

# Instruments of EU Corporate Governance

## European Company Law Series

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VOLUME 19

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### *Editor*

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# Instruments of EU Corporate Governance

## Effecting Changes in the Management of Companies in a Changing World

Edited by

Hanne S. Birkmose

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## CHAPTER 15

# Directors' Liability

*Carsten Gerner-Beuerle*

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### §15.01 INTRODUCTION

Conventional wisdom posits that shareholder litigation is a powerful corporate governance tool that allows shareholders to hold directors and managers to account if they do not act in the best interest of the shareholders. Strong shareholder enforcement rights mitigate the managerial agency problem by both deterring managerial misconduct *ex ante* and providing an avenue to recover any loss suffered by the corporation (or, depending on the cause of action, the shareholders individually) *ex post*.<sup>1</sup> The normative lesson is thus clear: the rights of shareholders to enforce breaches of directors' duties should be strengthened. A trend towards facilitating shareholder litigation could indeed be observed in the European Union (EU) and elsewhere over the last decades. For example, in Germany, the standing threshold to bring a derivative action was gradually reduced from 20% to 1% in 2005<sup>2</sup> and in Italy for listed companies to 2.5% in 2003.<sup>3</sup>

However, recently, the orthodox view on shareholder litigation has come under sustained attack from empirical scholarship. Most empirical studies focus on the United States (US) and here, in particular, on the staggered adoption of so-called

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1. Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert Ward Vishny, *Legal Determinants of External Finance*, 52 *J. Finance* 1131, 1136 (1997).
  2. The most recent reforms were introduced by *Gesetz zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts* (UMAG), Law of 22 September 2005, Federal Law Gazette I, p. 2802, which also established a claims admission procedure and changed the cost rules (§ 148 German Stock Corporation Act).
  3. Guido Ferrarini, Mario Stella Richter, and Paolo Giudici, *Company Law Reform in Italy: Real Progress?*, 69 *Rabels Zeitschrift für ausländisches und internationales Privatrecht* 658, 681–82 (2005).

universal demand laws by US states.<sup>4</sup> Several of these studies find that an increased risk of litigation is associated with efficiency *losses* and reduced information provision. For example, empirical evidence indicates that *weaker* shareholder litigation rights are associated with higher financial leverage and firm value,<sup>5</sup> a lower level of corporate cash reserves and increased investment in value-enhancing projects,<sup>6</sup> increased engagement in explorative innovation activities,<sup>7</sup> improved corporate takeover efficiency,<sup>8</sup> improvements in outside director experience and reputation,<sup>9</sup> and more frequent and comprehensive corporate disclosures.<sup>10</sup>

On the other hand, at least one study finds that weaker shareholder litigation rights are related to lower corporate social responsibility (CSR) scores (however, these are, in turn, associated with higher firm value),<sup>11</sup> and several studies provide evidence of further harmful consequences of creating obstacles to derivative lawsuits. These include a deterioration in information quality, increased risk-taking, and a greater risk of insider expropriation, which translate into a higher cost of capital for corporations,<sup>12</sup> lower stock market liquidity,<sup>13</sup> an increase in corporate governance arrangements that

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4. An overview of the empirical literature is given by Dain C. Donelson, Laura Kettell, John McInnis, and Sara Toynbee, *The Need to Validate Exogenous Shocks: Shareholder Derivative Litigation, Universal Demand Laws and Firm Behavior*, 73 J. Account. Econ. 101427 (2022) (listing 25 papers published since 2018). Research with a broader comparative scope is rare. One of the few studies compiling a broad cross-country sample is Matteo P. Arena and Stephen P. Ferris, *A Global Analysis of Corporate Litigation Risk and Costs*, 56 Int. Rev. Law Econ. 28 (2018) (finding no evidence of a significant relation between probability of litigation and economic indicators of firm performance for a sample of companies incorporated in 16 developed economies). For a comparison of shareholder lawsuits in the US and UK, see also John Armour, Bernard Black, Brian Cheffins, and Richard Nolan, *Private Enforcement of Corporate Law: An Empirical Comparison of the U.K. and the U. S.*, 6 J. Empir. Leg. Stud. 687 (2009) (concluding that formal private enforcement of corporate law plays a minor role in protecting shareholders in both countries).
  5. Nam H. Nguyen, Hieu V. Phan, and Eunju Lee, *Shareholder Litigation Rights and Capital Structure Decisions*, 62 J. Corp. Finance 101601 (2020).
  6. Hien T. Nguyen, Hieu V. Phan, and Lingna Sun, *Shareholder Litigation Rights and Corporate Cash Holdings: Evidence from Universal Demand Laws*, 52 J. Corp. Finance 192 (2018).
  7. Chen Lin, Sibio Liu, and Gustavo Manso, *Shareholder Litigation and Corporate Innovation*, 67 Management Science 3321 (2021).
  8. Yongqiang Chu and Yijia Zhao, *The Dark Side of Shareholder Litigation: Evidence from Corporate Takeovers*, 50 Financial Management 845 (2021) (measuring takeover efficiency based on announcement returns for acquirers and post-merger operating performance).
  9. Ronald W. Masulis, Sichen Shen, and Hong Zou, *Director Liability Protection and the Quality of Outside Directors*, ECGI Working Paper N° 672/2020, available at SSRN: [http://ssrn.com/abstract\\_id=3329220](http://ssrn.com/abstract_id=3329220) (2020).
  10. Audra Boone, Eliezer M. Fich, and Thomas Griffin, *Shareholder Litigation Risk and the Information Environment: Revisiting Evidence from Two Natural Experiments*, available at SSRN: <https://ssrn.com/abstract=3106086> (2022); Thomas Bourveau, Yun Lou, and Rencheng Wang, *Shareholder Litigation and Corporate Disclosure: Evidence from Derivative Lawsuits*, 56 J. Account. Res. 797 (2018).
  11. Steven Freund, Nam H. Nguyen, and Hieu V Phan, *Shareholder Litigation and Corporate Social Responsibility*, *J. Financ. Quant. Anal.* (forthcoming), available at SSRN: <https://ssrn.com/abstract=3889645> (2021).
  12. Joel F. Houston, Chen Lin, and Wensi Xie, *Shareholder Protection and the Cost of Capital*, 61 J. Law Econ. 677 (2018).
  13. Benedikt Downar and Mario Keiling, *Shareholder Rights and Capital Structure: Evidence from Derivative Lawsuits*, available at SSRN: <https://ssrn.com/abstract=3511349> (2019).

are traditionally opposed by shareholders, for example, staggered boards,<sup>14</sup> a tendency to engage in empire building,<sup>15</sup> and more frequent instances of real earnings management.<sup>16</sup>

The picture is further complicated by the possibility that these empirical studies overstate the legal changes brought about by universal demand laws and their impact on litigation risk, as asserted by some commentators.<sup>17</sup> On this view, the adoption of universal demand laws is an inappropriate instrument leading to spurious findings of an association between litigation risk and firm outcomes.<sup>18</sup> The empirical literature is therefore at an impasse. If the methodological criticism of studies relying on the adoption of universal demand laws to isolate the effects of shareholder litigation rights is correct, a more promising avenue is the exploitation of clear legal differences that exist between countries.<sup>19</sup> However, the challenge with this approach is that it is difficult to account for all potentially confounding variables.<sup>20</sup> In particular, in contrast to a sample that is limited to the US, where certain elements of investor protection laws are federal law, such as disclosure obligations under the Securities Act of 1933 and the Securities Exchange Act of 1934, and others are broadly similar even though they are state law, such as directors' duties, shareholder rights across countries are different in very different ways and thus difficult to translate into proxies for shareholder protection.

This contribution seeks to develop a framework that can be used to compare shareholder enforcement rights meaningfully across countries and thus assist in testing the effect of differences in the legal design of enforcement rights empirically. A good understanding of the link between the enforcement of directors' duties and firm outcomes is also important in light of recent initiatives establishing, or proposing to establish, 'due diligence duties', which require companies to take appropriate measures to identify and prevent or mitigate adverse human rights and environmental

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14. Ian Appel, *Governance by Litigation*, available at SSRN: <https://ssrn.com/abstract=2532278> (2019).

