executive director of a financially shaky company which had made purchases on credit. Shortly thereafter, the company went bankrupt. The director was held liable to the seller for his loss, because it should have been clear to him that it was impossible to continue the business without the creditors suffering a loss. The board, however, was not held liable since it had not participated in, or had any knowledge of, the director's illegal transactions. The later 1966 case (1966 UfR 732 SH) is similar to the 1961 case and was decided in accordance therewith. There the executive director had told the board that everything was under control, and the board had not in any other way been alerted to the financial difficulties which had arisen. Likewise, members of the board were not held liable in a 1982 Supreme Court case (1982 UfR 595 H) regarding a company which had obtained a credit, among other things on the basis of misleading annual accounts. The annual accounts had been endorsed without any reservations by the company's auditor, and board members did not seem to have been informed of errors in the accounts by the executive director or by anybody else. It appears from the case that normally a board member may rely upon the auditor's report on the annual accounts, and that the onus of proof that a board member is guilty of negligence is on the injured party.

A board choosing to keep its activities at as low a level as the Companies Act permits, will acquire only a limited insight into the company's organization and activity. Such a board runs a smaller risk of becoming liable than a more active board. It is not a sufficient ground for holding a passive board liable that had the board been more active in various ways it might have discovered, among other things, any possible illegalities and averted loss for the company, its shareholders, or the creditors.

The Companies Act gives in secs. 54 and 140 only a vague outline of the board's function and liability. It was not the intention of the legislator that this flexibility should be eliminated through creative interpretations and bold decisions. The Companies Act gives the board of each and every company a good deal of discretion in planning and exercising its work in the manner which it finds most appropriate. The board may in so doing take into account, *inter alia*, the nature and extent of the company's business, the varying degrees of expertise and experience possessed by executive directors and employees, and the tradition and organization of the company.

9.2. *Personal Liability Presupposes Personal Fault*

The issue as to whether members of a limited company's board are liable for illegalities committed in the course of the company's business has been submitted to the courts in several criminal actions. In these cases the questions of a personal criminal liability for board members, an objective criminal liability for the board or the company and the imposition of fines upon the company as such have not always been kept clearly apart.

Criminal actions regarding contraventions of provisions of the extensive, complicated and frequently equivocal, regulatory legislation often serve the same function as civil declaratory action. Where an activity is found to be illegal in either kind of action, the question of liability for damages arises in relation to the company and sometimes also in relation to the members of the board or to other persons associated with the company. The verdict on the company's criminal liability and liability for damages frequently follow identical lines, at least in so far as the verdict of guilty implies liability for damages. In the following the problem will be debated whether the board members of a company which has inflicted injury upon itself or a third party through an illegal act, become personally liable for damages to the company or to a third party.

If a limited company has incurred expenses stemming from fines, confiscation, or damages due to the fact that illegal or improper acts have taken place in the course of its operations, the company may demand reimbursement of the expenses involved from the person who has approved or undertaken the acts on behalf of the company, provided that person has acted wilfully or negligently by approving or undertaking the acts. Depending upon the particular circumstances a claim for damages may be made by the company, by individual shareholders, by the company's bankrupt estate, or by individual creditors, cf. sec. 144 of the Companies Act and sec. 137 of the Bankruptcy Act. The question of board liability must in these as well as in other situations be answered on the basis of fault. The board becomes liable if and only if the members ought to have realized that illegalities occurred or would occur within the company. This will not normally be the case if the decision to engage in illegal acts has not been brought before the board, and the board has neither had pertinent material submitted to it nor had any detailed discussion with the executive director(s) of the company's activities in the particular area.

