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THE LIABILITY OF DIRECTORS IN THE CASE OF INSOLVENCY OF THE COMPANIES – COMPARATIVE ANALYSIS OF THE ALBANIAN, GERMAN, FRENCH AND UK COMPANY LAW

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Abstract

The thesis addresses the issue of the liability of directors in the case of insolvency of the company. Through the comparative analysis of the relevant provisions of the company laws and insolvency laws of Albania, Germany, France and the UK, the thesis aims to identify the differences between the criteria employed by these countries with regard to the liability of directors.

The main purpose of this thesis it to see whether certain ambiguous articles of the Albanian law “On Bankruptcy”, in particular article 16, could be interpreted based on the way that similar provisions of the insolvency laws of Germany, France and the UK, are interpreted.

The legal analysis concludes that article 16 of the Albanian law “On Bankruptcy” is an idiosyncratic provision and recommends its modification.

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INTRODUCTION

In the years 2007 and 2008, Albania revised its legal framework with regard to company law. As a result a number of laws were enacted or amended, amongst which the law "On Entrepreneurs and Companies" and the law "On Bankruptcy". In the light of these changes and given the lack of relevant publications in Albania, except for "The New Albanian Company Law" by Thomas Bachner *et al*, a research that combines the analysis of both company law and insolvency law would provide a useful contribution to these fields of study.

The new Albanian Company Law has been drafted after the German and French model hence it was logical to conduct a comparative analysis between Albania and these two countries. As far as the UK is concerned, the choice in this case was driven by a desire to come up with a complete research on the topic, a research that compared not only civil law countries, but also common law ones.

The topic of this thesis is to see how the issue of the liability of directors in the case of insolvency of the company, has been regulated in the company laws under comparison. The analysis is based on the comparison of the relevant provisions of the company laws and insolvency laws of Albania, Germany, France and UK, with an eye of regard for differences in the standards of liability of directors in the situation of insolvency of the companies. The main purpose of the thesis is to see how the issues regulated in certain ambiguous provisions of the Albanian law "On Bankruptcy", have been regulated by the German, French and the UK insolvency laws. One of the said provisions is article 16, which presents the duty of directors to file for the opening of insolvency proceedings as a duty owed to creditors, and imposes on the directors personal liability *vis à vis* the creditors of the company.

The thesis begins by a discussion concerning the definition of the term “director” and the main duties of directors in a solvent company, focusing mostly on the aspects of the duty of care and the duty of loyalty that have a say in the liability of directors in the case of insolvency of the company. Then in its second chapter, the thesis is focused on the company in the zone of insolvency. The discussion begins with the definition of the term “insolvency”, followed by the additional duties of a director in two specific moments: when the company is in the brink of insolvency and when the company is in the course of insolvency. The main duties identified with regard to these two moments are respectively, the duty to call the shareholders meeting in case of serious loss, the duty to file for bankruptcy and in the second case, the duty to inform and assist the liquidator. The third chapter is devoted to the civil liability of directors and enforcement issues in Albania, Germany, France and the UK. The first part of the chapter contains an analysis of each country’s provisions regarding the civil liability of directors vis à vis the company and that same liability vis à vis the creditors. The second part is focused on private enforcement based on court proceedings. More precisely, in this part there will be an analysis on the direct and derivative suits, seen as procedural means in the hands of shareholders and creditors for holding directors personally liable for the violation of their duties. The last chapter of the thesis presents a short overview of the situation in the four countries of choice, concerning the criminal and administrative liability of directors when the company is in the zone of insolvency. The thesis ends by presenting the conclusions and recommendations.

As a final comment, it should be clarified that the thesis is focused only on limited liability companies and joint stock companies, excluding partnerships or any other type of legal person.

Chapter I

Directors and their duties in solvent companies

A limited liability corporation or joint-stock corporation is managed and supervised by boards of management, supervisory boards or individuals, depending on the governance system chosen by a corporation or imposed on it by statutory provisions. The rights and duties of a board of management are exercised through the members of the board, which are called directors, managing directors, members of the management board or administrators, depending on the legislation and on the type of company. These are the persons who actually manage and supervise the corporation, who owe duties to it and who are held jointly or severally liable in case of breach of these duties. This chapter will provide a review of the general duties of directors in the time when the company is conducting its business in a profitable way.

1.1 Definition of the term "director"

Based on the Black's Law dictionary a director is: 1. One who manages, guides, or orders; a chief administrator. 2. A person appointed or elected to sit on a board that manages the affairs of a corporation or other organization by electing and exercising control over its officers.[1]

None of the statutory provisions of the company laws of Albania, Germany, France and the UK contains a definition of the term "director". The formulation that comes the closest to an actual definition of this term but still falls short of providing one, is given by the Companies Act 2006, in the UK, according to which: " '[D]irector' includes any person occupying the

[1] Black's Law dictionary, http://www.westlaw.com

position of director, by whatever name called”.[2] Further, the same act provides that “[A] ‘shadow director’… means a person in accordance with whose directions or instructions the directors of the company are accustomed to act”.[3] Out of the four legislations under comparison, the UK company law is again the only one that offers a statutory definition of a type of director.

However, jurisprudence is rich in definitions of different types of directors. Based on the formality of the appointment, there is a distinction between a *de jure* director from a *de facto* director. A *de jure* director is a person who directs the company pursuant to a valid appointment. A *de facto* director, on the other hand, acts as a director but has not been validly appointed as such.[4] But, attention has to be paid not to confuse the term *shadow* director used in the UK law with the term *de facto* director. A *de facto* director, acts as a director even though he has not been validly appointed as such, while a shadow director does not act himself as a director, he only provides instructions for the direction of the company.

Additionally, based on the fact whether they are salaried employees of the company or not, there are executive or insider directors and non-executive or outsider directors. The former are directors who are full time employees of the company, while the latter, also known as outside directors, are not employees of the company.[5]

But the fact that the law does not include any definition of these other forms of being a director, does not mean that the persons acting as directors, without actually being such, will not be liable in case of breach of their duties. A director may be held liable despite the lack of a formal appointment as such, if he exercises management control.[6] In the UK, a shadow director is treated for all purposes as a director, but only when it is specifically stated

[2] Companies Act 2006, section 250
[3] Companies Act 2006, section 251
[4] Ferran Eilis, Company Law and Corporate Finance, 155, Oxford, 1999
[5] Keay Andrew & Walton Peter, Insolvency Law Corporate and Personal, 606, 2nd edition, Jordans, 2008 (2003),
[6] Wood Philip R., Principles of International Insolvency, 158, Sweet and Maxwell, 1995

so in the provisions of the Companies Act 2006. On the other hand, in the French Commercial Code, there are several provisions including formulations such as *directors in law or in fact, whether remunerated or not*, which clearly refer to the fact that besides for *de jure* and executive directors, the provisions containing the aforementioned apply also to *de facto* directors and non-executive directors.

The Company Laws of the four countries under analysis, have numerous provisions with relation to the way directors are appointed, removed, what criteria should they meet in order to be appointed, restrictions etc. It is not the purpose of this thesis to deal with all the aforementioned issues, but nevertheless there are several singular features in each of the said countries. For example, in Germany, only a natural person of full legal capacity may be a member of the management board. In the UK, as already mentioned, the Companies Act 2006 offers the only example of a partial definition of the term director and shadow director.[7] Although, the definition of the term *shadow director* excludes advisors of the company and mother companies, for the purposes of chapter 2, 4 and 6, solely because the directors of subsidiaries act according to its directions.[8] However, differently from Germany where only a natural person could be a director, here at least one director must be a natural person.[9] In France, the French Commercial Code includes a limitation with regard to the number of executive directors, which does not have to exceed one third of the serving directors.[10] According to it, a legal personality may be appointed as a director[11] but the chairman of Board of Directors must be a natural person.[12] A very peculiar feature of the French Commercial Code, not encountered in any of the other countries under comparison is the mandatory requirement for all directors to own shares of the company as specified in the

[7] *See supra* part 1.1 and notes 2-3
[8] Companies Act 2006, section 251
[9] Ibid, section 154
[10] French Commercial Code, article L225-22
[11] Ibid, article L225-20
[12] Ibid, article L225-47

memorandum and articles of association.[13] When it comes to Albania, it has to be clarified that the equivalent of the term "director" in the case of limited liability companies and joint-stock corporation with the one-tier system is "administrator". As in the case of Germany, here all the administrators must be natural persons[14].

As a summary, the UK Companies Act 2006 is the only one that includes a partial definition of the term director, the French Commercial Code includes no such definition but it nevertheless evidences that certain provisions apply to other persons, even though they are not *de jure* directors. There seems to be no similar provisions in the case of Germany and Albania's company law.

1.2 Directors duties

Under the principal-agent theory, directors owe duties to the company and according some opinions also to shareholders, as owners of the company. In common-law countries, these duties are recognized as fiduciary duties. The most important amongst them are the duty of care and the duty of loyalty. In the following sections of this thesis there will be an analysis of the duty of care, duty of loyalty and other legal duties, but only as far as aspects which are related to the liability of directors in case of insolvency of the company.

1.2.1 Duty of care

The duty of care is the duty of directors to exercise care and due diligence when carrying out their functions. The liability of directors is directly connected to this duty.

In Germany, the duty of care is composed of several individual duties of conduct, such as the observance of requirements of the law, articles of association and service

[13] Ibid, article L225-25
[14] Law no. 9901, "On Enterpreneurs and Companies", dated 14.04.2008, Art. 95 (1), English translation can be found on http://www.mete.gov.al/doc/20080716095903_ligji_per_tregtaret_dhe_shoqerite_tregtare_eng.pdf (last accessed on March, 23, 2011)

contracts, organization and monitoring of the company's activity, especially with regard to the financial situation, care in the making of business decisions etc.[15] But as mentioned earlier, the focus will be on the standard of conduct, whose breach results in liability in the case of insolvency. In this sense, the Act on Limited Liability Companies contains a general standard of conduct imposed on managing directors. When conducting the affairs of the company, they have to apply *the care of a prudent businessman*.[16] In the case of the Stock Corporation Act, the standard of conduct is that of *due care of a diligent and conscientious manager*.[17] These standards of conduct apply to all the stages in the life cycle of a company, including the situation when the company is on the brink of insolvency or de facto insolvent. In both cases, the standard is an objective one. The director is expected to go by his duties in the same way as a reasonable businessman or manager would do, without taking into account his actual knowledge and skills.

In the UK, the general duties owed by a director to the company are stated in sections 171-177 of the Companies Act 2006. Based on section 170, point 5: "The general duties apply to shadow directors where, and to the extent that, the corresponding common law rules or equitable principles so apply". These general duties include the duty to act within powers, the duty to promote the success of the company, duty to exercise independent judgment, duty to exercise reasonable care, skill and diligence, duty to avoid conflicts of interests, duty not to accept benefits from third parties and the duty to declare interest in proposed transactions or arrangements.[18] All of these duties are included in the concept of fiduciary duty, except for the duty to exercise reasonable care, skill and diligence. This conclusion is suggested by the formulation of section 178 of the Companies Act 2006: "The duties in those sections

[15] Wirth Gerard & Arnold Michael & Morshäuser Ralf & Greene Mark, Corporate Law in Germany, 46, 2nd edition, Verlag C. H. Beck München, 2010 (2004)
[16] Act on Limited Liability Companies, § 43 (1) (hereinafter referred to as GmbHG)
[17] Stock Corporation Act, §93 (1) (hereinafter referred to as AktG)
[18] Companies Act 2006, section 171-177

[sections 171-177] (*with the exception of section 174 (duty to exercise reasonable care, skill and diligence*)) are…enforceable in the same way as any other fiduciary duty owed to the company by its directors"[19]. Indirectly this provision suggests that the duties in sections 171-177 are fiduciary duties, with the exception of the duty to exercise reasonable care, skill and diligence, stated in section 174.[20]

This is the way the duty to exercise reasonable care, skill and diligence is formulated in the Companies Act 2006:

> 1) A director of a company must exercise reasonable care, skill and diligence.
>
> 2) This means the care, skill and diligence that would be exercised by a reasonably diligent person with-
>
> a. the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and
>
> b. the general knowledge, skill and experience that the director has.[21]

This section displays two standards, an objective and a subjective one. The objective standard consists in evaluating the conduct of business by the director, against the general knowledge that should be displayed by a person holding the same position as the latter. On the other hand, there is also the subjective standard, according to which, the conduct of business by the director should be evaluated also against the general knowledge of the said director. These two standards are cumulative, meaning that they have to be considered

[19] Companies Act 2006, section 178 (2)
[20] *See* Keay Andrew & Walton Peter, Insolvency Law Corporate and Personal, 607, 2nd edition, Jordans, 2008 (2003), referring to the case *Extrasure Travel Insurances Ltd v. Scattergood* [2003] 1 BCLC 598 (duty of care is not a fiduciary duty in the UK, because it is about competence and not loyalty)
[21] Companies Act 2006, section 174

together in order to conclude whether the director did exercise the care and diligence required by this section, or not.