15. Chune Young Chung, Incheol Kim, Monika K. Rabarison, Thomas Y. To, and Eliza Wu, *Shareholder Litigation Rights and Corporate Acquisitions*, 62 *J. Corp. Finance* 101599 (2020); Leye Li, Gary S. Monroe, and Jeffrey J. Coulton, *Litigation Risk and Cost Behavior: Evidence from Derivative Lawsuits*, AAA 2018 Management Accounting Section Midyear Meeting, available at SSRN: <https://ssrn.com/abstract=3020842> (2018).

16. Sterling Huang, Sugata Roychowdhury, and Ewa Sletten, *Does Litigation Deter or Encourage Real Earnings Management?*, 95 *Account. Rev.* 251 (2020).

17. Donelson et al., *supra* n. 4.

18. Specifically, Donelson et al., *supra* n. 4, observe that derivative litigation against public companies was very rare in states that adopted universal demand laws ('UD states') both before and after the adoption. Differences-in-differences in litigation rates that other studies have found between UD states and control states can be explained with different trends in litigation that predated the adoption of universal demand laws. Donelson et al. conclude that universal demand laws, accordingly, have little to do with changes in derivative litigation.

19. Compare, for example, differences in the EU highlighted in Carsten Gerner-Beuerle and Edmund-Philipp Schuster, *The Evolving Structure of Directors Duties in Europe*, 15 *EBOR* 191, 214-222 (2014).

20. Houston et al., *supra* n. 12, 682.

effects of business operations.<sup>21</sup> While due diligence obligations are imposed on corporations,<sup>22</sup> they are closely linked to directors' duties, since directors have overall responsibility for implementing due diligence procedures and ensuring that they are effective.<sup>23</sup> Moreover, under proposed EU legislation and the laws of some countries, they must consider the impact of their decisions on sustainability factors when discharging their duty to act in the best interest of the company.<sup>24</sup> This form of regulatory intervention is only justified if the regulatory burden imposed by due diligence duties is outweighed by a reduction in the adverse impact of business operations on societal interests. Whether this is the case requires that duties shape firm behaviour in positive ways. However, robust empirical evidence establishing a link between diligence duties, their enforcement, and sustainability outcomes is largely lacking.<sup>25</sup>

The remainder of this chapter is organised as follows. Section 15.02 identifies three challenges to capturing and quantifying legal rules, termed the problems of 'substitutability', 'complementarity', and 'complexity', and explains how they call into question the reliability of existing attempts to test the association between legal rules and economic outcomes. Section 15.03 gives a comparative overview of the building blocks of a system regulating directors' duties and their enforcement, covering the laws of Delaware, the United Kingdom (UK), Germany, and France. Section 15.04 takes the duty of care as an example to suggest a mapping of the interdependencies of the building blocks discussed in §15.03 that can be translated into legal variables. Section 15.05 concludes.

## §15.02 IDENTIFYING CORRELATION AND CAUSATION

Traditionally, correlation and causation between certain aspects of the legal environment and economic outcomes, on the level of either the economy or the firm, have been tested by compiling 'legal indices'. Influential indices include the 'Anti-Director

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21. European Commission, Proposal for a Directive on Corporate Sustainability Due Diligence, COM(2022) 71 final, Arts 6–8. Comparable national initiatives include the French duty of vigilance (Loi no 2017–399 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre, 27 March 2017) and the German law on corporate due diligence obligations in supply chains (Gesetz über die unternehmerischen Sorgfaltspflichten in Lieferketten, 16 July 2021). On due diligence duties, *see also*, Beate Sjøfjell, Chapter 3 in this volume.

22. *See, e.g.*, Proposal for a Directive on Corporate Sustainability Due Diligence, Art. 4. The proposal envisages that companies are liable for damages if they fail to comply with their due diligence obligations and an adverse impact that should have been identified, prevented, or mitigated occurred and led to damage as a result of this failure, *ibid.* Art. 22.

23. *Ibid.*, recital 64 and Art. 26.

24. *Ibid.*, Art. 25. The proposed Directive conceptualises the above obligation as part of the directors' duty of care and stipulates that this duty shall be 'understood and applied in a manner which is coherent and consistent with the due diligence obligations introduced by this Directive', *ibid.*, recital 63. On the duty to act in the best interest of the company from a comparative perspective, *see*, Jessica Östberg, Chapter 2 in this volume.

25. Some existing studies suffer from the methodological challenges outlined earlier, e.g., Freund et al., *supra* n. 11.

Rights index' ('ADR index') introduced by La Porta et al.,<sup>26</sup> the 'anti-self-dealing index' by Djankov et al.,<sup>27</sup> the 'Governance index' ('G-index') by Gompers, Ishii, and Metrick,<sup>28</sup> the 'entrenchment index' ('E-index') by Bebchuk, Cohen, and Ferrell,<sup>29</sup> which builds on the G-index, and the 'Management Insulation index' ('MI-index') by Ferreira et al.<sup>30</sup>

Most of these indices are based on a list of legal and regulatory variables that quantify certain shareholder rights and other aspects of the regulatory environment relevant to outside investor protection. These are either simply aggregated, usually without weighting and without any attempt to explore possible interconnections between index components or added as separate explanatory variables. For example, the ADR index contains several proxies for the strength of shareholder rights generally, such as the existence of pre-emption rights or the right of shareholders to call a general meeting, and one proxy that concerns enforcement, namely the availability of a judicial venue to challenge management decisions (termed 'oppressed minorities mechanism').<sup>31</sup> The relevant rules are coded in a binary manner and aggregated to form the ADR index. Similarly, the anti-self-dealing index equals the average of scores for approval and disclosure requirements for related-party transactions and provisions concerning the enforcement of liability provisions, which each range from 0 to 1 (partly with incremental steps).<sup>32</sup> The E-index condenses the G-index into six provisions that capture different aspects of an investor protection regime. Sample firms are then given a score ranging from 0 to 6 that represents the number of provisions that apply to them.<sup>33</sup>

This approach to capturing the essence of legal rules faces several challenges, which may be termed the problems of 'substitutability,' 'complementarity', and 'complexity'. They are addressed below. The only exception to this methodology among the above indices is the MI-index, which captures the time it takes for a majority

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26. Rafael La Porta, Florencio López-de-Silanes, Andrei Shleifer, and Robert W. Vishny, *Legal Determinants of External Finance*, 52 *J. Finance* 1131 (1997); Rafael La Porta, Florencio López-de-Silanes, Andrei Shleifer, and Robert W. Vishny, *Law and Finance*, 106 *J. Political Econ.* 1113 (1998); Rafael La Porta, Florencio López-de-Silanes, and Andrei Shleifer, *What Works in Securities Laws?*, 61 *J. Finance* 1 (2006). The literature relying on and criticising the anti-director rights index is voluminous. See, among others, John Armour, Simon Deakin, Priya Lele, and Mathias M. Siems, *How Do Legal Rules Evolve? Evidence from a Cross-Country Comparison of Shareholder, Creditor, and Worker Protection*, 57 *Am. J. Comp. Law* 579 (2009); Mathias M. Siems, *What Does Not Work in Comparing Securities Laws: A Critique on La Porta et al.'s Methodology*, 16 *ICCLR* 300 (2005); Holger Spamann, *The 'Antidirector Rights Index' Revisited*, 23 *Rev. Financ. Stud.* 467 (2009).
27. Simeon Djankov, Rafael La Porta, Florencio López-de-Silanes, and Andrei Shleifer, *The Law and Economics of Self-dealing*, 88 *J. Financ. Econ.* 430 (2008).
28. Paul Gompers, Joy Ishii, and Andrew Metrick, *Corporate Governance and Equity Prices*, 118 *Q. J. Econ.* 107 (2003).
29. Lucian Bebchuk, Alma Cohen, and Allen Ferrell, *What Matters in Corporate Governance*, 22 *Rev. Financ. Stud.* 783 (2009).
30. Daniel Ferreira, David Kershaw, Tom Kirchmaier, and Edmund Schuster, *Corporate Governance and Bank Failures*, *ECGI Working Paper* No 345/2013 (2020).
31. La Porta et al., *Law and Finance* *supra* n. 26, 1122–23.
32. Djankov et al., *supra* n. 27, 434–435.
33. Bebchuk, Cohen, and Ferrell, *supra* n. 29, 785.