In 1955 a criminal case (1955 UfR 1004 H) was appealed to the Supreme Court involving the issue of whether the board of a limited company was obliged to monitor the company's activities in such detail that the board members could be penalized for contraventions committed as part of the company's activities under the penal provisions in legislation regulating the business in question. It follows from secs. 2 and 19 of the Criminal Code that a board member is normally subject to personal criminal liability for contravention of other legislation than the Criminal Code, if his failure to recognize and intervene against any illegal activity is wilful or must be considered negligent. The 1955 case involved an illegal increase of rent in an apartment house belonging to a real estate company. The board consisted of three members, one of whom was a majority shareholder and in charge of the day-to-day management of the company. All three members were indicted for having violated statutory regulations on rent. The City Court and the High Court (courts of first and second instance) held that the two ordinary members of the board were jointly liable, even though they had not participated in the calculation of the rents or otherwise in the administration of the apartments. Both courts held that the two members ought to have known that the rents were fixed at an illegal level. All board members apparently ought to have checked the legality of the rents charged. A majority of the Supreme Court (6 out of 7 judges), however, stated that the two board members could not be held criminally liable exclusively on the basis of their membership of the board. A criminal liability presupposes evidence of particular circumstances indicating that the two board members had known, or ought to have known, that the company was charging illegal rents. The decision of the Supreme Court deals only with criminal liability. One must, however, assume that the result would have been the same had tenants brought a civil action, not against the real estate company but against the two board members personally, claiming repayment of the excessive rents.

Besides rules on guilt and causality (in sec. 23) the Criminal Code contains a special provision delimitating the group of persons who may be held liable for a violation as perpetrators or accomplices. No clear corresponding rule has been formulated in the law of torts on what persons might, because of their advice or help, be held liable for damages. It does, however, follow from the general rules on fault and causality in tort law that liability for damages presupposes a personal activity as being a substantial factor causing the damage. Activity as a board member fulfilling his task as a general planner, etc., does not normally have this quality.

9.3. *Excusable Ignorance or Misconception of Statutory Regulations*

In general, ignorance or misunderstanding of the law does not excuse anyone from criminal liability or liability for damages. Criminal liability may, however, be mitigated or no penalty imposed where the ignorance or misunderstanding is excusable, cf. secs. 2 and 84 of the Criminal Code. The provision of the Criminal Code on ignorance of law includes only ignorance of the criminal law, not ignorance of law having an indirect bearing on the application of the criminal law. An "indirect" *error juris* is treated as ignorance of facts and excludes guilt. However, no sharp distinction can be drawn between direct and indirect ignorance of law. Also there is a difference between ignorance of the rules of the Criminal Code dealing with the traditional crimes and an ignorance of or a misconception of one of the innumerable technical prescriptions which nowadays regulate production and trade. The Supreme Court has, however, maintained that in principle ordinary citizens are not exonerated on the basis of ignorance or misconception of special provisions outside the Criminal Code known only to a narrow circle of experts. The fact that misunderstandings of the law may be excusable or actually unavoidable is only recognized by the Criminal Code by giving the courts the possibility to declare the party accused guilty but to impose on him only a reduced penalty or no penalty at all, cf. sec. 84(2). Civil responsibility for a proven illegality cannot in general be avoided because of an excusable ignorance of law. A similar possibility has not existed in the law of torts until recently but could perhaps evolve on the basis of sec. 143 of the Companies Act, cf. no. 11 below. Also inequity may in some cases be avoided by limiting the rights of third parties to claims against the company, whereas board members (and employees) who are only "guilty" of excusable ignorance of the law are not held personally liable. Such a limitation of personal liability is in harmony with the general rule on liability of a stock company (or other companies with limited liability). The principle of *respondeat superior* as spelled out in the Danish Code of 1683 involves liability for the principal combined with a right of recourse against the culpable servant. This old provision should not—300 years later—bar imposing liability on a company without any corollary right of recourse against employees or company management.

A modification of the traditional principle of *ignorantia juris semper nocet* seems to be inescapable. Board members, as well as the employees of a company, have a need for protection against normal, and for all practical purposes unavoidable, business risks. The protection called for cannot in all cases be established by denying that board members participated as initiators or accomplices in the contravention. Danish courts have not—as yet—formulated a rule offering the desirable limitation of the venerable *ignorantia juris* maxim. Some leniency in the assessment of damages may as pointed out already be based upon sec. 143 of the Companies Act, but in relation to excusable ignorance of the law in the field of the specialized regulating legislation a firm rule on exemption from personal liability is necessary. A discretionary mitigation of the liability for fines and of the responsibility for damages cannot fully meet the need for a limitation of the basic rule. It should be recognized that a *bonus pater* is not an expert in any field, nor in the field of special legal regulations.