In Albania, the administrators, members of the Board of Administration and Supervisory Board, have to exercise their rights taking into account the interests of the company and other partners, members and shareholders.[22] They must also "[E]xercise due diligence and care in the performance of their functions"[23]. As Thomas Bachner *et al* have interpreted it: "The persons in charge of managing the company owe the company to fulfill their function with such competence as can be expected by a reasonable administrator…. [T]he duty of care and skill therefore introduces an objective standard by which the administrator's actions have to be assessed".[24] Additionally, administrators must perform their duties in good faith and in the best interest of the company as a whole, paying special attention to the activity of the company with regard to the environment.[25]

As far as France is concerned, the French Commercial Code is silent about the duty of care. But the managers and the general managers are vested with extensive powers to act on behalf of the company, which means they have to act its name and interest.[26]

In summary, France is the only country whose company law does not contain any explicit provision with regard to the duty of care. The other countries introduce objective standards of liability, except for the UK which opts for a double standard of liability compound of one objective and one subjective part.

1.2.2 Duty of loyalty

[22] Law no. 9901, On Entrepreneurs and Companies, dated 14.04.2008, article 14
[23] Ibid, art. 98 (1) (dh) & 163 (1) (dh)
[24] Bachner Thomas & Schuster Edmund-Philipp & Winner Martin, The New Albanian Company Law Interpreted According to Its Sources in European Law, 112, Dudaj, 2009
[25] *Supra* note 22, art. 98 (a) and art. 163 (a)
[26] French Commercial Code, art. L. 223-18 and art. 225-56

The duty of loyalty is the duty of directors to act in the best interest of the company, disregarding their own interest. This section will focus only in the way self-dealing transactions and loans to directors have been regulated by the company laws of the countries under comparison. While confidentiality and prohibition to compete with the company are also aspects of the duty of loyalty, they do not have the direct impact on the capital of the company, as self-dealing and granting of loans to directors.

Based on the definition provided by the Black's Law Dictionary, self-dealing means the participation in a transaction that benefits oneself instead of another who is owed a fiduciary duty.[27] The choices of the legislator with regard to this issue differ from country to country. In Germany, self-contracting is prohibited "unless otherwise authorized…"[28]. This authorization may come from a shareholders' resolution which would free the managing directors from this prohibition.[29] In the UK, directors which are directly or indirectly interested in a proposed or existing transaction with the company, must declare to the other directors the nature and extent of their interest.[30] In France, the approval requirements are stricter especially in the case of public limited companies. If in the context of limited liability companies, self-dealing transactions are subject to approval by the shareholders' meeting[31], when it comes to public limited companies, these transactions are subject to prior consent of the board of directors, to a scrutiny by the auditor of the company and then to yet another approval from the general meeting of shareholders[32]. As for Albania, the situation is somehow similar to the UK. Self-dealing transactions are allowed upon disclosure of the terms of transaction, nature and scope of the administrator's interest and upon prior authorization of the shareholders, in the case of limited liability company and of the

[27] Black's Law Dictionary at http://international.westlaw.com
[28] BGB, §181
[29] Müller Klaus J., The GmbH A Guide to the German Limited Liability Company, 35, 2nd edition, Verlag C. H. Beck München 2009 (2005)
[30] Companies Act 2006, sect. 177 and 182
[31] French Commercial Code, art. L223-19
[32] Ibid, art. L225-38, L225-40

management or supervisory board, in the case of a joint-stock corporation.[33] This requirement applies also in case of transactions between the company and persons related to the administrator.

In summary, French law displays the strictest standards with regard to self-dealing transactions, followed by Germany, Albania and the UK.

As far as the issue of loans granted by the company to its directors, the situation again differs from country to country. In Germany, paragraph 89 of the Stock Corporation Act, states that: "The company may only grant the members of its management board credit on the basis of a supervisory board resolution"[34] The same is valid also with regard to loans granted to persons related with members of the management board. But the aforementioned is not applicable if the company is a credit institution or financial services institution, governed by section 15 of the Banking Act.[35] In the UK, the company cannot make a loan to a director without the approval through a resolution of the members of the company.[36] This resolution, must not be made unless the members have been provided with a memorandum that includes information on "[T]he nature of the transaction, the amount of the loan and the purpose for which it is required, and the extent of the company's liability under any transaction connected with the loan"[37].

On the other hand, France displays again a stricter standard. Directors are prohibited from contracting loans from the company, arranging for a loan or arranging for the company to stand as a surety or guarantor for their obligations to third parties.[38] However, there are three exceptions to this prohibition. In the case of public limited companies, the prohibition

[33] S*upra* note 14, article 13 (2) (3)
[34] AktG, § 89
[35] Ibid, article 89 (6)
[36] Companies Act 2006, section 197 (1)
[37] Ibid, section 197 (3) (4)
[38] French Commercial Code, art. L 223-21 and L. 225-43

does not apply to directors who are legal persons.[39] Also, if the company is a bank or financial establishment, current commercial transactions under normal conditions are not subject to the aforementioned prohibition.[40] The last exception regards loans granted by the company to directors elected by the employees.[41]

Meanwhile, the Albanian company law follows a different pattern. Entering into contracts of loan and guarantee with the company is prohibited but only when the person is both administrator and the single shareholder of the company.[42] This formulation allows a deduction as to the fact that in all the other cases, except the aforementioned, loan contracts between the company and an administrator are allowed[43].

There is one last point to make with regard to self-dealing and loans granted to directors and this is the issue of the participation of interested directors in the voting process, whenever approval of these transactions is required. French and Albanian company law have provisions stating that the directors concerned may not participate in the vote and shall not be calculated in the quorum. German and UK law are silent with regard to this issue.

In summary, French law displays again the strictest criteria, by prohibiting the loans to directors altogether, with three exceptions, as explained earlier. German law allows them but only upon approval of the supervisory board, the UK law also allows them upon approval of the members and the Albanian law allows them upon shareholders' approval, but imposes a prohibition in the case when the administrator who will benefit from the loan is also the single shareholder of the company.

[39] Ibid, art. L. 225-43
[40] French Commercial Code, art. L.225-43
[41] See article L. 313-1 of the Construction and Dwelling Place Code.
[42] *See supra* note 14, article 13 (7)
[43] *See supra* note 33 and accompanying text (the granting of the loan will still be subject to the respective requirements)

1.2.3 Other duties

As already mentioned in the previous parts of the thesis, the directors owe duties to the company. Indeed the duty of loyalty and the duty of care are the most important amongst these duties, but they are not the only ones. There are also other legal duties which the directors are required to comply with. Based on the topic of this thesis, this section will provide a review of the duty of directors to ensure the keeping of accounts by the company.

With regard to the duty to keep proper accounts, in Germany, paragraph 41 of the Act on Limited Liability Companies states that: "The managing directors are obligated to ensure that the company maintains proper accounting records".[44] Section 42a of the same act adds another duty on directors, namely their obligation to submit to shareholders in due time, the annual financial statements and the management reports, for approval purposes. In England, this duty is contained indirectly in section 387 of the Companies Act 2006: "If a company fails to comply with any provision of section 386 (duty to keep accounting records), an offense is committed by every officer of the company who is in default"[45]. The term "officer" includes directors of the company. In France according article L. 123-12 of the Commercial Code "[L]egal persons having the status of a commercial person must enter in their accounts movements affecting the assets of their undertaking…"[46] and according to article L. 232-1 "At the end of the financial year, the board of directors, management…shall prepare the inventory and annual accounts…."[47] The Albanian company law, also stipulates the duty of directors to ensure the keeping of accounting books and documents and to provide for the annual statement of accounts.[48]

[44] *GmbHG*, §41
[45] Companies Act 2006, section 387
[46] French Commercial Code, art. L. 123-12
[47] Ibid, art. L.232-1
[48] *See supra* note 14, art. 95 (c) (ç) and art. 154 (e)

It is evident that there are almost no differences in the way Germany, UK, France and Albania have regulated this duty. It has been recognized as an important duty in each of these countries' company laws and it is associated to the duty of directors to prepare the annual accounts. Breach of this duty will result in civil and criminal liability, depending on the country, as it will be illustrated in the third and fourth chapter.

Additionally, there is a very singular feature of the Albanian company law that is worth mentioning. The latter contains a directors' duty that is not encountered in any of the other legislations under comparison. More precisely article 95 (d), applicable to limited liability companies and article 158 (d), applicable to joint-stock corporations, state that: "An administrator shall create a [timely] warning system with respect to the developments threatening the business welfare and existence of the company"[49]. The new law "On Entrepreneurs and Companies" has been approved only in the year 2008 and there are no cases with regard to this particular duty, but it will be very interesting to see what is the criteria that determines the compliance of directors with this duty, in the sense of how is it going to be determined if this warning system has been established, and how is it going to be determined whether it is a timely one or not.

[49] *See supra* note 14, art. 95 (d) and art. 158 (d)

Chapter II

Company in the zone of insolvency - Additional duties of directors

In the previous chapter, there was a discussion about the fiduciary and other legal duties of directors, during the time when the company is solvent. This chapter will analyze the additional duties imposed on directors of the companies in the period when the company is experiencing a financial crisis. The chapter is divided in two sections, one that deals with directors' duties when the company is in the brink of *de facto* insolvency and the other that deals with directors' duties when the company is *de jure* insolvent.

2.1 Definition of the term "insolvency"

As Philip R. Wood defines it, insolvency is the "[I]nability to pay debts as they fall due, or the balance sheet test of excess of liabilities over assets, or both…"[50] Usually there are two tests employed to determine the insolvency of a company: the cash flow or commercial insolvency test and the balance sheet or absolute insolvency test.[51] Based on the first test, a company is regarded as insolvent when it is unable to pay debts when they become due.[52] Based on the second test, a company is insolvent if the total of liabilities is greater than the value of the assets, so the debtor cannot fulfill the liabilities.[53]

In Germany, the Insolvency Statute employs both of these tests. According to it, a corporation is in the state of insolvency, and therefore insolvency proceedings shall be opened, when reasons to do so exist.[54] These reasons consist of illiquidity, imminent illiquidity and overindebtedness. A corporation is in the state of illiquidity if it is unable to

[50] Wood Philip R., Principles of International Insolvency, 6-1, 109, Sweet & Maxwell, 1995
[51] RM Goode, The Principles of Corporate Insolvency Law, pp 86-87, Sweet & Maxwell, 3rd edition, 2005
[52] Ibid.
[53] Ibid, at pp 88 and 101-102
[54] German Insolvency Statute, section 16

pay for its due debts.[55] On the other hand imminent illiquidity is explained as the likelihood that the corporation will be unable to pay its existing debts on their due date.[56] The last reason to open the insolvency proceedings is overindebtedness, which exits if the debtor's assets do not cover its existing debts, unless it is highly likely that the enterprise will continue to exist. [57] As one author explains: "The company is overindebted if the total amount of liabilities… exceeds the total amount of its assets, computed on the basis not of the 'normal' balance sheet but of a special balance sheet…In this special balance sheet, the assets of the company are booked at their market value, respectively at the value likely to be realized in liquidation proceedings."[58]

As far as the UK is concerned, a terminology issue should be clarified first. In the UK only individuals can go bankrupt, while insolvent companies unable to initiate some procedure for their rescue, might enter winding up, or, as it is often referred to, "liquidation".[59] The term insolvency proceeding is not used. The UK legislation also uses both of the insolvency tests mentioned earlier in this section. Based on the Insolvency Act 1986, a company may be wound up by the court if the company is *unable to pay its debts*.[60] Section 123 of the same act, explains what unable to pay its debts means, by basically using the cash flow test in its first paragraph and the balance sheet test in its second one.