group of shareholders to gain control of the board.<sup>34</sup> In contrast to the other indices, it does not award scores by assessing the presence or absence of a set of governance provisions but the *interaction* of different legal rules. For this reason, the authors call the MI a ‘contingent index’. It takes account of the fact that ‘certain governance arrangements can be rendered functionally irrelevant by the presence or absence of other rules’ and seeks to measure how *combinations* of governance provisions affect the insulation of board members.<sup>35</sup>

### [A] Substitutability

The problem of substitutability arises where legal institutions are compared across jurisdictions, as in the case of the ADR or anti-self-dealing indices. Such a comparison faces the problem that legal systems are structured in different ways, use different terminology, and sometimes employ different mechanisms to address the same social conflicts. Thus, the compilation of legal data cannot proceed based on legal concepts that exist in one jurisdiction, then search for the same legal instrument in other jurisdictions and conclude, if it cannot be found, that the respective issue is less comprehensively regulated.

Enforcing directors’ duties is a case in point. All legal systems rely on a combination of public or semi-public and private enforcement mechanisms. In some jurisdictions, the two forms of enforcement function effectively as substitutes, and policy goals are achieved by relying predominantly on either public or private enforcement. For example, in the UK, the possibility to disqualify directors under the Company Directors Disqualification Act (CDDA) 1986<sup>36</sup> is more important than private enforcement through a derivative action.<sup>37</sup> The latter had long been ineffective because of the rule in *Foss v. Harbottle*,<sup>38</sup> which generally allowed minority shareholders to bring a lawsuit only if the act complained of ‘amount[ed] to ... a fraud on the minority and the wrongdoers [were] themselves in control of the company’.<sup>39</sup> The Companies Act 2006 now contains a codified derivative action mechanism that is more conducive to minority shareholder litigation but directors’ disqualification remains of greater practical relevance.<sup>40</sup> Under the Company Directors Disqualification Act 1986, the relevant government minister or the liquidator if a company is being wound up can make an application for a disqualification order. The court will disqualify a director, among other reasons, if it is satisfied that the director is ‘unfit to be concerned in the

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34. Ferreira et al., *supra* n. 30, 3.

35. *Ibid.*

36. 1986, c. 46.

37. On directors’ disqualification, *see also* Jesper Lau Hansen, Public Enforcement of Directors’ Duties, Chapter 17 in this volume, § 17.08.

38. (1843) 2 Hare 461.

39. *Ibid.*, 1067.

40. Annually, between 1,000 and 1,400 directors are disqualified and, as a consequence, prohibited from serving as a director of a company or participating directly or indirectly in the formation or management of a company, Carsten Gerner-Beuerle and Michael Schillig, *Comparative Company Law* 717 (Oxford University Press 2019).



management of a company.<sup>41</sup> Unfitness 'may be shown by conduct which is dishonest (including conduct showing a want of probity or integrity) or by conduct which is merely incompetent'.<sup>42</sup> The concept thus encompasses breaches of directors' duties, including breaches of the duty of care in situations where a director acts in good faith and without a conflict of interest.<sup>43</sup> Director disqualification mechanisms can therefore be seen as a functional substitute for purely private enforcement. They have the advantage of relieving shareholders of any litigation risk and the requirement to pay court fees, which may otherwise disincentivise them from bringing a minority shareholder lawsuit.<sup>44</sup>

Shareholders benefit from similar advantages if corporate misconduct is qualified as a criminal offence and consequently enforced in criminal proceedings.<sup>45</sup> This is particularly relevant in France, where the criminal offence of *abus de biens sociaux* complements traditional directors' duties in cases where a director uses corporate assets in bad faith for private purposes.<sup>46</sup> These conditions are interpreted broadly by the courts and cover not only cases of outright embezzlement or the exploitation of a corporate opportunity but also management decisions that result in a waste of assets, for example, the decision to enter into a transaction that does not provide for any, or not for adequate, consideration for the company.<sup>47</sup> Abuse of corporate assets entails not only criminal liability but, generally, also civil liability.<sup>48</sup> This gives minority shareholders the opportunity to file a criminal complaint and combine this with a claim for damages on behalf of the company (*plainte avec constitution de partie civile*).<sup>49</sup> The judge will open criminal proceedings if the shareholders can show that 'the existence of a loss and the direct link between the loss and a criminal offence' (that is, the

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41. CDDA 1986, ss. 6(1)(b), 8(2). Other grounds for disqualification include the commission of an indictable offence in relation with the promotion, formation, management, or liquidation of a company, persistent breaches of reporting requirements under the Companies Acts and the Insolvency Act 1986, or the finding that a director is liable to contribute to the company's assets because of wrongful or fraudulent trading, CDDA 1986, ss. 2-4, 10.

42. *Re Barings plc and Others* (No 5) [1999] 1 BCLC 433, 483.

43. *Barings*, *supra* n. 42. However, it is important to note that a disqualification order will not be issued in all instances of a breach of duty. Rather, the courts require a showing of recklessness or 'negligence in a very marked degree', for example, where a director repeatedly fails to keep proper accounting records, fails to file annual returns, and causes loan transactions to be made between companies of a corporate group that were in severe financial difficulties, *Re Sevenoaks Stationers (Retail) Ltd* [1991] Ch 164, 184. For further details, see Gerner-Beuerle and Schillig, *supra* n. 40, 717-18.

44. On this problem, see also §15.03.

45. This paragraph is adapted from Gerner-Beuerle and Schillig, *supra* n. 40, 720.

46. French Commercial Code, Article L242-6.

47. This has been held to be the case where a director receives excessive remuneration (Cass. Crim., 22 September 2004, no 03-82266, *Bull. Joly Sociétés* 2005, 45) or remuneration that has not been authorised (Cass. Crim., 22 March 2017, no 15-84229, *Revue des sociétés* 2017, 591), assets are transferred, or services rendered, at rates below market value within a corporate group (Cass. Crim., 25 October 2006, no 05-85998, *Bull. Joly Sociétés* 2007, 243), or a director enters a self-dealing transaction that is of no economic value to the company (Cass. Crim., 12 September 2001, no 01-80895, *Droit des sociétés* 2002, no 6).

48. French Commercial Code, Article L225-251.

49. French Code of Criminal Procedure, Articles 2, 3, 85.



conditions for being able to act as *partie civile* in the criminal proceedings<sup>50</sup>) are ‘possible’.<sup>51</sup> Thus, the evidentiary burden is relatively easy to satisfy, and if the necessary link has been shown, the judge is under a duty to investigate.<sup>52</sup> This enforcement mechanism is important in practice, with several hundred convictions for abuse of corporate assets per year. Its function within the French enforcement architecture is somewhat comparable to the UK directors’ disqualification regime, insofar as the latter allows creditors to obtain compensation for a loss suffered by the company because of the misconduct of a director.<sup>53</sup> In both cases, private parties can take advantage of a public enforcement mechanism to obtain damages. However, crucially, parties to the French *action civile* have control over the proceedings, whereas the creditors of companies falling within the scope of the UK Company Directors Disqualification Act 1986 must rely on the Secretary of State to seek first a disqualification order and then compensation.

The problem of substitutability arises not only in relation to public and private enforcement mechanisms but also within the realm of private enforcement. As a basic principle, directors’ duties are in most legal systems and under most circumstances owed to the company and not to shareholders individually.<sup>54</sup> The question, therefore, is how the company’s damages claim can be enforced. Legal systems give different answers, which are partly a function of differences in prevalent corporate governance structures and partly of policy preferences regarding the perceived desirability of private enforcement and court supervision. In legal systems where companies predominantly operate under a one-tier board structure, the board of directors is typically empowered to take enforcement decisions,<sup>55</sup> with the general meeting having a subsidiary or complementary power to commence proceedings.<sup>56</sup> In two-tier board

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50. *Ibid.*, Art. 2.