9.4. *Company Liability for Fines*

Regulatory legislation and fiscal legislation normally prescribe penal sanctions for contravention of its material provisions as well as of executive orders issued on the basis of such legislation. Most such statutes further provide that contraventions committed in the course of the business of a limited company (or other legal person) may be punished by a fine imposed upon the entity as such, cf. e.g. sec. 35(4) of the Value Added Tax Act, sec. 19(6) of the Marketing Practices Act and sec. 86 of the Labour Environment Act. The now current special company liability for fines has eliminated the rationale for a previous judicial practice under which a board chairman or an executive director personally could be subjected to criminal sanctions due to their position as representatives of the company. This former practice has now been abandoned and is irreconcilable with the 1955 Supreme Court judgment reviewed in no. 9.2 above. The fact that a company is liable as such does not of course exclude criminal liability for board members or other parties when the contravention has been committed wilfully or negligently, cf. secs. 2 and 19 of the Criminal Code.

10. LIFTING THE CORPORATE VEIL AND THE LIABILITY OF BOARD MEMBERS. PERSONAL LIABILITY FOR THE DEBTS OF ECONOMICALLY WEAK COMPANIES

10.1. According to Danish law a public limited company must at the time of formation have a minimum capital of 300 000 DKK (and a private limited company 80 000 DKK), regardless of the nature and extent of the business in which the company intends to engage. The legislator has not limited a company's possibility of engaging in business to such activities as may be financed in other ways. Nor does the Bankruptcy Act require that a company must suspend payments and/or enter into liquidation, should the shareholders' equity fall below a certain critical minimum. The Companies Act on this point merely contains the provision of sec. 69(a), introduced in 1982 as an implementation of art. 17 of the 2nd EEC directive, prescribing that within a six-month period after the company is found to have lost half of its share capital the board shall explain the company's financial position to the shareholders at a general meeting and submit proposals on measures that are necessary. The few reported cases indicate that criminal liability for fraud on creditors—on the basis of secs. 279, 283, 298, 300 and 300(a) of the Criminal Code—will be imposed only in extreme cases of defraudation.[24] The legislator has wisely refrained from setting a minimum ratio of a limited company's net capital to the total capital. A courageous initiative may or may not succeed. Outsiders may—with hindsight—find the courage visionary or imprudent respectively.

[24] Some legal systems, among others French law, impose a "quarantine period" on the leaders (*dirigeants*) of a bankrupt company, cf. the report of J. Lemontey on the EEC draft convention on bankruptcy (doc. III/D/222/80-FR at p. 128). Similar provisions have been adopted in Norway and Sweden but not (yet?) in Denmark.

Well-meant rules should not be allowed to stifle initiative. The capital foundation of a limited company may, however, be so inadequate and the company's prospect of survival so poor that it would constitute fraud on the creditors or be incompatible with honest business practice to allow the company to receive credit. In such extreme situations those who have nonetheless accepted credit ought to be held personally liable to the creditors for their loss. In several cases this view has been adopted by courts.

However, the courts have held that embarking upon and maintaining an extensive activity on the basis of outside financing does not in itself constitute an improper act which may entail personal liability for board members to creditors (cf. 1981 UfR 274 H). The courts stick to the fundamental principle of limited liability when the device of a limited company is used in order to limit the possible losses the entrepreneurs might incur in a risky business. In cases where collapse of the business is likely owing to unfortunate incidents or unforeseen unfavourable developments it would be neither equitable nor practicable to enforce a rule making the board liable simply because the company's calculations did not include any substantial margin of solvency. Liability should be imposed only if the company obviously had no reasonable prospect of providing the liquidity necessary for going through with the project. There are no reported cases dealing with such situations.

10.2. As a consequence of the increasing number of bankruptcies (the number has grown from 250 in 1971 to 2 500 in 1981) several actions have been brought by creditors with claims for compensation against board members (as well as executive directors and auditors) for losses incurred because the company has continued operating much too long in spite of financial difficulties or even when the board must have realized that the situation was hopeless. It is quite usual in such cases that the board has worked hard to find a way out of the difficulties and try to save the company. Making the difficulties known would have jeopardized their efforts. In some recent cases the Supreme Court has refused to hold members of a board liable, if they have endeavoured to keep the company—and its staff—in business, even if the chance of avoiding bankruptcy was small and there was an obvious risk that creditors in general and new creditors in particular would suffer losses. Only if the situation is completely hopeless and bankruptcy is so obviously unavoidable that the company's conduct in relation to suppliers may be classified as a credit fraud (secs. 279 and 298(1) of the Criminal Code), or where an established "quiet (secret) suspension of payments" has not been strictly adhered to, have the courts imposed personal liability for credit which the company ought not to have received. In other words, a board may rely on being given an opportunity to work in peace and quiet on a realistic reconstruction of an ailing company.