Coming to the Albanian Bankruptcy law it should be mentioned that it has been modeled after the German law. The reasons to open the insolvency proceedings are therefore the same as in the case of Germany: illiquidity, imminent illiquidity and overindebtedness.[61]

[55] German Insolvency Statute, section 17
[56] Ibid, section 18
[57] Ibid, section 19
[58] Müller Klaus J., The GmbH A Guide to the German Limited Liability Company, 44, 2nd edition, Verlag C. H. Beck München 2009 (2005), *citing* BGH, judgment of January 8, 2001, - II ZR 88/99 -, NJW 2001, 1280
[59] Keay Andrew & Walton Peter, Insolvency Law Corporate and Personal, 12, Jordans, 2nd Edition, 2008 (2003)
[60] Insolvency Act 1986, section 122 (1) (f)
[61] Law no. 8901, "On Bankruptcy", dated 23.05.2002, as amended by law no. 9919, dated 19.05.2008, article 13, Albania (translation added by the author)

While the first two reasons are defined in the same way as in Germany, overindebtedness follows a different pattern. In order for a company to be overindebted, it has to be proved that the "[A]*ssets do not cover obligations toward third parties*, ***and*** based on the circumstances and after the evaluation of the debtor's assets, that *there no longer exists a possibility for the company to continue the activity*"[62]. These two conditions are cumulative, so they both have to be met in order to open insolvency proceedings because of overindebtedness of the company. But it is not very clear how the evaluation of assets, included in the definition is related to overindebtedness. Perhaps it could be interpreted in the sense that besides the balance sheet test, there will be a separate valuation, which could mean that the assets will not be valued at a going-concern value, but based on their "liquidation value" which may be different[63].

As for the French law, it employs the cash-flow test as a pre-condition for the opening of the procedures of court-ordered restructuring or court-ordered liquidation, connecting the latter to the suspension of the payments for current liabilities.[64]

In conclusion, the UK, Germany and Albanian law, employ both insolvency tests, with the last two of them including also imminent illiquidity as a reason to initiate the insolvency proceedings. While French law, apparently uses only the cash-flow test.

2.2 Duties in the brink of insolvency

Before starting to analyze the duties of directors when the company is in the brink of insolvency, it should be first clarified what does the phrase 'company in the brink of insolvency' mean. This phrase has been used to indicate the period of time when the company is *de jure* solvent but *de facto* insolvent. During this time, the directors have to

[62] Ibid, art. 13 (4)
[63] Bachner Thomas & Schuster Edmund-Philipp & Winner Martin, The New Albanian Company Law Interpreted According to Its Sources in European Law, 148, Dudaj, 2009
[64] French Commercial Code, article L. 621-1

fulfill two important duties, namely the duty to call the shareholders' meeting in case of serious loss of the company and the duty to file for the opening of insolvency proceedings.

2.2.1 Duty to call the shareholders meeting in case of serious loss

Article 17 of the Second Council Directive (77/91/EEC) imposes on joint-stock companies a duty to call a general shareholders meeting in the case of serious loss of the company. The purpose of this meeting must be to decide *whether* in the face of such loss, the company should be wound up *or* if any other measures should be taken. The article leaves to the member states the decision as to within what period of time this meeting should be convened and also what amount of loss constitutes a *serious* loss, imposing however a limit that the said figure cannot be higher than half of the subscribed capital.

Germany and France have complied with this requirement through the inclusion in their respective company laws of provisions implementing the aforementioned article. The UK and Albania, even though not members of the European Union, also have provisions in their respective company laws that address the situation when the company incurs a serious loss. But there are several differences in the way this issue has been regulated by the company laws of these countries.

In Germany, the Act on Limited Liability Company envisages the obligation of managing directors to convene a shareholder's meeting, *without undue delay* in case of loss of *half* of the registered share capital.[65] The Stock Corporation Act, imposes the same duty on the management board in the case it becomes apparent or if it is to be assumed a loss of the company amounting to half of the share registered capital.[66]

[65] GmBH, §49 (3)
[66] ActG, §92 (1)

France, on the other hand, provides that in case of limited liability companies, if the capital falls *below half*, there is an obligation for the partners, *within 4 months* from approval of accounts showing the loss to decide on early dissolution of the company or if that is not decided, on the reduction of capital. The chief executive or the auditor have to secure this decision-making, otherwise, any interested party may ask the court to dissolve the company.[67] The same applies also in case of public limited liability companies where the board of directors or management has the obligation to call a special shareholder's meeting, if the company has incurred a serious loss.[68]

But in Albania, there is a different, more complicated formulation of this duty. In the case of limited liability companies the administrators are obligated to call the general assembly of shareholders if, based on balance sheet, it results or there is the risk that the assets of the company do not cover to debts that become due within the following 3 months.[69] In the case of joint-stock companies, the board of administration has to call immediately the general assembly to consider dissolution or the undertaking of other measures, if it results or it is clearly foreseeable that the losses amount to a value equal to 50% of the registered capital or that the assets of the company do not cover debts due in the 3 following months.[70]

The situation is even more peculiar in the UK. Here, when the net assets are *half or less* of the called- up share capital, the directors must, not later than 28 days from when this fact is known to them, call a general meeting to consider *whether any,* and if so, what steps should be taken in that case.[71]

The first crucial difference with regard to the aforementioned provisions is the one between France and Albania on one side and UK and Germany on the other, as far as the

[67] French Commercial Code, article L. 223-42
[68] Ibid, article L. 225-248
[69] Albanian Law On Entrepreneurs and Companies, article 95 (4) referring to article 82 (3)
[70] Ibid, at article 154 (2) referring to article 136 (3)
[71] Companies Act 2006, section 656

purpose of the shareholders meeting is concerned. In the first two countries, the shareholders' meeting has to decide whether to dissolve the company or reduce the capital, in the case of France, or dissolve or take other measures, in the case of Albania. But in the case of UK the shareholders' meeting decides whether to take any measures at all and in the case of Germany, the purpose of the meeting is not specified. Obviously, as non-members of the EU, Albania and the UK do not have any obligation to follow the Second Council Directive, so the aforementioned conclusions are reached for the sake of comparative analysis and not with relation to the said directive. But in the case of Germany, such an obligation exists and nevertheless the legislator's choice was not to include the purpose of the general shareholders meeting in the relevant provisions.

In all the four countries under analysis, the directors (administrators in the case of Albania) have the duty to call the shareholder's meeting in case of serious loss of the company. Breach of this duty results in liability as it will be explained in the third chapter. But when does this duty exactly begin? In Germany, the meeting should be called without undue delay, if the loss of the company becomes apparent or if it is to be assumed, in Albania immediately from the day when the loss results or it is foreseeable or there are no assets covering the debts due in the following three months. On the other hand in France and UK, the directors should convene the meeting within respectively four months and 28 days from when the loss is ascertained.

Based on the aforementioned facts it can be concluded that this duty is broader in Germany and Albania because directors must comply with it also when the loss is assumed or is foreseeable, instead of only when it is ascertained as in France and UK. Additionally, the lack of a specified period of time within which the meeting has to be convened makes directors in these two countries, more vulnerable to liability, given that "without undue delay" and "immediately" are both open to interpretation, as opposed to the pre-established terms in the case of France and UK.

2.2.2 Duty to file for the opening of insolvency proceedings

When the company is *de facto* insolvent, the directors have to make a decision with regard to its future, be it taking a loan, selling part or all of the assets of the company, reorganization (restructuring in France), voluntary winding up or compulsory winding up. As the word suggests, while the other alternatives are optional, the compulsory winding up is not. In order to protect the creditors from the depletion of capital and to prevent the company from incurring further debts, insolvency and company laws, usually contain mandatory provisions, with regard to the filing for the initiation of insolvency proceedings.

In Germany, *any member of the board of directors* is entitled to request the opening of insolvency proceedings.[72] When the company is illiquid or over-indebted *the members of the board of directors* are under the obligation to file a request for the opening of insolvency proceedings without culpable delay, at the latest, three weeks after the commencement of illiquidity or over-indebtedness.[73]

In Albania, the relevant provisions are almost the same as in Germany. The insolvency procedure in case of companies is opened only by request of the debtor, creditors or in the case of legal persons, also by the tax organs when for a period of 3 years the balance sheet results in losses.[74] Making the request to the court constitutes an act of representation so it is carried out by the administrators or members of the board of administration, as the legal representatives of the company. Every member of the governing body has *the duty* to require

[72] German Insolvency Statute, section 15
[73] Ibid, section 15a (1)
[74] Law On Bankruptcy, dated 23.05.2002, amended by law no. 9919, dated 19.05.2008, article 14 (1)

the immediate opening of insolvency procedures, but not later than 21 days from the date when the legal person is in the state of insolvency because of over-indebtedness.[75]

What is striking in this formulation is the fact that this duty arises only in the case of over-indebtedness of the company, but not in the case of illiquidity or imminent illiquidity. Possible explanations for this choice could be that over-indebtedness is more difficult to detect by creditors, so they face problems making the request for the opening of bankruptcy proceedings themselves, or the fact that usually an illiquid company will also be over-indebted, even though these are two separate criteria.[76]

In the UK, "[A]n application to the court for the compulsory winding up of a company shall be by petition presented either by the company, or the directors, or by any creditor…".[77] There is no specific provision with regard to delay in petitioning for winding up. But as one author, argues:

> [G]erman liability for delayed filing for insolvency (*Insolvenzverschleppung*) and English liability for wrongful trading…may be seen as functional equivalents….a response to one and the same functional problem, viz. to discourage those in control of a financially distressed company to gamble their way out of the crisis on the back of the creditors who are burdened with all the added risks.[78]

For the aforementioned reason, wrongful trading will be discussed in this section, instead of the chapter about civil liability of directors in case of insolvency. Section 214 of the Insolvency Act 1986, named wrongful trading applies to directors if, during the time when the company is in insolvent liquidation, they carry out trading despite the fact that they knew or should have known that there was no prospect of the company

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[75] Ibid, article 16 (2) referring to article 13 (4) which gives the definition of "over-indebtedness"
[76] Bachner Thomas & Schuster Edmund-Philipp & Winner Martin, The New Albanian Company Law Interpreted According to Its Sources in European Law, 150, Dudaj, 2009
[77] Insolvency Act 1986, section 124 (1)
[78] Bachner Thomas, Creditor Protection in Private Companies Anglo-German Perspectives for a European Legal Discourse, 246, Cambridge University Press, 2009

becoming solvent again. The section applies the balance sheet test to determine what insolvent liquidation means. The criteria employed with regard to liability is a three prong test: the objective test, the subjective one and the evaluation of director's efforts or lack thereof to minimize the damages, with the director having to attain the highest of the standards.[79] The objective test consists of the director having the knowledge, awareness that a diligent man holding that position out to have. The subjective test is cumulative to the objective one, and consists of the level of knowledge, awareness that the said director actually has. The third cumulative element is whether the director, taking into account his actual knowledge and the knowledge a person in that position out to have, took all the necessary steps to minimize potential damages to creditors, or not. If the director is held liable pursuant to this provision, he may have to make such contributions to the company's assets, as the court thinks proper.[80]

This section has to be analyzed in connection with section 1157 of the Companies Act 2006, which provides for the court granting a director relief from liability, in proceedings for negligence, default, breach of duty or breach of trust, if it appears that he acted honestly and reasonably.[81] If a director cannot avoid liability pursuant section 214, he cannot be granted relief based on section 1157 of the Companies Act 2006, because the latter employs a subjective criterion which is not compatible with the objective criteria employed by the first.[82]

In France, on the other hand, the debtor *must* apply for the opening of court-ordered liquidation[83] or court-ordered restructuring, not later than fifteen days following the

[79] Keay Andrew & Walton Peter, Insolvency Law Corporate and Personal, 589, Jordans, 2nd edition, 2008 (2003)
[80] Insolvency Act 1986, section 214
[81] Companies Act 2006, section 1157
[82] Supra, note 36, at 592
[83] French Commercial Code, article L. 622-1, referring at article L. 621-1

suspension of the payments.[84] In the case of liquidation, the procedure may be opened when the company is illiquid and has discontinued the business or when the company's restructuring is clearly impossible, while in the case of restructuring, illiquidity is what triggers the duty to file with the court.