51. Cass crim, 5 November 1991, no 90-82605 (*Société Industrielle et Financière Bertin*), *Revue des sociétés* 1992, 91. For a brief discussion of the decision in English, see Pierre-Henri Conac, Luca Enriques, and Martin Gelter, *Constraining Dominant Shareholders’ Self-Dealing: The Legal Framework in France, Germany, and Italy*, 4 ECFR 491, 518 (2007).

52. Conac, Enriques, and Gelter, *supra* n. 51, 518, with references.

53. Pursuant to the CDDA 1986, Arts 15A and 15B, the Secretary of State may seek compensation from the director for the benefit of the creditors if the company is insolvent and the conduct that has given rise to the disqualification order or disqualification undertaking has caused a loss to the company’s creditors.

54. See, for example, the UK Companies Act 2006, s. 170(1) and the German Stock Corporation Act, § 93(2) sentence 1 (liability of the members of the management board); §116 (liability of the members of the supervisory board).

55. For example, in the UK, US, and France, enforcement decisions are regarded as falling within the general management powers of the board, see, e.g., *John Shaw & Sons v Shaw and Shaw* [1935] 2 KB 113 (UK); *Zapata Corp v Maldonado*, 430 A.2d 779 (Del. 1981).

56. On this point, there is considerable variation across legal systems. In the UK, enforcement powers of the general meeting are subsidiary: The general meeting, ‘in the absence of an effective board, has a residual authority to use the company’s powers. ... Moreover, although the general meeting cannot restrain the directors from conducting actions in the name of the company, it still seems to be the law that the general meeting can commence proceedings on behalf of the company if the directors fail to do so.’ *Alexander Ward & Co Ltd v Samyang Navigation* [1975] 1 WLR 673, 679 (per Lord Halisham). In Italy, it is complementary. Shareholders can always direct the board to commence litigation by way of ordinary resolution, Article 2364(1) no 4 Italian Civil Code. Under Delaware law, the shareholders enjoy neither a

systems, this power is generally vested in the supervisory board, which also represents the company in legal proceedings.<sup>57</sup> Again, the general meeting may enjoy a subsidiary or complementary power to bring litigation or request the company to do so.<sup>58</sup>

Because of the conflict of interest that exists if the board of directors in a unitary board system and, to a lesser extent, the supervisory board in a dual board system are entrusted with making enforcement decisions concerning one or more board members, the basic rules sketched in the previous paragraph are complemented in most legal systems by ancillary mechanisms designed to safeguard the interests of shareholders if the board does not act and the general meeting is unable to step in for practical or legal reasons. Here, substitutability becomes relevant. Many legal systems provide for a derivative action mechanism that enables individual shareholders or groups of shareholders to bring a lawsuit and enforce claims of a company against its directors. The design of the minority shareholder lawsuit differs considerably across jurisdictions. How to quantify this variation is a non-trivial question, to which we return in §15.03 and §15.04. For present purposes, it is important to note that the derivative action is not the only mechanism employed by legal systems to alleviate the conflict of interest that affects board enforcement decisions.

As an alternative,<sup>59</sup> some legal systems permit minority shareholders to petition a court to appoint a special auditor who is empowered to investigate potential misconduct, which may then form the basis of a liability claim.<sup>60</sup> An example of such a mechanism that has received considerable attention are the Dutch inquiry proceedings.<sup>61</sup> These proceedings are conducted by the Enterprise Chamber of the Amsterdam Court of Appeal. They are different from other shareholder rights to appoint a special auditor in that the proceedings, once initiated on the application of shareholders holding at least 10% of the issued share capital or shares with a nominal value of EUR 225,000,<sup>62</sup> are largely reliant on public resources. If shareholders can substantiate the claim that the company has not been managed properly, the court will appoint an independent investigator, who is empowered to inspect the corporate books and

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complementary nor a subsidiary power to bring a lawsuit, but must always make a demand on the board, *Zapata Corp v Maldonado*, 430 A.2d 779, 782 (however, a derivative action is possible when demand was refused in breach of directors' duties or demand is excused, see §15.03).

57. For example, German Stock Corporation Act, § 112.

58. German Stock Corporation Act, § 147(1). For further examples, see, Carsten Gerner-Beuerle, Philipp Paech, and Edmund Schuster, *Study on Directors' Duties and Liability*, prepared for the European Commission DG Markt 194 (2013).

59. The paragraph that follows is adapted from Gerner-Beuerle and Schillig, *supra* n. 40, 719–20.

60. For example, under German law, shareholders representing at least 1% of the legal capital or EUR 100,000 have the right to apply to the court to appoint a special auditor, German Stock Corporation Act, §142(2). A similar right exists in France for shareholders holding at least 5% of the share capital, French Commercial Code, Article L225-231. A precondition for the exercise of the right under German, but not French, law is prima facie showing that the conduct complained of involved dishonesty or a gross violation of the law. Importantly, pursuant to both German and French law, the court can decide that court fees and the remuneration of the special auditor must be borne by the company. For a discussion of both provisions, see Conac, Enriques, and Gelter, *supra* n. 51, 512–13.

61. Dutch Civil Code, Articles 2:344 to 2:359.

62. Dutch Civil Code, Article 2:346(b). The request can also be made by the advocate general at the court, if this is in the public interest, Article 2:345(2), or by a workers' union, Article 2:347.

records and request any other relevant information from the company's directors.<sup>63</sup> The Enterprise Chamber can adopt a range of measures to remedy problems identified in the investigator's report, including the annulment of resolutions, dismissal of directors, appointment of external auditors or independent directors, disapplication of specific provisions of the articles, and, as a last resort, winding up of the company.<sup>64</sup> It has been argued that this flexibility, combined with the power of the court to grant injunctive relief in a fast-track procedure, explains the success of the inquiry proceeding.<sup>65</sup> The procedure is also cost-efficient for investors, provided they meet the filing threshold, since costs are imposed on the company, and the court oversees the investigation.<sup>66</sup>

Finally, on a more fundamental level, a degree of substitutability (as well as complementarity<sup>67</sup>) also exists between the formulation of directors' duties and their enforcement. If it is believed that the correct benchmark to measure the effectiveness of a regulatory regime in constraining managerial misconduct is the threat that directors who engage in misconduct are found liable to pay damages, both the strictness of duties and the ease of their enforcement play a role. This point is explored further in §15.03 below.

### [B] Complementarity

Some legal instruments are ineffective if not complemented by others. Complementarity of legal rules has a substantive and a procedural dimension. An example of both facets is the right of minority shareholders to challenge decisions of the board of directors or the general meeting, which is mentioned by La Porta et al., as part of their 'oppressed minorities' variable (a component of the ADR index).<sup>68</sup> This right has little relevance if the law does not provide for substantive requirements to which decisions of the general meeting or the board must conform and that reflect the interests of the shareholders.<sup>69</sup> In addition, the law must ensure that minority shareholders can enforce their right without unreasonable difficulties. This is, for example, the crucial problem of appraisal rights in the US, where several structural and procedural deficiencies render the remedy largely ineffective.<sup>70</sup> Legal coding that does not take

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63. Dutch Civil Code, Articles 2:350(1), (4), 2:351.

64. *Ibid.*, Arts 2:355, 2:356.

65. Erik P.M. Vermeulen and Dirk A. Zetzsche, *The Use and Abuse of Investor Suits: An Inquiry into the Dark Side of Shareholder Activism* (2010) 7 ECFR 1, 18–19. Injunctive relief is set out in Art. 2:349a(2) Dutch Civil Code.

66. Dutch Civil Code, Art. 2:350(3).

67. On this latter point, see, §15.02[B].

68. See the text *supra* n. 31.

69. The German Stock Corporation Act provides for an example of such a substantive requirement in § 243(2), which allows a resolution adopted by the shareholders in general meeting to be challenged on the ground 'that a stockholder, by exercising the voting right, sought to obtain special benefits for himself or for a third party to the detriment of the company or of the other stockholders and that the resolution is suited to serve this purpose'.