10.3. What is important is whether the board in a company faced with difficulties should be more active than boards in companies that are operating smoothly, and in particular whether a board has to be on the alert if the company is faced with, or may be expected soon to be faced with, illiquidity or insolvency. Of course, situations have occurred where a board has remained passive in a crisis, but whether passivity *per se* in such a situation involves liability is something that has not yet been brought before the courts. It seems, however, that a board which understands or should understand that its company is faced with difficulties ought to run the risk of being held liable for losses inflicted upon the creditors (and shareholders) if it takes no action to clarify the situation or prepare appropriate measures. In the future, sec. 69(a) of the Companies Act (implementing art. 17 of the 2nd EEC directive), according to which the board has to inform the general meeting of a dangerous development, will strengthen the obligation of a board to follow the affairs of a company in crisis.

11. THE LIABILITY OF LESS KNOWLEDGEABLE BOARD MEMBERS

The members of the boards of Danish companies constitute a varied group of people. Many board members are present or former members of the executive management of other companies, advocates or engaged in other liberal professions, shareholders with major share holdings and representatives of such shareholders sometimes associated with them through family ties or ties of friendship. Many board members have extensive business experience. They serve on the board of several companies and acquire thus a certain professionalism as board members. Except in very small companies (less than 50 employees) the employees may request representation on the board equal to half the number of members elected by the shareholders.

Not all board members have the required insight into the functions of a limited company, nor are they as familiar with general business problems as professional board members generally are. This may, for example, be the case with family representatives or newly-elected representatives of employees. Thus, not all board members may, e.g., be aware *that* it is now (since January 1, 1983) illegal to grant loans to shareholders and that existing loans must be repaid (sec. 115 of the Companies Act and sec. 3 of the 1982 amending Act), *that* granting major donations out of the assets of the company should be submitted to a general meeting (sec. 114), *that* if their personal interests are in conflict with the interests of the company, board members may be disqualified and barred from voting (sec. 58), *that* board members must not take part in speculative transactions concerning shares in the company (sec. 53(2)), or *that* a company faced with financial difficulties may have to suspend payments.

The issue of personal liability must be assessed individually for each and every board member. Whether a board member has acted intentionally depends in principle upon the knowledge and understanding which this board member has actually had, and at first glance it may seem fair that an assessment of negligence also be based on the knowledge and understanding of each particular member.

Of course, in electing a member of the board the general meeting may have attached importance to various qualifications, but a person accepting an assignment which obviously presupposes certain general qualifications should not be able to escape liability merely by referring to the fact that he completely lacks the necessary knowledge, *in casu*, of business management. In recent years there has been a desirable trend towards increased professionalism for board members. This trend has been furthered, among other things, by the increased competition that has accompanied free trade in the EC and in the world at large, by the increased demands upon enterprises made necessary by the economic recession, and also by employee representation on the boards of most medium-sized and major companies. This trend should not be impeded by a substantial differentiation in legal liability. It should—in accordance with general rules on liability—be maintained that, in principle, the liability of each and every board member is assessed by the same standards.

In Scandinavia it is a widely held view that the functions of civil responsibility—*inter alia* prevention and compensation—are not considerably impeded by a mitigation in appropriate cases of the damages awarded. Some concessions to a board member who, in spite of good intentions, has got himself into trouble may be reasonable, and can be made by reducing the amount of damages imposed, cf. sec. 143 of the Companies Act (cf. 1979 UfR 777). This rule is applicable to all organs of the company but has its strongest justification in relation to board members: a board member is engaged in transactions that may involve very substantial amounts of money, and no well-defined code of conduct sets a pattern for the fulfilment of his task. Also, he or she does not function on a full-time basis. Finally, liability as a board member is not normally covered by insurance.