If we compare these similar provisions, the first thing that catches the eye is the fact that differently from the other countries under analysis, in the UK Insolvency Act there is no period of time within which the directors, as representatives of the company, must file for winding up when the company is unable to pay its debts. But liability pursuant wrongful trading is the functional equivalent of liability for delay in filing for the initiation of insolvency procedures. On the other hand, the duty to initiate the insolvency procedures in three of the countries in comparison begins at the moment when the company is insolvent, however insolvency is defined in the relevant articles of the respective legislation. The Albanian law differs at this point. According to the latter, the company is insolvent when it is illiquid, imminently illiquid or over-indebted, but the directors have the duty to file for the opening of insolvency proceedings only in case of over-indebtedness.

2.2.3 Other duties

Despite the main duties of calling the shareholders' meeting in case of serious loss and filing for opening of insolvency proceedings, there are other duties imposed on directors in the time when the company is on the brink of insolvency. For example, in Germany the managing directors have the duty not to make payments after the company becomes illiquid or after its over-indebtedness is ascertained[85]. Similarly, in joint stock companies, the

[84] ibid, article L. 621-1
[85] GmbH, §64

management board cannot make any payment once the company has become illiquid of over-indebted, except for payments made in accordance with the due care of a diligent and conscientious manager[86] In the UK, the directors have the duty to deliver a solvency statement, certifying the ability of the company to pay the debts as they fall due and in case of intended winding up, to pay the debts within twelve months from the commencement of proceedings.[87] The Albanian law also contains a provision similar to the aforementioned, according to which the administrators issue an insolvency certificate for the purpose of certifying that a distribution of dividends will not result in over-indebtedness or illiquidity of the company.[88] In France, as in the other countries, there is the capital maintenance rule, based on which the distribution of dividends is not allowed if the equity capital is or would become afterwards, less than the share capital plus the reserves that cannot be distributed by law.[89]

2.3 Duties in the course of insolvency

Once the insolvency proceedings are initiated, the directors of the company owe no more fiduciary duties to the company. Now the interests of the creditors have the priority. But despite the fact that during insolvency proceedings the company is managed by a liquidator, the representatives of the company (directors) still have some obligations, mostly in the framework of cooperation with the liquidator.

Before mentioning some of these duties, it should be clarified that the term “liquidator” is a general (umbrella) term, used for practical reasons, but depending on the legislation and on what kind of insolvency regime the company chooses, other terms such as

[86] ActG, §92
[87] Companies Act 2006, section 643 (1) (b)
[88] Albanian Bankruptcy law, article 77
[89] French Commercial Code, art. L. 232-11

bankruptcy administrator or insolvency administrator, receiver, custodian or office-holder, could be used.

2.3.1 Duty of information and assistance with regard to the liquidator

First of all as far as Germany is concerned, the managing directors or management board, in the case of the joint stock company, have the duty to apply for the first liquidators to be registered in the commercial register[90]. The debtor shall disclose to a temporary insolvency administrator or a permanent one, any necessary information, circumstance related to the insolvency proceedings, shall support him in the fulfillment of his duties and shall be available to meet his obligations of disclosure and cooperation[91]. If the debtor is not an individual, this duty will apply *mutatis mutandis* to the members of the body representing or supervising the debtor[92].

In the UK, as well, the persons who are or have at any time been officers of the company shall give to the office-holder all the information that the office-holder may at any time require, and also be available to him at such times as the latter may reasonably require.[93] Office-holder means the administrator, the administrative receiver, the liquidator or the provisional liquidator, as the case may be.[94]

In Albania, when the court makes the decision of opening the insolvency procedure the directors have the duty to submit to the court all the necessary data, fulfilling all the duties imposed on them.[95] More precisely they have the duty of inform the court and the bankruptcy administrator about all the circumstances that have to do with the insolvency procedure[96],

[90] GmBH, §67; ActG, §266
[91] German Insolvency Statute, section 22, 27, 97
[92] Ibid, section 101
[93] Insolvency Act 1986, section 235
[94] Ibid, section 234 (1)
[95] Albanian law “On Bankruptcy”, art. 20
[96] Ibid, art. 81 (1)

they have to help the bankruptcy administrator in the carrying out of his duty[97] and be ready at any time to meet their obligations.[98] If necessary, they may have to submit a declaration to the court certifying that they have conveyed true, accurate and complete data, as required.[99] These obligations are valid also when the directors have left their positions, not less than two years before any of them required the opening of the insolvency procedure.[100] Additionally the debtor must allow to the temporary bankruptcy administrator the inspection of accounting books and provide him will all necessary data.[101]

In France, in the case of court-ordered restructuring, the debtor cooperates with the receiver for the preparation of a report on the financial situation of the company.[102] The receiver also consults with the debtor for the purpose of gathering information about the company.[103] But compared to the other legislations where the directors have the duty to assist the liquidator, there seems not to be such duty for them under the French Commercial Code. As mentioned above, in the case of court-ordered restructuring, the debtor cooperates with the liquidator or is consulted by him, but it is not required by the law to do so. Additionally, there is no provision with regard to any duty of assistance to liquidators, in the case of court-ordered liquidation.

In conclusion, out of the four legislations under comparison, France is the only one who does not have a clearly defined duty to assist the liquidator during the insolvency proceedings.

[97] Ibid, art. 81 (2)
[98] Albanian law "On Bankruptcy", art. 81 (3)
[99] Ibid, art. 82 (1)
[100] Ibid, art. 85 (2)
[101] Ibid, art. 22 (3)
[102] French Commercial Code, article L. 621-54
[103] Ibid, art. L. 621-56

2.3.2 Other duties

Besides the main duty of assistance to the liquidator, there are other duties imposed on the directors, depending on the insolvency regime chosen by the company. For example, in Albania in the case of a reorganization plan, the debtor (represented by his directors/administrators/members of the management board) submits the reorganization plan to the commercial sector of the court.[104] If the court decides for self-administration, the debtor may administer the estate assets under the control of a supervisor.[105] Contrary to the usual situation where the bankruptcy administrator manages the proceedings, in this case the debtor acts as a bankruptcy administrator, but he is subject to the control and supervision of a person appointed by the court. In such a case the debtor, amongst other duties, specifies the list of items of the estate asset and the list of creditors[106] and makes the distributions to the latter.[107]

Similarly, in Germany if instead of liquidation, the insolvency proceedings are based on an insolvency plan, aiming to maintain the enterprise , the debtor along with the insolvency administrator submits the insolvency plan to the court.[108] Most importantly, if while deciding on the opening of the insolvency proceedings, the insolvency court orders personal management, the debtor may manage and dispose of the insolvency estate, under the supervision of a custodian.[109] In this case the debtor still retains powers and has to fulfill duties such as establishment of the record of the insolvency estate, the creditors record and the survey of property[110], the distribution to satisfy the insolvency creditor etc.

[104] Albanian law On Bankruptcy, art. 181 (1)
[105] Ibid, art. 233 (1)
[106] Ibid, art. 244 (1)
[107] Ibid, art. 246 (2)
[108] German Insolvency Statute, section 1 and 217
[109] Ibid, section 270
[110] Ibid, section 281

In the UK, in case of voluntary arrangements, the directors are the ones who begin the process.[111] In case of creditors voluntary winding up, the directors have to prepare a statement of affairs, which amongst other things, contains information about the company's assets, debts and liabilities.[112] In France, in case of court-ordered restructuring the debtor, continues to carry out with regard to his/her assets, acts of disposal and administration and to exercise rights and actions as long as they don't interfere with those of the receiver.[113]

In conclusion, it can be stated that it is true, generally speaking, that once the insolvency proceedings are initiated, the directors authority ceases to exist. But nevertheless, they still have the obligation to cooperate with the liquidator and to carry out additional duties, based on the regime applied or imposed on the company in the case of its insolvency.

[111] Insolvency Act 2000, schedule 1
[112] Insolvency Act 1986, section 99
[113] French Commercial Code, article L. 621-23

Chapter III

Civil liability of directors and enforcement

The purpose of the first two chapters of this thesis was to provide a general picture of the duties imposed on directors of the company, when the latter is solvent and insolvent. Logically, a duty has to be complied with or otherwise it results in liability of the person who has to comply with it. This chapter will provide an insight with regard to how Germany, Albania, France and the UK have regulated the civil personal liability of directors in the case of failure to perform their duties. The first section of this chapter will focus on the liability of the directors *vis à vis* the company, the second one on their liability *vis à vis* creditors and the last section will analyze the procedural means through which directors' duties are enforced. Although the aim is to write about the liability faced by directors in case of breach of all the duties mentioned in the first two chapters, the said breaches do not always result in civil liability *vis à vis* the company or third parties. Sometimes, they result in criminal liability. For this reason the last chapter of the thesis has to be consulted as well, in order to clearly see what happens in case of breach of each of the duties described in this thesis.

3.1 Liability of directors vis à vis the company

Based on the principal-agent concept the directors owe to the company the duty to act in its best interest, disregarding their own. While directors liability to third parties is a disputable issue, their internal liability *vis à vis* the company has not been under discussion. The aim of the following subsections is to see how the internal liability of directors has been regulated in each of the four countries under comparison. Every subsection starts with the respective general articles regarding the liability of directors in case of breach of their duty of care and duty of loyalty. Afterwards the focus is directed on liability vis à vis the company resulting from breach of any of the other duties described in the first two chapters.

3.1.1 Liability of directors vis à vis the company in Albania

The duties and liability of directors in the case of limited liability companies and joint stock companies are almost the same, so hereinafter they will be no distinction between the two.

The administrators of the company are held liable for every action or omission that constitutes a breach of their duties.[114] They are exempted from liability only in the situation when, based on the investigation and assessment of the relevant information, it results that they acted or omitted to act in good faith. In the case of breach of the duties of care and loyalty, based on the respective paragraph 2 of articles 98 and 163 of the law "On Entrepreneurs and Companies", the administrators face two consequences: 1. Obligation to compensate the company for the damages caused; and 2. Obligation to disgorge the personal profits gained from the said breach. The administrators have the burden of proof. In particular, the same rules apply when the administrators permit the company to continue its activity when it should have been foreseen that the company would not have been able to pay for the due debts.[115] It seems like the liability of administrators in this case, starts immediately when they should have discovered the state of insolvency.