70. For an overview of these deficiencies, see, Arthur R. Pinto and Douglas M. Branson, *Understanding Corporate Law* § 6.06 (5th ed., LexisNexis 2018).

these substantive and procedural complementarities into consideration, such as, arguably, La Porta et al.'s 'oppressed minorities' variable, fails to assess the effectiveness of an instrument correctly.<sup>71</sup>

These considerations are of direct relevance to the present analysis. Starting point of an inquiry into the effectiveness of a regulatory regime establishing directors' duties and regulating their enforcement is the observation that the risk of monetary liability sets incentives and thus influences the behaviour of directors and managers.<sup>72</sup> If calibrated correctly, it will minimise the sum of agency costs, enforcement costs (particularly through litigation), and principal costs (costs incurred by the shareholders because of risk averse behaviour of the directors or a higher level of compensation demanded by directors because of heightened liability standards).<sup>73</sup> It is not the purpose of this contribution to examine under which conditions legal rules are optimal in this sense—for example, whether it is more efficient to limit liability to situations where directors are conflicted, act in bad faith, or without appropriate information (business judgment rule) than holding them liable for any loss caused by a negligent act<sup>74</sup>—or which legal system provide for the most efficient solution to the problem of managerial misconduct.

Rather, the important point is that an optimal regulatory solution can be reached through different routes. If it is correct that there is a trade-off between agency costs, enforcement costs, and principal costs (that is, a minimisation of, say, agency costs considered in isolation through high liability standards is not optimal), as argued in the literature, a regime is optimal if it facilitates shareholder enforcement but at the same time limits the liability exposure of directors in some form.<sup>75</sup> This can be achieved either through an appropriate formulation of directors' duties, notably the business judgment rule, or limitations on enforcement. On the other hand, reforms that seek to strengthen enforcement against the backdrop of stringently formulated duties, or vice versa, may create an inefficiently high risk of liability.<sup>76</sup> It is important to be aware of this interdependence between the content of duties and their enforcement.

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71. The original definition of the variable can be found in La Porta et al., *Law and Finance*, *supra* n. 26, 1122, and a revised version in Djankov et al., *supra* n. 27, 455.

72. It is debatable whether the mere pronouncement of a behavioural standard without the threat of liability in case of non-compliance is sufficient to incentivise directors to act according to that behavioural standard. Under US law, for example, the standard of conduct of directors is different from the standard applied by courts to review the behaviour of directors. The former is informed by the 'amount of care which ordinarily careful and prudent men would use in similar circumstances', *Re Walt Disney Co. Derivative Litigation*, 907 A.2d 693, 749 (Del. Ch. 2005). The latter is known as the business judgment rule. However, it is plausible to assume that the formulation of a behavioural standard that is unenforceable will have a limited effect on behaviour. This is indeed a standard assumption in the literature, *see, e.g.,* Holger Spamann, *Monetary Liability for Breach of the Duty of Care?*, 8 J. Leg. Anal. 337, 343 (2016).

73. On the concept of principal costs, *see* Zohar Goshen and Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 Columbia Law Rev. 767 (2017).

74. For formal models exploring this question, *see* Spamann, *supra* n. 72; Andreas Engert and Susanne Goldlücke, *Why Agents Need Discretion: The Business Judgment Rule as Optimal Standard of Care*, 13 Rev. Law Econ. 1 (2017).

75. *See* Spamann, *supra* n. 72; Engert and Goldlücke, *supra* n. 74.

76. Engert and Goldlücke, *supra* n. 74, 5.

**[C] Complexity**

Necessarily, any model of the real world needs to operate at a sufficiently abstract level to have explanatory value. The question is how to balance the need for simplification and the risk of over-simplification. As mentioned, legal indices initially often quantified legal rules in a binary and linear fashion. More recently, revised indices developed by La Porta et al. and other researchers seek to capture nuances of legal rules by introducing incremental steps between 0 and 1. For example, the anti-self-dealing index uses smaller increments of, for example, one-half, one-third, or one-fifth points.<sup>77</sup> This method addresses partly the fact that a quantification of legal rules needs to account for gradual differences in how rules are formulated across countries, but it continues to be subject to concerns. First, it is based on the implicit assumption that each transition from one incremental step to the next is equally important in assessing the effectiveness of a legal rule, since all steps are weighted equally. The same assumption underlies the use of indices that aggregate or average the scores allocated to index components, as is the case with most of the indices discussed earlier.<sup>78</sup>

Second, and arguably even more importantly, legal rules (and elements of rules, where an index disaggregates them) are often meaningless if assessed in isolation. The effectiveness of a legal systems in regulating a particular economic conflict generally only becomes clear if the full set of relevant rules is analysed holistically. The reason is partly that some rules have substitutes and complements, as discussed in §15.02[A] and §15.02[B], but also that rules operate differently depending on decisions of economic actors—issuers, shareholders, directors—at earlier stages, which, in turn, are constrained or enabled by other legal rules. An illustrative example is a variable from Djankov et al.’s self-dealing index that measures the ease with which an interested director can be held liable. The variable ranges from 0 to 1 and receives the following values:<sup>79</sup>

Equals 0 when the interested director is either not liable or liable only in cases of bad faith, intent, or gross negligence. Equals 1/2 when the interested director is liable if he either influenced the approval or was negligent. Equals 1 if the interested director is liable if the transaction is unfair, oppressive, or prejudicial.

This definition is difficult to apply to the duty of loyalty as formulated under Delaware law (and in many other jurisdictions). Pursuant to Delaware law, an interested director is liable if a related-party transaction is not entirely fair to the corporation (thus, the variable should arguably receive the value 1), *unless* the transaction was approved by the disinterested directors or shareholders.<sup>80</sup> The latter point, approval by disinterested shareholders, is a separate component of the self-dealing index, which ‘[e]quals 1 if the transaction must be approved by disinterested shareholders, and zero otherwise’.<sup>81</sup> Under Delaware law, transactions do not have to

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77. Djankov et al., *supra* n. 27, 434–435.

78. See the text to notes 26–33 *supra*.

79. Djankov et al., *supra* n. 27, 434.

80. Delaware General Corporation Law, § 144(a).

81. Djankov et al., *supra* n. 27 434.

be approved by disinterested shareholders, but they can, in which case interested directors are generally not liable even if the transaction is unfair.<sup>82</sup> The self-dealing index does not capture this interaction effect.

The next two sections analyse in more detail how legal rules interact in the context of liability for managerial misconduct. The next section gives an overview of legal rules relevant to this question, regarding both the substantive formulation of duties and their enforcement. Section 15.04 takes one duty, the duty of care, as an example to illustrate a possible mapping of interactions and offer a framework for quantifying different legal and contractual arrangements concerning directors' duties.

### §15.03 DIRECTORS' DUTIES AND THEIR ENFORCEMENT

The risk of monetary liability is a function of the content of directors' duties (for example, the formulation of the standard of care), their enforcement, and ancillary legal rules that allow or disallow private ordering that affects the liability exposure of directors. In particular, shareholders and directors may seek to curtail the reach of duties, authorise or ratify certain acts, indemnify directors against liability, or arrange for the company to take out insurance for the benefit of the directors.

Table 15.1 summarises these aspects of directors' duties in four influential jurisdictions: Delaware, the UK, Germany, and France. It includes information on the content of the two main fiduciary duties that impose behavioural expectations on directors—care and loyalty—and the availability of contractual mechanisms that could limit the liability of directors. The duties of care and loyalty can be found, in one form or another, in virtually all legal systems, including Delaware, the UK, Germany, and France.<sup>83</sup> They differ to some extent in their conceptual design and the standards of conduct they impose on directors, but in all four jurisdictions directors are expected to exercise the care of a reasonably diligent person and avoid conflicts of interest. In all four jurisdictions, liability can furthermore be modified or limited through private ordering. Again, legal systems differ in the extent to which this is possible, but no jurisdiction prohibits all arrangements that would limit the liability exposure of directors. Table 15.1 distinguishes between *ex ante* limitations, for example, a broad authorisation of certain types of conduct by the shareholders or in the articles of association, such as the exploitation of specified categories of corporate opportunities, indemnification against liability or expenses incurred by a director in an action of the company against the director, *ex post* limitations, in particular, the ratification of acts that amount to a breach of duty, and directors and officers (D&O) insurance.