However, attention should be paid also to the first paragraphs of articles 98 and 163, according to which the administrators are obligated to perform their legal or statutory duties in good faith and in the best interest of the company, paying special attention to the impact of the company's activity on the environment. These provisions establish a double standard of conduct the directors have to abide to. First of all they have to act in good faith. This a subjective standard which requires of the administrator to honestly believe he is acting on the

[114] *See supra* note 14, art. 98 (2) and art. 163 (2)
[115] Ibid, art. 98 (4) (ç) and art. 163 (4) (dh)

company's best interest. The second standard is an objective one expressed through the prohibition regarding personal profit and conflict of interest. Additionally, when considering the best interest of the company, the administrators have to take into account the environmental impact of company's operations[116]. In order to escape liability for breach of duties, as explained earlier, the administrators have to prove that they have acted in compliance with these standards and of course that they have exercised due diligence and care. The claims against directors become time-barred within tree years.

But the Albanian law includes also a second somehow general provision with regard to the liability of directors in a situation related specifically to insolvency. Based on article 16 of the law "On Entrepreneurs and Companies", the administrators are jointly or personally liable *for all the debts of the company*, if they abuse with the legal form of the company, use the company's assets as their own, and if, in the moment when they were aware or should have been aware of the company's insolvency, they fail to take the appropriate measures to ensure sufficient capital for the company to meet its obligations towards third parties.[117] This article imposes an additional extensive liability on administrators and members of the board of administration, without providing any period of time within which the directors have to act. Given the wording, it would seem that the administrators are held liable if they don't act immediately once they know or should have known about the state of insolvency of the company. Furthermore, the administrators are personally liable to the company with the restitution of the distributed dividends, if they negligently issue an inaccurate certificate of solvency[118].

[116] Bachner Thomas & Schuster Edmund-Philipp & Winner Martin, The New Albanian Company Law Interpreted According to Its Sources in European Law, 111, Dudaj, 2009
[117] *See supra* note 14, art. 16
[118] Ibid, art. 78

As a final remark, it should be clarified that there are no provisions in the Albanian law regarding the exemption of administrators from liability because of prior authorization or ratification of their actions by the shareholders' meeting.

In summary, the general liability of directors *vis à vis* the company is regulated by two sets of provisions. According to the first one, administrators who breach their duties, can be held personally liable to compensate the company for damages and to disgorge personal profits deriving from the breach in question. The administrators that breach the duty of care, duty of loyalty, duty to ensure the proper keeping of accounts, duty to call the shareholders meeting in the case of serious loss and the duty to cooperate with the liquidator, will face the liability in accordance with this provision, unless it results that they acted or omitted to act, in good faith. The burden of proof is on the administrator. According to the second provision, administrators will face personal liability and also liability for all the debts of the company if they abuse with form of the company, with its assets or fail to ensure sufficient capital for the company to carry on its activity, in case of current or foreseeable insolvency. Finally, the law is silent with regard to waiver of claims by the company or exemption from liability because of prior authorization or ratification of the act by the shareholders.

3.1.2 Liability of directors *vis à vis* the company in Germany

The general standards of liability of directors in limited liability companies and joint-stock corporation are that when conducting the affairs of the company they have to apply respectively the *care of a prudent businessman* and the *care of diligent and conscientious manager.*[119] The managing directors are jointly and *severally* liable to the company for damages that arise from breach of their duties. This means that they will indemnify the company for the damages caused, out of their personal assets. In particular, the managing

[119] GmbHG, § 43 (1) and AktG, § 93 (1)

directors of the limited liability company have to compensate the company for the damages caused by the violation of duties arising from the sections 30 (rules about maintenance of capital) and 33 (acquisition by the company of its own shares). On the other hand, the members of the management board of the joint-stock corporation have to compensate the company for damages caused, in particular, by the violation of section 92 (2), which prohibits payments when the company is insolvent.

In the case of limited liability companies, the company may waive the claim for damages arisen out of violation of sections 30 and 33, mentioned earlier but only to the extent that it is not required to satisfy the creditors' claims. Additionally, to the extent the indemnification is required to satisfy the company's creditors, prior authorization of the shareholders allowing the director to act, does not exempt the latter from the obligation to indemnify the company for damages.

In conclusion, section 43 imposes personal civil liability on directors to indemnify the company for damages arisen if when complying with their duties, they did not apply the care of a prudent businessman. The company cannot waive its claim for indemnification to the extent the latter will serve to indemnify its creditors, which means that if no creditors have been damaged, and as a result the company does not have to indemnify any of them, then the company may waive its claims. However, if creditors have to be indemnified for damages, the company cannot waive its claims for indemnification against the managing director, expect when the latter is illiquid or undergoing an insolvency plan. On the other hand, the prior authorization of the shareholders allowing directors to make payments against the rules envisaged in section 30 and 33, does not exempt them from the liability vis à vis the company to indemnify the damages, again to the extent the indemnification is required to satisfy the company's creditors. We can deduce that if the directors were authorized by the shareholders to act in a certain way, which later on resulted in damages to the company and creditors, the managing directors will nevertheless have to compensate the damage to the extent required to make good the damages caused to the creditors. The claims of the company become barred in five years. As far as the burden of proof is concerned, the Act on Limited Liability Companies is silent.

On the other hand, the situation is different with joint-stock corporations. The members of the management board are jointly and severally liable to the company for breach of their duties. There is no breach of duty if the member of the management board can reasonably assume to be based on adequate information and for the benefit of the company. They bear the burden of proof when sued for breach of duty. The lawful resolution of the general shareholders meeting, exempts them from liability to pay damages to the company but the approval by the supervisory board does not have the same effect.[120] The company may waive the claim for damages, only three years after such claim arises and only with the consent of the general meeting, without objection by minority shareholders (1/10 of aggregate holding). The claims become time-barred after five years.

Additionally according to section 64 of the Limited Liability Act, the managing directors that make payments *after* the company became illiquid or after its over-indebtedness are obligated to reimburse the company. There is no liability if the payments are consistent with the care of a prudent businessman. This obligation applies also to the payments made to shareholders, to the extent they had to result in the illiquidity of the company, unless that was not recognizable even when applying the care of a prudent businessman. As for the claim for reimbursement, the provisions of section 43, paragraphs 3 and 4 apply.

It seems that the standard of liability for managing directors in Germany is related to the concept of care of a prudent businessman or due care of a diligent and conscientious

[120] AktG, §93

businessman. If the actions of the managing directors or members of the management board are consistent respectively with these standards, they face no liability.

As far the duty to cooperate with the liquidator is concerned, in the case when the members of the body representing the debtor do not comply with this duty, the court may sub poena them and detain them after taking their affidavit.[121] Additionally, if they do not comply with their duties to disclose and cooperate they may, if the request to open the insolvency proceeding is rejected, be charged with the costs of such proceeding.[122]

In conclusion, the liability of directors is regulated by two general provisions. The first set of provisions, imposes compensation for damages, in the case of breach of their duties of care and loyalty. If directors act in compliance with the duty of care, they face no liability. On the other hand, the second provision holds them liable to reimburse the company in the case when they make payments once the company is insolvent. The burden of proof is on the members of the management board. Under certain conditions, the company may waive the claims for damages against directors and prior authorization of the shareholders exempts them from liability, but that does not apply to the resolution of the supervisory board.

3.1.3 Liability of directors *vis à vis* the company in France

The French Commercial Code differently from the other legislations under comparison has only one set of provisions that apply both to the liability of directors *vis à vis* the company and *vis à vis* third parties. According to article L. 223-22: “The managers shall be jointly or severally liable…to the company or to third parties, for breaches of the legislative or regulatory provisions applicable to limited liability companies, for breaches of the memorandum and articles of association, and for their errors of management”[123].

[121] German Insolvency Statute, sect. 98
[122] Ibid, sect. 101 (3)
[123] French Commercial Code, art. L. 223-22

This provision establishes an objective standard of liability and a subjective one. The breach of legal and statutory provisions is obviously objective, as those are clearly defined provisions whose content does not depend on the director. Regarding the last standard, consisting of errors of management, one author comments that:

> Examples of error of management which have been held to give rise to personal liability of managers include: the continuing operation of the company at a loss, the implementation of corporate policies which are beyond the financial means of the enterprise, the use of corporate funds for personal interests, the failure to declare a *cessation de paiements* in a timely manner…the lack of diligence exhibited by failure to keep regular and up-to date accounts, the failure to maintain the principal asset of the company…[124]

Civil proceedings against managers, for whatever of the reasons mentioned earlier, cannot be made subject to prior notice or authorization of the shareholders' meeting. In the case of errors of management, these proceedings cannot be extinguished by shareholders decision. The proceedings is question shall be time-barred after three years from the act or its disclosure, unless the act is a criminal one, in which case it would be become time-barred after ten years.

The situation is almost the same in the case of public limited companies. Directors and managing directors shall be individually or jointly and severally liable to the company or third parties, either for violation of laws or breaches of memorandum and articles of association or for tortuous or negligent acts of management.[125] The first two standards of liability are almost the same as in the case of limited liability companies. The third one

[124] Siméon & Associes & Moquet Borde & Associes, Doing Bussiness in France, 18A-60, Volume 2, Mathew Bender, 1994 (1983)
[125] French Commercial Code, art. L. 225-251

provides a different formulation. Here we talk about tortious or negligent acts of management. There is no mention of any circumstance that would relieve the director from liability. Additionally, clauses in the memorandum and articles of association that subject the right to initiate procedures against directors to any prior notice or consent of the general meeting or contain a waiver of this right are deemed non-existent. In particular, when proceedings are initiated against directors for tortious or negligent acts of management, possible decisions the general meeting of shareholders cannot extinguish the legal action.[126]

The claims for liability against managers or directors and managing directors of limited liability companies and public limited companies are time-barred after three years from the act or its disclosure, but after ten years if the act is classified as criminal.[127] In the case of court-ordered restructuring or liquidation of any of the two types of companies, managing directors or directors may be held liable for the debts of the company and be subject to prohibitions, in accordance with the provision of Book VI, title II of the Commercial Code.[128]

As far as the burden of proof is concerned, the Commercial Code is silent, which means that the plaintiff, be it the company or the third party has to prove his case, in order for the director to be held liable. This is a different feature compared to Albania where the burden of proof is on the administrator of both limited liability company and joint-stock corporation and Germany where the burden of proof is on the managing director only the in the case of the joint-stock corporation.

The provisions discussed till now were general provisions regulating the liability of directors. From now on the provisions that will be discussed are those related to liability in

[126] French Commercial Code, art. L. 225-253
[127] Ibid, art. L. 223-23, art. L. 225-254
[128] Ibid, art. L 223-24, art. L 225-52, art. L.225-255

case of insolvency. The said provisions are part of Book VI of the French Commercial Code, which contains provisions on the Undertakings in Difficulty.

Based on art. L. 624-3, if management errors have contributed to the lack of assets of the legal person under restructuring or liquidation, the court may decide for executives, in law or in fact, whether remunerated or not, to bear wholly or partially, with or without joint and several liability, the debts of the legal person.[129] Based on the use of phrases such as *in law or in fact* and *whether remunerated or not*, the aforementioned provision applies also to de facto directors and non-executive directors. The statute of limitations for these proceedings is three years from the court judgment about restructuring or liquidation.[130]

Additionally, article L. 624-5 of the French Commercial Code states that in the case of restructuring or liquidation of a legal person, the court may open a procedure for a court ordered restructuring or liquidation with respect to any executive, including de facto and non-executive directors,[131] with regard to allegations about several acts. More precisely, the acts in question are disposal of assets of the legal person as if they were his/her property, carrying out of commercial transactions for personal interest using the legal form of the company, using company's assets to the detriment of its interests for personal or someone else's gain, wrongful trading that was bound to result in insolvency of the company, keeping incomplete, irregular, false accounts of the legal person, ones that do not comply with the legal requirements and misappropriation of the company's assets or fraudulent increase of its liabilities.[132] Pursuant to this article, the liabilities include personal liability and liability for the debts of the legal person. Moreover, if the executive, including non-executive and de facto directors, has committed one of the acts referred in the previous article, the court may

[129] French Commercial Code, art. L. 624-3
[130] ibid
[131] See previous paragraph of the document for an explanation on that conclusion.
[132] French Commercial Code, art. 624-5 (I)

declare his culpable bankruptcy. Based on the aforementioned, if the executive of a company commits one of the acts enumerated in article L. 624-5, he could be held personally liable, could bear the debts of the company and the court could declare his culpable bankruptcy. A declaration of culpable bankruptcy would prohibit the director, for not less than five years, to hold the same position in a legal person and would impose on him the prohibitions that apply on persons who are declared to be in a state of bankruptcy.[133] This provision places an extended liability on executives, partially similar to that provided for by article 16 of the Albanian law "On Entrepreneurs and Companies" and different from the German law where there is no provision imposing this kind of liability on directors. In the case of procedures instituted based on articles L. 624-3 and L. 624-5, the court may instruct the relevant member of the judicial panel to inspect documents or information held by different public authorities and bodies regarding the financial situation of the executives of the companies, *regardless of any legal provision to the contrary*.[134] This provision provides another example of the stricter approach of the French law regarding the liability of directors in case of insolvency.

In conclusion, the liability of directors is regulated by two almost identical general provisions of the French Commercial Code, applicable to the limited liability companies and public limited ones. Based on these provisions the directors may be held jointly or severally liable for damages to the company or creditors, for violation of legal or statutory regulations or for errors of management. This kind of liability applies with regard to the breach of the duty to file for the initiation of insolvency proceedings, of the restriction of distributions and of the rules related to self-dealing and loans granted to the directors. Besides these general provisions, other provisions of the Commercial Code may impose on directors the liability to bear the debts of the legal person or may allow the court to declare the culpable bankruptcy of the director. Authorizations of shareholders do not exempt directors from liability and as

[133] French Commercial Code, art. L.625-2
[134] Ibid, art. L. 624-7

far as the burden of proof is concerned, the law is silent which means that the latter is not on the directors.

3.1.4 Liability of directors *vis à vis* the company in the UK

The general duties of directors of companies are contained in sections 171-177 of the Companies Act 2006. The consequences of breach or *threatened breach* of sec. 171-177 are the same as would apply if the corresponding common law rule or equitable principle applied.[135] What is evident with regard to these provisions is that in each of them there is either an exception or a standard of liability regarding the duty they contain. Director's liability cannot be exempted by any provision made in the articles of the company or in contracts with the company, but there are exceptions for the provisions of insurance, qualifying third party indemnity or pension scheme indemnity.[136]

What is interesting is that while provisions in the articles of the company cannot exempt directors from liability, excluding the aforementioned cases, the resolution of the members of the company can ratify directors' acts that give rise to liability.[137] The provision applies also to former directors and shadow directors.

In addition, the Companies Act 2006 contains a particularly interesting provision which is contained in section 1157. According to this section: "If in proceedings for negligence, default, *breach of duty* or breach of trust against an officer of a company… it appears to the court hearing the case that the officer… is or may be liable but that he acted honestly and reasonably, and that having regard to all the circumstances of the case (including those connected with his appointment) he ought fairly to be excused, the court may relieve him, either wholly or in part, from his liability…" The provision applies not only to the case when the court is seized in action, but also when an officer of the company applies

[135] Companies Act 2006, section 178
[136] Ibid, section 232
[137] Ibid, section 239

for such relief after apprehending that a claim will or might be made against him for negligence, default, breach of duty or breach of trust. The provision is applicable in proceedings against an officer of the company for breach of duty, which means that it is applicable for each of the duties contained in sections 171-177. Through this provision, the director of a company has an additional possibility to be exempted from liability, even when he is actually liable, as long as the court hearing the case thinks he should be excused because he acted honestly and reasonably and all circumstances of the case point to such decision.

The aforementioned were the general provisions of the Companies Act 2006 that were considered as relevant to the topic of this thesis. But there are other provisions contained in the Insolvency Statute 1986, amended in the year 2000, which are directly related to liability in the case of insolvency. Keeping in mind the fact that wrongful trading was explained in section 2.2.2 of this thesis, only two provisions of this statute have been chosen for analysis in this section. The provisions in question are section 212 and 213 of the Insolvency Statute.

Section 212 of the Insolvency Act 1986, provides for a summary remedy and offers a broad possibility of action against officers of the company. In order to be held liable, a current or previous officer of the company must have misapplied or retained, or become accountable for money or property of the company, or be guilty of any misfeasance or breach of any fiduciary or other duty in relation to the company. If one of these conditions is met, the court may compel the officer to either repay, restore or account of the money or property, with interest rate as the court thinks just, or to contribute such sum to the company as a compensation for the misfeasance or breach of fiduciary or other duty as the court thinks just.[138] The persons who can apply to the court are the official receiver or any creditor or contributory. The action attacked by this proceeding could be carried out before the winding

[138] Insolvency Act 1986, sect. 212

up of the company or during it, what matters is that the company has to be undergoing its winding up in the moment when the applicant makes the application to the court. The section applies to breach of any fiduciary or other duties, so it can be used as the basis for applications regarding all the director's duties mentioned in the first two chapters of this thesis.

As far as fraudulent trading, there are two provisions that deal with it. The first is section 213 of the Insolvency Act 1986 which gives rise to civil liability in the form of contributions to the company's assets and the second is section 993 of the Companies Act 2006, which gives rise to an offence punishable by imprisonment or fine. The second provision will be analyzed in the last chapter of the thesis.

Regarding section 213, the elements that trigger the liability for fraudulent trading are the intent to defraud creditors or any other fraudulent purpose and the fact that the person has knowingly been a party to the carrying on of the business with that intent.[139] The liquidators are the only ones that can bring such case in front of a court, when the company is in the course of winding up.

Besides what is stipulated in the provisions of the Companies Act 2006 and Insolvency Act 1986, the directors of a company may also be subject to disqualification based on the Companies Directors Disqualification Act 2000. Section 6 of the aforementioned act is of particular importance as it states that directors of an insolvent company may be declared unfit to manage a company and be disqualified (prohibited from doing so) for a specific period of time. This procedure is of a civil nature and it is not meant to punish the director, but to protect the public.[140]

[139] Insolvency Act 1986, sect. 213
[140] Keay Andrew & Walton Peter, Insolvency Law Corporate and Personal, 630-631, Jordans, 2nd edition, 2008 (2003)

In conclusion, the consequences for the breach or threatened breach of the general duties of directors are the same as those applicable if the corresponding common law rule or equitable principle applied. There is one general provision (section 212) in the Insolvency Statute which provides for summary remedy and is applicable when the company is in the course of winding up, in case of breach of fiduciary or other duties. The liability imposed on directors pursuant to the said provision consists in repayment and restore of money or property or in contributions to the company, as a compensation for the misfeasance. What is noticeable is the fact that the directors can be exempted from liability is several ways. First, all the provisions of the Companies Act 2006 with regard to the general duties of directors, contain either exceptions or clear standards of liability. Second, the court may relieve the director from liability, even if he is liable, if it thinks that he has acted honestly and in good faith. And third, shareholders may ratify the actions of the directors. The law is silent as far the burden of proof is concerned, which means that the plaintiffs have to prove the breach of duty by the director.

After this rather lengthy section, it can be concluded that Albanian, German and French law have general provisions regulating the liability of directors, which are also applicable in the case of insolvency. The UK on the other hand, refers the terms of liability to the corresponding rules of common law or equitable principles. As far as the burden of proof is concerned, in Albania and Germany it is on the directors, while in France and in the UK, the law makes no mention of this issue, which means that the plaintiffs have the burden of proof. In Germany the law provides for exemption of liability because of prior authorization of the shareholders' meeting, while in the UK the latter may ratify the actions of the directors. On the other hand, German law provides the only example of waiver of the claims of the company against the directors, in certain exceptional cases. The French law provides the strictest criteria of liability, with almost no exemptions, while the UK law provides the more relaxed one, offering several possibilities that lead to the exemption of liability. Albania and Germany are somewhere in between the two aforementioned approaches.

3.2 Liability of directors *vis à vis* the creditors

A corporate is a legal person, with a distinct legal personality. According to Philip R Wood: "[T]he owners [the shareholders] are liable on insolvency only up to the amount unpaid of their shares. The managers are not intended to be liable since they are purely agents of the legal person"[141]. But during the last years there has been a tendency of piercing the corporate veil and holding directors personally liable, especially for violations taking place when the corporation is in times of a financial crisis. The following analysis aims at creating a picture of how the legislators of Albania, Germany, France and UK have tailored the criteria for the personal civil liability of directors *vis à vis* creditors.

3.2.1 Liability of directors *vis à vis* the creditors in Albania

In the Albanian company law there is only one provision that provides for liability of directors *vis à vis* the creditors. This is article 16, paragraph 2 of the law "On bankruptcy", according to which:

> In the case of a legal person, every member of the governing body is obliged to request the immediate opening of insolvency procedures, but not later than 21 days from the date when the legal person is insolvent, in accordance with point 4 of article 13 of this law [over-indebtedness]. These persons are ***personally liable to compensate the creditors for damages*** *[emphasis added]*, if the creditors incur losses due to the failure to present the request within this 21 days term[142].

[141] Wood Philip R., Principles of International Insolvency, 138, Sweet and Maxwell, 1995
[142] Law On Bankruptcy, art. 16 (2) (translation provided by the author)

It seems that with this singular provision, the Albanian legislator has imposed a direct duty that directors owe to creditors. In other words, directors of the company are personally liable to creditors for breach of their organizational duty to file for the initiation of the bankruptcy procedures. This provisions seems to be a form of piercing the corporate veil but it also clashes with the established principles of company law, in particular the limited liability principle.

Despite its singularity, it is not very clear how this provision of the law "On Bankruptcy" functions, as compared to articles 98 (4) (ç) and 163 (4) (dh) of the law "On Entrepreneurs and Companies". Based on these articles, the administrators and members of the board of administration are liable for damages and have to disgorge any profits, if they let the company do business when it should have been foreseen that the company would be unable to pay its debts. There is no period of time within which the administrators have to act. This means that their liability starts immediately from the moment they should have foreseen the insolvency of the company[143]

Moreover, according to article 16 of the law on "Entrepreneurs and Companies", the administrators and members of the board of administration are personally and jointly liable for all the commitments of the company, if in the moment when they knew or should have known of the state of insolvency, they did not take the necessary measures to ensure that the company will have sufficient assets to pay its debts to third parties. Again, there is no period of time within which the action has to be taken by the administrators or members of the administration board. The liability starts immediately from the moment the latter knew or should have known about the insolvency of the company.

[143] Bachner Thomas & Schuster Edmund-Philipp & Winner Martin, The New Albanian Company Law Interpreted According to Its Sources in European Law, 150, Dudaj, 2009

As it can be seen, there is some lack of clarity with regard to the moment when the liability of administrators and members of the administration board begins. Can they be held liable 21 days after the de facto insolvency of the company or immediately upon insolvency, without giving them the time to take any possible measure to try to overcome the insolvency of the company? Court cases would have been useful in order to clarify this issue, but from interviews with judges of the Tirana District Court[144] it results that there have been no cases till now, where the creditors have sued the administrators of the company for damages incurred because of the delay in filing for bankruptcy or for not taking measures based on the other two articles discussed earlier.

3.2.2 Liability of directors *vis à vis* the creditors in Germany

As far as statutory provisions are concerned, there are no sections in the Act of Limited Liability Companies that provide for liability of directors *vis à vis* the creditors.