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82. If disinterested shareholder or director approval has been obtained, courts will not enter into a full fairness review. See, e.g., *Marciano v. Nakash*, 535 A.2d 400, 405 (Del. 1987): '[A]pproval by fully-informed disinterested directors under section 144(a)(1) [Delaware General Corporation Law], or disinterested stockholders under section 144(a)(2), permits invocation of the business judgment rule and limits judicial review to issues of gift or waste with the burden of proof upon the party attacking the transaction'.

83. Gerner-Beuerle and Schuster, *supra* n. 19, 199.

Table 15.1 *Directors' Duties in Comparative Perspective*

	<i>Delaware</i>	<i>UK</i>	<i>Germany</i>	<i>France</i>
<b>Duty of care</b>	Business judgment rule: no liability unless plaintiffs can show a conflict of interest, bad faith, or that the defendants did not act on an informed basis; <sup>84</sup> if the business judgment rule does not apply, directors must show entire fairness <sup>85</sup>	Directors must exercise reasonable care, skill, and diligence; <sup>86</sup> no business judgment rule	Directors must exercise the care of a conscientious manager; business judgment rule applies: no liability if directors show that they acted in good faith in the best interest of the company and based on appropriate information <sup>87</sup>	Directors must act as prudent and diligent managers; no business judgment rule <sup>88</sup>

84. See, for example, *Aronson v Lewis*, 473 A.2d 805, 812 (Del. 1984): 'The business judgment rule ... is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company. ... Absent an abuse of discretion, that judgment will be respected by the courts. The burden is on the party challenging the decision to establish facts rebutting the presumption.'

85. For example, in *In re Walt Disney Co. Derivative Litigation*, 906 A.2d 27, 52 (Del. 2006), the Supreme Court of Delaware explained: The presumptions of the business judgment rule 'can be rebutted if the plaintiff shows that the directors breached their fiduciary duty of care or of loyalty or acted in bad faith. If that is shown, the burden then shifts to the director defendants to demonstrate that the challenged act or transaction was entirely fair to the corporation and its shareholders.'

86. UK Companies Act 2006, s. 174.

87. German Stock Corporation Act, § 93(1), (2).

88. For example, Cass. Com., 30 March 2010, FP-P + B + R + I, n° 08-17.841, *Fonds de garantie des dépôts (FGD) c/ Sté Caribéenne de conseil et d'audit (Crédit Martiniquais)*, *Revue des sociétés* 2010, 304.



	<i>Delaware</i>	<i>UK</i>	<i>Germany</i>	<i>France</i>
<b>Duty of loyalty</b>	Related-party transactions must be entirely fair unless approved by disinterested directors or shareholders <sup>89</sup>	Related-party transactions must be disclosed; default rule is that interested directors abstain from decisions; <sup>90</sup> shareholder approval under some conditions <sup>91</sup>	Supervisory board decides on related-party transactions between the company and members of the management board, but no explicit disclosure requirement <sup>92</sup>	Certain types of transaction (regulated agreements) require board and shareholder approval, but complex and non-transparent procedure <sup>93</sup>
<b>Ex ante limitation of liability</b>	Exclusion of liability for monetary damages for breach of the duty of care possible in the certificate of incorporation, except for acts in bad faith; <sup>94</sup> corporation may waive any interest in specified business opportunities or classes or categories of opportunities in the certificate of incorporation <sup>95</sup>	Liability for breach of the duty of care cannot be contractually excluded <i>ex ante</i> ; authorisation of transactions that would violate the duty of loyalty can be given <i>ex ante</i> by the disinterested directors if permitted in the articles <sup>96</sup>	Impermissible to contractually alter liability <i>ex ante</i> ; <sup>97</sup> if the management board lays a resolution before the general meeting authorising an act of a director, and shareholders vote accordingly, the company cannot claim damages based on that act, but creditors continue to be able to enforce the company's claim under certain conditions <sup>98</sup>	Impermissible to contractually alter liability <i>ex ante</i> <sup>99</sup>

89. Delaware General Corporation Law, § 144.

90. UK Companies Act 2006, s. 177.

91. For example, companies with a premium listing on the London Stock Exchange are required to obtain disinterested shareholder approval of related-party transactions that exceed certain size thresholds, FCA Handbook, Listing Rule 11.1.7.

92. German Stock Corporation Act, § 112.

93. French Commercial Code, Articles L225-38 to L225-42.



	<i>Delaware</i>	<i>UK</i>	<i>Germany</i>	<i>France</i>
<b>Indemnification in an action of the company against a director</b>	Indemnification against expenses and attorney's fees permissible, provided the director is held not to be liable, acted in good faith, and reasonably believed that the challenged conduct was in the best interest of the company <sup>100</sup>	Indemnification against expenses and attorney's fees permissible, provided the director is held not to be liable <sup>101</sup>	Not explicitly addressed in the Stock Corporation Act, but predominantly regarded as impermissible <sup>102</sup>	Indemnification regarded as impermissible <sup>103</sup>

94. Delaware General Corporation Law, § 102(b)(7).

95. Delaware General Corporation Law, § 122(17).

96. UK Companies Act 2006, s. 175(4)(b), (5).

97. This follows from the principle of limited contractual freedom in the law on stock corporations, German Stock Corporation Act, § 23(5).

98. German Stock Corporation Act, § 93(4), sentence 1, (5). Creditors are entitled to enforce the company's damages claim if the company is unable to satisfy the creditors' claim(s) and the directors acted grossly negligently or violated certain capital maintenance provisions listed in § 93(3).

99. French Commercial Code, Article L225-53.

100. Delaware General Corporation Law, § 145(b).

101. UK Companies Act 2006, s. 234(b)(ii).

102. It has been argued that indemnification by the company would be tantamount to a violation of § 93(4) Stock Corporation Act. See text to n. 111 and Gerner-Beuerle and Schillig, *supra* n. 40, 673 for references.

103. Bernard Black et al., *Legal Liability of Directors and Company Officials Part 2: Court Procedures, Indemnification and Insurance, and Administrative and Criminal Liability*, Colum. Bus. L. Rev. 1, 58 (2008).

	<i>Delaware</i>	<i>UK</i>	<i>Germany</i>	<i>France</i>
<b><i>Ex post</i> waiver of liability</b>	Ratification by fully informed disinterested shareholder vote permissible, unless the act is non-ratifiable (i.e., <i>ultra vires</i> , fraudulent, or a waste of corporate assets); <sup>104</sup> however, note that ratification does not extinguish liability, but reinstates business judgment rule review <sup>105</sup>	Ratification of conduct by a director amounting to negligence, default, or breach of duty by shareholder resolution permissible; votes of interested directors and connected members are disregarded <sup>106</sup>	The company can only waive claims three years after they arose and only if approved by shareholders and no objection is registered by minority shareholders holding at least 10% of the share capital; <sup>107</sup> the waiver has no effect in relation to creditors, who may be able to enforce the company's claim under certain conditions <sup>108</sup>	No <i>ex post</i> waiver of liability claims permissible <sup>109</sup>

104. *Michelson v Duncan*, 407 A.2d 211, 219 (Del. 1979). Ultra vires acts have been defined as 'acts specifically prohibited by the corporation's charter, for which no implicit authority may be rationally surmised, or those acts contrary to basic principles of fiduciary law', *Solomon v. Armstrong*, 747 A.2d 1098, 1114, fn. 45 (Del. Ch. 1999).

105. *Gantler v. Stephens*, 965 A.2d 695 (Del. 2009). If the business judgment rule implies, shareholder plaintiffs can only succeed if they are able to show that the challenged conduct amounts to a waste of corporate assets, see, e.g., *Fliegler v. Lawrence*, 361 A.2d 218, 221 (Del. 1976): '[S]hareholder ratification of an 'interested transaction', although less than unanimous, shifts the burden of proof to an objecting shareholder to demonstrate that the terms are so unequal as to amount to a gift or waste of corporate assets.'