On the other hand, section 93 of the Stock Corporation Act states that: "The company' claims for damages may also be asserted by creditors of the company to the extent that said creditors are unable to obtain fulfillment of their claims from the company"[145]. In the case of actions enumerated by paragraph 3 of the same section, where the payments made once the company has become illiquid or over-indebted (section 92/2) are of particular relevance to the topic, creditors can assert their claims for damages based on the breach of duty of care of a diligent and conscientious manager. As for breaches not included in paragraph 3, the creditors can assert their claims under paragraph 5, only if the members of the management board have *grossly* breached their duty of care of a diligent and conscientious manager. Unlike what mentioned with regard to liability *vis à vis* the company, neither waiver nor composition by the company or prior approval of the general meeting can

[144] Judge Blerina Mucaj and Judge Enkela Bajo
[145] AktG, § 93 (5)

exempt the members of the management board from liability for damages vis à vis the creditors of the company. The claims become time-barred after five years.[146] However, differently from the provision described in the section regarding Albanian law, here the creditors can assert the company's claims to the extent they are unable to fulfill these claims from the company, but there is no duty owed by directors to creditors.

But the managing directors or members of the management board may be held liable *vis à vis* the creditors also if the dealing with the company has resulted in tort. As one author explains:

> There may also be a personal liability of directors vis à vis creditors on grounds of causing a delay in filing for insolvency on one hand and on grounds of the infringement of further regulations designed to protect creditors on the other. However, such a liability presupposes culpability by the directors[147].

More precisely, besides the case of delay in filing for insolvency proceedings, directors may be held personally liable also in the case of misrepresentation of financial position, failure to keep proper accounts, violation of other regulations regarding information on the financial situation of the company and also in the case of fraudulent trading.[148]

3.2.3 Liability of directors *vis à vis* the creditors in France

The statutory provisions regarding liability of directors *vis à vis* the creditors are article L. 223-22 and L. 225-251 which have been analyzed in section 3.1.3 of the thesis. In order to avoid repetitions, these articles will not be explained again in this section.

[146] AktG, §93 (6)
[147] *Müller Renate & Thierhoff Michael, Risks to Which Directors of Corporations in Crisis Are Exposed Under German Civil and Criminal Law* at Norton Annual Review of International Insolvency, 213, Bruce Leonard editor in chief, Thomson Reuters/West., 2009
[148] Ibid, page 214

Besides from the liability deriving from the aforementioned articles, the liability of directors *vis à vis* the creditors can also stem from the general rules of tort. As one author explains: "When a director deals with a person at a time when he knows or negligently fails to apprehend that the company is insolvent, it is understandable that he is liable for any loss of the person under the general rules of tort"[149].

3.2.4 Liability of directors *vis à vis* the creditors in the UK

There is no provision under the Companies Act 2006 with regard to the liability of directors vis à vis the creditors. This fact reflects the position of the English law that "[D]irectors do not owe direct duty to the creditors of the company"[150]. But they can be personally liable to creditors if they have been guilty of a tort, in addition to breach of duties. In principle, a director may be held personally liable for committing a delict, despite the fact that the said conduct is related to his position as a director.[151] As one author states: "Directors are personally liable to persons who lend money to the company, if they obtain the loan by fraudulent misrepresentation"[152].

From the aforementioned, it results that Albania is the only country where the liability of directors vis à vis the creditors for delay in filing for insolvency proceedings, has been included in a company law provision and transformed thus in a direct duty the directors owe to the creditors. In Germany, creditors can assert company's claims against directors, but only to the extent that they cannot recover the debt from the company. In France, the Commercial Code includes provisions that hold directors liable also to the creditors and in England, the Company's Act 2006 does not include any such provision. Additionally in France, Germany

[149] *Mitsumasa Tanabe, Directors' Liabilities to Third Parties*, at International Corporate Law Annual, 71, Volume 1, Fiona Macmillian ed., Hart Publishing Oxford and Portland, Oregon, 2000
[150] Bachner Thomas, Creditor Protection in Private Companies Anglo-German Perspectives of a European Legal Discourse, 209, Cambridge University Press, 2009
[151] Ibid, pg. 183
[152] R.R.Pennington, Company Law, 814, 7th edition, London Butterworths, 1995

and England directors can be held liable on the base of tort law. As far as Albania is concerned, theoretically there should be no problems in suing a director for tort, but there is no case law with regard to this issue.

3.3 Enforcement of directors liability

In the first and second chapter of this thesis there was a discussion on the duties of directors when the company is solvent and on the additional duties of the directors when the company is in the zone of insolvency. In the current chapter the focus is on the civil liability of directors *vis à vis* the company and *vis à vis* the creditors. But in order for directors to be held liable for breach of their duties, certain legal procedural mechanisms have to be in place. The following section focuses on private enforcement through court proceedings, explaining in what ways the company, the shareholders and the creditors can enforce the liability of directors through court proceedings. The discussion starts with the direct suits of the company, shareholders and creditors and ends with derivative suits, as a special procedural means in the hands of the shareholders of the company.

3.3.1 Direct suits

As already mentioned, the directors owe duties to the company. In this sense it is usually the company that brings before the court direct suits against them. In the four legislations under comparison, it is the general shareholders meeting which makes a decision with regard to the initiation of a legal proceeding by the company against its director.[153] But while the company is always legitimated in its law suits against the directors, the situation is not the same with direct suits from creditors and shareholders.

[153] For Albania, Law on Entrepreneurs and Companies, art. 81 (g) and art. 135 (gj); For Germany, GmbHG §46 (8) and AktG §147 (1)

As far as creditors are concerned, they cannot sue the directors for breach of their organizational duties (with the exception of Albania, in our case), because those duties are not owed to them, but it is generally accepted that they can bring a lawsuit against a director if they personally suffer damages from the latter's actions.

The problematic issue lies in the right of shareholders to bring direct suits against the director. The reason stands in the fact that as mentioned several times during this thesis, the directors owe duties to the company and not to shareholders. Additionally, when the company initiates a legal action against the director, it does so to protect the rights and interests of the shareholders, as owners of the company. Based on these presumptions, direct shareholders suits against directors for breach of their duties are not easily accepted, except for France. In fact, article L. 223-22 of the French Commercial Code, applicable to limited liability companies, evidences the shareholders' right to instigate civil liability proceedings for reparation of prejudice suffered personally. Similarly, in the case of public limited companies, article L. 225-251, evidences the shareholders right to initiate actions for personal loss or damage. These actions are allowed when the shareholder has personally suffered a distinct damage from the one the company suffered because of the director's action.

According to a recent case of the *Cour de Cassation* in France, a shareholders' direct action was endorsed based on the concept that they had incurred a direct personal loss due to misleading or incorrect information provided by management.[154] This case was brought by shareholders who claimed to have been induced to invest in the shares issued by the company because of false and misleading information provided by the management about the financial statements of the company.[155] Obviously, a causal link between the personal loss of the

[154] El Ghozi Bouchez Phillippe & D'Arvisinet Sylvie of Paul Hastings Paris Lawyers, Shareholders Versus Directors: The New Rules of the Game, in <http://www.paulhastings.com/assets/publications/1679.pdf?wt.mc_ID=1679.pdf>
[155] For additional information, see Com. 9 mars 2010, no. 08-21.547, 08-21.793

shareholder and the directors action has to be proven. Clearly this case in not related to the liability of directors in case of insolvency, but nevertheless it is a decision of the French Supreme Court which could be followed in future similar lawsuits, possibly also in the case of direct shareholder's suit against directors, if their breach of duties in the brink of insolvency, has caused a personal loss to the said shareholders.

3.3.2 Derivative suits

Derivative suits constitute a very important procedural means through which shareholders can bring a lawsuit against a director, on behalf of the company. In this case, the sum of money in the form of damages or compensation that might be awarded at the end of the proceedings, belongs to the company and not to the shareholders that initiated the action. All the four countries under comparison have express provisions regulating this kind of legal action.

In Albania, shareholders representing at least 5% of the total of votes or less, as specified in the statute, OR *each of the creditors* of the company, within 30 days from refusal of the company to bring suit, can sue to nullify the decisions of administrators, to ask for compensation of damage incurred by the company or for other reasons provisioned by the Albanian company law[156], especially regarding the breach of their legal duties[157]. These legal actions are time-barred after 3 years. The right to bring a derivative suit cannot be limited or excluded neither by provisions in the statute, nor by resolution of the shareholders' assembly.[158] Shareholders and creditors of the company may bring a derivative suit directly to the court, without any requirement of a prior leave to do so.

[156] Law On Entrepreneurs and Companies, article 92 and article 151
[157] Ibid, articles 98 (5), 163 (5) and 164
[158] ibid, article 94 and article 153

A very particular feature displayed by the aforementioned provisions is that every creditor of the company has the right to initiate a derivative action. There exists the possibility that this right may be used improperly by the creditors. For this reason, the provision in question provides that in the case of a lawsuit brought by creditors who are in bad faith, the court may impose on them a fine of 50,000 leke, apart from possible claims for damages, pursuant to article 34 of the Code of Civil Procedure.[159]

In Germany, the shareholders' derivative suit follows a more complicated procedure. First the shareholders with an aggregate holding amounting to one hundredth of the registered share capital or a proportionate amount of 100 000 euro *apply for admission of action* to enforce the damage claims of the company, pursuant to sec. 147, para 1, sentence 1, in their own name.[160] However, the company may at any time enforce its damage claim in court and may also assume the pending proceedings in the state they are.[161] If the court grants the application, the actual complaint may be brought only within 3 months after the decision has become *res judicata*. The applicant [shareholders] will bear the costs of the admission proceedings to the extent the application is rejected.[162] All these provisions apply accordingly to agreements which were entered into, in order to avoid complaint proceedings.[163] Differently from Albania, where the previous agreements could not exclude the right of shareholders to bring derivative suits, in Germany existing agreements can provide for the avoidance of this right.

In England, Northern Ireland and Wales a derivative action is brought only against an actual or proposed act or omission involving negligence, default, breach of duty or breach of

[159] Law on Entrepreneurs and Companies, article 92 (7) and article 151 (7)
[160] AktG, §148 (1)
[161] Ibid, (3)
[162] Ibid, (6)
[163] ibid, §149 (3)

trust by a director of the company.[164] The action can also be brought against a shadow director. The shareholders have to apply to the court for permission (leave in case of Northern Ireland) to bring a derivative claim, continue a claim of the company as a derivative claim or continue the claim of another person.[165] The derivative claim in Scotland, although regulated by a separate provision, can be brought under basically the same conditions and obeys to the same rules as in the case of England, Northern Ireland and Wales. However, statistics show that shareholders derivative actions with regard to breach of directors' duties are very few. For example in the period 1990-2006 there were only three cases in which a derivative shareholders action was brought in relation to a breach of directors' duties in a listed company.[166]

In France, members of the limited liability company, individually or as group, may initiate civil proceedings against managers and can pursue reparation for the entirety of the prejudice suffered by the company, to which potential damages may be granted[167]. Similarly, the members of the public limited company holding at least five percent of the voting rights, individually or in an association, may bring an action against the directors or managing directors, on behalf of the company.[168] These lawsuits have to be instigated in accordance with the provisions of the *Conseil d'Etat* decree. The clauses of the memorandum and articles of association that alter this right, by providing for prior notice or authorization or waiver, shall be deemed null and void and the decisions of shareholders meeting cannot extinguish civil liability proceedings for errors of management.[169]

[164] Companies Act 2006, section 260
[165] Companies Act 2006, sections 161, 162 and 164
[166] Armour John, Enforcement Strategies in UK Corporate Governance: A Roadmap and Empirical Assessment, 14, Law Working Paper No. 106/2008, at < http://ssrn.com/abstract=1133542>
[167] French Commercial Code, article L. 223-22
[168] Ibid, article L. 225-252
[169] ibid, article L. 223-22 and article L. 225-253

In conclusion, in Albania and France the shareholders' right of derivative claim cannot be altered or extinguished neither by provisions of the articles of association, nor by decision of shareholders meeting, while in Germany, the relevant provisions have to be applied in accordance with agreement that might avoid this kind of civil proceeding. As far as procedure is concerned, the Albanian law is the only one who allows a shareholders' derivative suit to be presented directly to the court, as opposed to Germany, the UK and France which have specific procedures in place. Additionally, the Albanian law contains a very peculiar provision that gives the right to every creditor of the company to initiate a derivative suit on its behalf, while no such feature is encountered in the other legislations. Even though shareholders' derivative suits are recognized in all the legislations under comparison, their use is not very frequent. This is due mainly to the fact that the shareholders sue on behalf of the company, which means that if they win the case, any possible compensation will go the company, but if on the other hand, they lose, they will have to bear all the expenses of the legal proceedings. Despite this, it is often very difficult to prove why the lawsuit cannot be brought by the company itself, if this is a requirement that has to be met in order for the shareholders to get the leave to present the derivative action, as in the case of Germany and the UK.

Chapter IV

Criminal and administrative liability of directors when the company is in the zone of insolvency

In the previous chapter the focus was on the civil liability of directors in the case of insolvency. But there are several of the duties included in the first and second chapter of this thesis, which do not result in civil liability, but rather in criminal or administrative liability. Again, the aim of this chapter is not to analyze all the cases when directors are held criminally liable but rather to focus on those directors' duties explained in the first two chapters, whose violation can impose criminal or administrative liability on the said directors.

4.1 Criminal and administrative liability of directors in Albania

The law "On Entrepreneurs and Companies" and the law "On Bankruptcy" do not contain any provisions according to which a director would be held criminally liable. But the Criminal Code contains a section about crimes related to bankruptcy. More precisely, this section contains four provisions according to which causing the bankruptcy of the company, intentionally, trade transactions by the company with thirds, with the purpose of concealing the state of bankruptcy, concealment of the assets of the company, after bankruptcy, for the purpose of avoiding the consequences and the violation of the obligations imposed on the company, in case of bankruptcy, constitute a criminal offense and are punishable by fine or imprisonment.[170]

4.2 Criminal and administrative liability of directors in Germany

In Germany non compliance with several of the duties mentioned in the first two chapters is punishable by imprisonment or fine. For example, failure to inform or call the

[170] Albanian Criminal Code, art. 193-196

shareholders' meeting, in case of loss of half of the registered capital, results in imprisonment or fine for the managing directors/members of the board of management.[171]

More importantly, the members of the board of directors who, contrary to section 15a, subsection 1, first sentence of the Insolvency Statute, do not file a request for the opening of insolvency procedures, do not file it correctly or do not file in good time, are punished with imprisonment for not more than three years or a fine and in the case of negligent action, for not more than one year or a fine.[172]

Regarding administrative liability, administrative fines are imposed by the register court on members of the management board who fail to comply with the respective sections enumerated in section 407 of the Stock Corporation Act.

4.3 Criminal and administrative liability of directors in France

As in Germany, the managers are punishable by imprisonment and fine if they breach their duty to convene the general shareholders meeting in the cases when the equity capital becomes less than half of the share capital.[173] Another important provision is the one about criminal bankruptcy, based on which a person who, directly or indirectly, in law or in fact has made purchases with the intent to delay the initiation of court-ordered restructuring or liquidation, has misappropriated or concealed debtor's assets, has fraudulently increased the debtor's liability and *has kept inaccurate or irregular accounts* is punishable by imprisonment and a fine.[174]

[171] GmbHG, §84, AktG §401
[172] German Insolvency Statute, sect. 15a (4) (5)
[173] French Commercial Code, art. L 241-6 and art. L. 242-29
[174] French Commercial Code, art. L. 626-2

In addition to the punishment related to criminal bankruptcy, the court may also declare the culpable bankruptcy of the director.[175]

4.4 Criminal and administrative liability of directors in the UK

With regard to the duty to declare interest in existing transactions, a director who fails to do so, commits an offence and is liable to a fine.[176] In relation to the duty to make a solvency statement, doings so without reasonable grounds for the opinions expressed, makes the director liable of imprisonment or fine.[177] Most importantly, the director who knowingly authorizes or permits the failure to convene or continue the shareholders meeting in case of serious loss, commits an offence and is liable to a fine.[178]

As far fraudulent trading concerns, as it was mentioned earlier, there are two provisions that result respectively in civil liability and criminal liability. The first provision, namely section 213 of the Insolvency Act 2006, was discussed in section 3.1.4 of the thesis. Fraudulent trading as on offence contains almost the same elements that trigger the liability: there has to be the intent to defraud creditors or any fraudulent purpose and the person (which could be a director) must knowingly be a part of carrying out the business with such intent.[179] Differently from section 213, where the court action can be initiated when the company is the course of winding up, in the provision is question, the offence is committed regardless of whether or not the company is or has been in the course of winding up. The offence of fraudulent trading is punishable with imprisonment up to ten years or a fine.

[175] Ibid, art. L. 626-6
[176] Companies Act 2006, section 183
[177] ibid, section 643 (4)
[178] ibid, section 656 (4) and (5)
[179] Companies Act 2006, section 993

Furthermore, for violation of the duty to keep accounting records as established by section 386, every officer of the company who is in default commits an offence and is liable to imprisonment for or a fine.[180]

Given its use in numerous provisions, it should be explained that officer in default means every officer who authorizes or permits or fails to take all reasonable steps to prevent the contravention.[181]. This criteria of liability is very broad and subjects to liability not only the officer who personally committed the offence, but also all the others who by action or omission to act participated in it.

As a final remark, as far as the duty to assist the liquidator is concerned, current or previous officers of the company, who without reasonable excuse fail to comply with this duty are liable to a fine and, for continued contravention, to a daily default fine.[182] Additionally, misconduct in course of winding up, which includes also not delivering to the liquidator what he needs to perform his duty, constitutes an offence punishable by imprisonment or fine.[183]

In conclusion of this chapter, from the enumeration of the duties whose breach imposes criminal liability on directors of companies, it results that breach of the duty to call the shareholders meeting in case of serious loss, results in criminal liability in all the countries under comparison, except for Albania. The breach of the duty to file for bankruptcy results in criminal liability only in Germany and the UK (wrongful trading as the functional equivalent of this duty). The duty to ensure the proper keeping of accounts results in criminal liability for directors in France and in the UK. The breach of the duty to cooperate with the liquidator, the duty to declare an accurate solvency statement, and failure to declare the

[180] Companies Act 2006, section 387
[181] Ibid 2006, section 1121
[182] Insolvency Act 1986, section 235 (5)
[183] ibid, section 208

interest in transactions of the company, results in criminal liability only for directors in the UK. Amongst the four countries under comparison, Albania is the only one where there are no provisions resulting in the criminal liability of directors, neither in the law On Entrepreneurs and Companies, nor in the law On Bankruptcy. As mentioned, the Criminal Code includes several provisions about bankruptcy offences/crimes, but none of them can be used to hold directors criminally liable for the duties described in this thesis.

Conclusions and recommendations

The present thesis was based on the comparative analysis of Albanian, German, French and the UK company laws and insolvency laws, with regard to the liability of directors in the case of insolvency of the company. The main purpose of the thesis was to see how the issues regulated in certain ambiguous provisions of the Albanian law "On Bankruptcy", have been regulated by the German, French and the UK insolvency laws.

Based on the combined analysis of company law and insolvency law provisions, it results that the Albanian law "On Bankruptcy" presents several idiosyncratic features. The most problematic provision is article 16 of this law, according to which:

> In the case of a legal person, every member of the governing body is obliged to request the immediate opening of insolvency procedures, but not later than 21 days from the date when the legal person is insolvent, in accordance with point 4 of article 13 of this law [overindebtedness]. These persons are ***personally liable to compensate the creditors for damages*** *[emphasis added]*, if the creditors incur losses due to the failure to present the request within this 21 days term[184].

This article places on every member of the governing body (to be interpreted as members of the management board) a direct duty owed to the creditors. According to it, every member of the governing body who fails to file the request for the opening of insolvency procedures, within the established 21-days term, is personally liable for damages to the creditors, if they have incurred any losses because of the said failure.[185] This provision is matched by none of legislations of the countries of choice. Although the concept of civil liability of directors *vis à vis* third parties, such as the creditors of the company, is known and accepted in the other

[184] Law On Bankruptcy, art. 16 (2) (translation provided by the author)

[185] Law no. 8901, "On Bankruptcy", dated 23.05.2002, amended by law no. 9919, dated 19.05.2008, art. 16 (2)

legislations, this liability generally derives from the law of tort and not from statutory provisions of company law or insolvency law. Even in the case of the French Commercial Code, where the directors can be held personally liable to third parties for infringement of applicable laws, provisions of the memorandum and articles of associations and for errors of management, the formulation is an '*either or'* type of formulation, meaning that the directors can be liable to the company OR to third parties.[186] The way the provision is drafted would allow the judges to decide on a case by case basis, whether directors can be liable to third parties. But article 16 (1) of the Albanian law "On Bankruptcy" states no such options. It presents the duty to file for the opening of insolvency proceedings, as a duty owed directly to creditors of the company, which will result in personal liability of directors , if the creditors have incurred any loss because of breach of this duty. This choice seems to extend to the extreme the basic concepts of company law, namely the limited liability concept and especially the concept of duties owed to the company. Perhaps, this choice of the Albanian legislator could be explained in the framework of corporate social responsibility, as an additional safeguard to the interests of creditors, as stakeholders of the company. But I personally disagree with the tendency to make such for the simple reason that modifying basic principles of company law to such extent, will soon make the latter useless.

Additionally, article 16 of the Albanian law "On Bankruptcy" presents another peculiarity. Although the company is considered as insolvent when it is illiquid or over-indebted[187], the duty to file for the opening of insolvency proceedings arises only when the company is over-indebted.[188] There could be several reasons to justify this choice. First, the creditors can verify illiquidity very easily and thus file themselves for the opening of insolvency proceedings, but they cannot do the same with over-indebtedness which can be

[186] French Commercial Code, art. L. 223-22 and art. L. 225-251
[187] Albanian law "On Bankruptcy", art. 13
[188] Ibid, art. 16 (1)

very difficult to detect. Second, almost always a company that is over-indebted will also be illiquid.[189] But the cash-flow test and the balance sheet test are two distinct ways of determining the insolvency of the company. If the choice of the legislator was to define insolvency of the company as illiquidity or over-indebtedness, there is no reason why the duty to file for the initiation of insolvency proceedings should apply to only one of them, given that they represent two different situations of the company.

Another particular feature of the Albanian law “On Bankruptcy” is that as opposed to the insolvency laws of the other countries, the Albanian law “On Bankruptcy” does not include provisions that apply criminal liability on directors, for breach of their duties during the insolvency of the company. Obviously, the Criminal Code of the Republic of Albania contains several provisions about offences in this field, but none of them applies specifically to any of the duties analyzed in this thesis.

In conclusion, it should be clarified that the aforementioned analysis is not meant to be a general critique to the Albanian law “On Bankruptcy”, on the contrary. The purpose of this analysis is to provide a modest contribution to the improvement of this law. In this sense, it is recommended the amendment of article 16 (1) of the law “On Bankruptcy”, as following:

> In the case of a legal person, every member of the governing body is obliged to request the immediate opening of insolvency procedures, but not later than 21 days from the date when the legal person is insolvent, in accordance with article 13 of this law. These persons are *may be* personally liable to compensate the creditors for damages, if the creditors incur losses due to the failure to present the request within this 21 days term.

189 Bachner Thomas *et al,* The New Albanian Company Law Interpreted According to its Sources in European Law, 149-150, Dudaj publications, 2009

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