106. UK Companies Act 2006, s. 239.

107. German Stock Corporation Act, § 93(4).

108. German Stock Corporation Act, § 93(5). See also, *supra* n. 102 above on the position of creditors.

109. French Commercial Code, Article L225-253.

	<i>Delaware</i>	<i>UK</i>	<i>Germany</i>	<i>France</i>
<b>Insurance</b>	Company can take out insurance for the benefit of its directors, including for damages claims of the company against a director and where indemnification would not be permissible <sup>110</sup>	Company can take out insurance for the benefit of its directors, including for damages claims of the company against a director and where indemnification would not be permissible <sup>111</sup>	Company can take out insurance for the benefit of its directors, including for damages claims of the company against a director, but the insurance policy must provide for an excess of at least 10% of the damage, capped at not less than 1.5 times the director's fixed annual remuneration <sup>112</sup>	Company can take out insurance for the benefit of its directors, including for damages claims of the company against a director, <sup>113</sup> except against criminal liability and liability arising from intentional or fraudulent conduct <sup>114</sup>

Source: XX.

If the risk of monetary liability is key to calibrating behaviour, as suggested in §15.02 [B], the effectiveness of directors' duties is a function of (1) the range of conduct amounting to a breach of duty (first two rows of Table 15.1); (2) conduct excluded *ex ante* from the set of behaviour that potentially amounts to a breach of duty (third row of Table 15.1); (3) the right of directors to be indemnified by the company (fourth row of Table 15.1); (4) conduct that can be excluded *ex post* from the set of behaviour that potentially amounts to a breach of duty (fifth row of Table 15.1); (5) the coverage of D&O insurance (sixth row of Table 15.1); and (6) the ease with which potential breaches of duties can be enforced. Points (1) and (6) are governed by a country's legal system, whereas points (2) to (5) are governed by the private arrangements between a company, its shareholders, and directors within the limits on private ordering drawn

110. Delaware General Corporation Law, § 145(g). However, it is worth noting that insurance policies typically provide for deductibles and exclude coverage for intentional or reckless behaviour and violations of securities regulation, Pinto and Branson, *supra* n. 70 § 14.11[H].

111. UK Companies Act 2006, s 233.

112. German Stock Corporation Act, § 93(2) sentence 3.

113. Cass. Civ., 1 June 2011, decision no 10-18143, *Bull. Joly Sociétés* 2011, 860.

114. French Insurance Code, Art. L113-1(2).

by a legal system. Data compiled according to this methodology is therefore firm-level data that will exhibit variation at both the country and firm level.

Since directors' duties are generally owed to the company, and not to shareholders directly, the company is the proper plaintiff in an action enforcing duties.<sup>115</sup> In most jurisdictions, the body authorised to take enforcement decisions on behalf of the company is the board of directors.<sup>116</sup> Entrusting the board of directors (or even the supervisory board in companies with a two-tier board structure<sup>117</sup>) with the decision to enforce a potential claim of the company against a director gives rise to an evident conflict of interest. For this reason, legal systems have developed mechanisms that allow minority shareholders to instigate enforcement actions. In many cases, these are designed as a derivative action, that is, a lawsuit in which shareholders have standing to bring a cause of action in the company's name, although substitute mechanisms exist.<sup>118</sup> The conditions under which minority shareholders can bring a derivative action can be divided into three groups: standing requirements, further conditions (or screening mechanisms) that serve to distinguish between meritorious and frivolous claims or between efficient and inefficient enforcement actions, and cost rules.<sup>119</sup> Standing rules specify whether anyone holding at least one share can file a derivative action, or claimants must satisfy a holding threshold expressed in percentage terms or as a minimum nominal value amount. Further conditions may relate to minimum holding periods, the requirement that an enforcement of the company's claim must be in the best interest of the company, or, most restrictively, the defendant director is in control of the general meeting.<sup>120</sup> Procedural rules that determine whether the company or the claimant bears the costs of the proceedings and, if the latter is the case, whether the claimant has a right to be indemnified by the company, are important because enforcement through minority shareholders faces a collective action and free-rider problem. If the company's claim is successfully enforced, it is the company who recovers damages, and the payoff accrues only indirectly to the shareholders in proportion to their shareholdings. The shareholders' incentives to bring a derivative action are, therefore, inefficiently low if they bear the litigation risk. Table 15.2 summarises Delaware, UK, German, and French law along these three dimensions.

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115. See *supra* n. 54.

116. For a more detailed discussion of this point, see Paul L. Davies, Sarah Worthington, and Christopher Hare, *Gower: Principles of Modern Company Law* 15-002 (11th ed., Sweet & Maxwell 2021); Gerner-Beuerle and Schillig, *supra* n. 40, 678-81.

117. See, for example, § 112 German Stock Corporation Act.

118. See §15.02[A].

119. Gerner-Beuerle and Schuster, *supra* n. 19, 215-216.

120. This is the famous rule in *Foss v. Harbottle* (1843) 67 ER 189 that applied in the UK until the derivative action was codified in the Companies Act 2006: The defendant directors must have committed a wrong that benefitted them personally and have de jure or de facto control of the general meeting.

Table 15.2 Comparative Effectiveness of the Derivative Action

	Delaware	UK pre-2006	UK post-2006	Germany pre-2005	Germany post-2005	France
<b>Size of shareholding</b>	1 share	1 share	1 share	1884: 20% 1965: 10% 1998: 5%	1% or EUR 100,000	1 share
<b>Additional conditions</b>	Demand refused or excused	Fraud on the minority	Claim admission procedure	1998: Bad faith or gross negligence	Claim admission procedure	Company refuses to take action
<b>Cost rules</b>	Court decides (corpora tion if lawsuit beneficial); contingency fee possible	Indemnifi cation order if good faith and reasonable grounds	Indemnifi cation order if good faith and reasonable grounds	Shareholder bears litigation risk	Plaintiff can generally claim re-imbursement	Shareholder bears litigation risk

Source: Adapted from Gerner-Beuerle and Schillig (n 40) 714.

The relationship between the three types of legal requirement is not self-evident. Martin Gelter has argued that several preconditions must be satisfied simultaneously for a derivative action to be an efficient shareholder protection tool, and the absence of any of them renders the derivative action largely ineffective.<sup>121</sup> This observation is important because it underlines that a construction of legal indices based on a simple aggregation of scores or averages may introduce bias and misrepresent the true operation of legal rules.

In Table 15.2, the red shaded entries represent aspect of a legal system's derivative action mechanism that are either difficult to satisfy by minority shareholders or likely to deter them from bringing a derivative action. In the UK, until a codification of derivative actions in the Companies Act 2006,<sup>122</sup> the common law position was known as the rule in *Foss v. Harbottle*, which required that the challenged act constituted a fraud on the minority and the defendants were in control of the

121. See Martin Gelter, *Why do Shareholder Derivative Suits Remain Rare in Continental Europe?*, 37 Brook, J. Int'l L. 843, 856–880 (2012) (arguing that standing requirements must be favourable and not include a minimum ownership threshold, the claimant must not bear the litigation risk, access of shareholders to information must be secured, and it must be possible to include controlling shareholders as potential defendants).

122. UK Companies Act 2006, ss. 260–269.

company.<sup>123</sup> This rule effectively made minority shareholder lawsuits in public companies, which were unlikely to have a controlling shareholder, impossible. The 'fraud on the minority' and 'wrongdoers in control' requirements have not been retained by the Companies Act 2006,<sup>124</sup> and minority shareholder lawsuits have become more common now.<sup>125</sup>

Similarly, in Germany, a high threshold of initially 20% of the share capital, which was gradually reduced to 5% in 1998, as a prerequisite to bring a derivative action made it difficult for minority shareholders to enforce a claim of the company. This threshold was further reduced to 1% or EUR 100,000 in 2005,<sup>126</sup> but it is questionable whether this change goes far enough. In addition, cost rules were unfavourable until 2005 and continue to impose a certain litigation risk on claimants. Until the reforms of 2005, claimant-shareholders bore the full litigation risk under Germany's 'loser pays' system. The 2005 reforms introduced a claims admission procedure similar to the one established by the Companies Act 2006 in the UK.<sup>127</sup> Claimants now bear the costs of the proceedings if the court dismisses the petition to grant leave.<sup>128</sup> If leave is granted, but the lawsuit is dismissed, the claimants have a right to be reimbursed for their costs by the company.<sup>129</sup> The litigation risk is therefore partly shifted to the company. However, since the decision of the court whether to grant leave depends on an assessment of what is in the best interest of the company,<sup>130</sup> the outcome of the procedure will often not be easy to predict. This may explain why derivative actions have remained rare in Germany even after the reforms of 2005.<sup>131</sup>

UK law has developed a similar cost rule. In *Wallersteiner v. Moir*,<sup>132</sup> a decision that predates the Companies Act 2006, the Court of Appeal held that 'where a shareholder has in good faith and on reasonable grounds sued as plaintiff in a minority shareholder's action, the benefit of which, if successful, will accrue to the company and

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123. See *supra* n. 38 and accompanying text. The courts had developed several exceptions to this rule, see, *Edwards v. Halliwell* [1950] 2 All ER 1064, but these were of limited scope.

124. Some ambivalence remains, see David Kershaw, *The Rule in Foss v Harbottle is Dead; Long Live the Rule in Foss v. Harbottle*, (2015) J. Bus. L. 274 (arguing that wrongdoer control continues to be a threshold condition to derivative litigation). A different position is taken by John Armour, *Derivative Actions: A Framework for Decisions*, 135 Law Q. Rev. 412, 423–26 (2019). A version of the rule in *Foss v. Harbottle* also remains in force in some other common law jurisdictions, for example, Ireland, see *Fanning v. Murtagh* [2008] IEHC 277.

125. Armour et al., *supra* n. 4, 690 (observing that before 2006, 'the chances of a director of a publicly traded U.K. company being sued under corporate law [were] virtually nil'). While the rate of derivative litigation has increased since the adoption of the Companies Act 2006, the absolute number of minority shareholder lawsuits in the UK remains small in comparison with Delaware and some other common law and East Asian jurisdictions, Armour *supra* n. 129, 426–28.

126. Stock Corporation Act, § 148(1). See also the reference in n. 2 *supra*.

127. Stock Corporation Act, § 148. For similarities and differences between the German and UK derivative action mechanisms, see Gerner-Beuerle and Schuster, *supra* n. 19, 217–18.

128. Stock Corporation Act, § 148(6).

129. *Ibid.*

130. Stock Corporation Act, § 148(1), sentence 2, no. 4.

131. Sebastian Mock in Gerald Spindler and Eberhard Stolz (eds.), *Grosskommentar Aktienrecht* § 148 AktG para. 28 (5th ed., C.H. Beck 2022) (observing that only two decisions on a petition to grant leave have been reported since 2005).

132. [1975] QB 373.

only indirectly to the plaintiff as a member of the company, and which it would have been reasonable for an independent board of directors to bring in the company's name',<sup>133</sup> it is appropriate for the courts to make use of their judicial discretion to grant minority shareholders a cost indemnification. When leave is granted under the statutory derivative action mechanism that now applies, the *Wallersteiner v. Moir* test will typically be satisfied.<sup>134</sup> However, the outcome of an application for permission to continue a claim cannot be predicted with certainty. In addition, even where an application is successful, an indemnification order is within the discretion of the court, and there is thus a residual financial risk for the claimants.<sup>135</sup> Given the misaligned incentives in derivative actions, any litigation risk that is borne by the claimant-shareholders likely operates as a deterrent to enforcing a claim.

In Table 15.2, the fact that the post-2005 German rules and the *Wallersteiner v. Moir* test in the UK do not fully shift the litigation risk to the company is represented by orange shaded entries. Admittedly, the financial disincentive is greater if general civil procedure rules apply, as in Germany before the reforms of 2005 and in France still today. The French rules are a particularly illustrative example, since the French minority shareholder lawsuit is in principle permissively regulated. Any shareholder can bring an *action ut singuli*; claimants do not have to apply for permission to continue the claim, and the law does not establish any other restrictive conditions. The fact that minority shareholder litigation is almost non-existent in France is thus presumably attributable to the French cost rules.<sup>136</sup>

This leaves Delaware law as the only jurisdiction of the sample analysed here that regulates minority shareholder lawsuits appropriately across all three dimensions depicted in Table 15.2. It is worth emphasising that the Delaware courts have developed a relatively stringent screening mechanism to distinguish between meritorious and frivolous claims. The authority to bring a lawsuit lies with the board of directors. Shareholders must therefore make a demand on the board to enforce a claim.<sup>137</sup> A claim brought by shareholders will be dismissed if directors decide, in compliance with their fiduciary duties, to refuse demand or the shareholders failed to make a demand, unless 'the directors are under an influence which sterilizes their discretion [such that] they cannot be considered proper persons to conduct litigation on behalf of the corporation.'<sup>138</sup> While the demand requirement pursues the same goal

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133. *Ibid.*, 403–404.

134. *Iesini v Westrip Holdings Ltd* [2010] B.C.C. 420, 450.

135. For references to the relevant case law, see Davies, Worthington, and Hare, *supra* n. 116, 15–19.

136. Conac, Enriques, and Gelter, *supra* n. 51, 508–509.

137. See *Aronson v. Lewis*, 473 A.2d 805, 811–12 (Del. 1984): 'By its very nature the derivative action impinges on the managerial freedom of directors. Hence, the demand requirement of Chancery Rule 23.1 exists at the threshold, first to insure that a stockholder exhausts his intracorporate remedies, and then to provide a safeguard against strike suits. Thus, by promoting this form of alternate dispute resolution, rather than immediate recourse to litigation, the demand requirement is a recognition of the fundamental precept that directors manage the business and affairs of corporations.'

138. *Ibid.*, 814. To establish whether this is the case and demand is excused, courts ask three questions on a director-by-director basis: '(i) whether the director received a material personal benefit from the alleged misconduct that is the subject of the litigation demand; (ii) whether the

as the claims admission procedure under UK and German law, it therefore uses a different technique that presents, arguably, a bigger hurdle to plaintiffs than the UK and German rules: The evaluation of whether the enforcement of a claim is in the best interest of the company is left to the board of directors rather than a court, unless plaintiffs create a reasonable doubt that the directors could have formed an independent and disinterested business judgment.

On the other hand, cost rules are more favourable to plaintiffs than in any of the other jurisdictions. The possibility to enter into a contingency fee agreement combined with the 'American rule', according to which each party pays its own fees and expenses, allows plaintiffs to eliminate the litigation risk almost completely. As an additional incentive, Delaware law allows fees to be calculated based not only on the monetary fund produced by an action but also the value of a non-monetary benefit conferred on the company or its shareholders if an action does not result in a monetary recovery, for example, the annulment of an election or the production of amendments to corporate bylaws (so-called corporate benefits doctrine).<sup>139</sup>

#### **§15.04 TOWARDS A CONCEPTUALISATION OF THE DUTY-LIABILITY NEXUS: THE DUTY OF CARE**

This section takes the duty of care as an example to develop a framework for capturing the interdependence between the elements of directors' duties and their enforcement that were discussed in §15.03. Figure 15.1 visualises this interdependence. It charts paths that depend on the formulation of directors' duties, the permissiveness of a legal system regarding arrangements to limit the liability exposure of directors, and enforcement mechanisms. These paths determine a Duty of Care Index (DCI) ranging from 0 to 6 and an Enforcement Index (EI) ranging from 0 to 4, with higher scores indicating a greater liability exposure of directors. If directors do not face liability for any type of behaviour, that is, the DCI is equal to zero, the EI must also be zero. In other cases, there is no evident a priory relationship between the degree of liability exposure stemming from legal rules and contractual arrangements associated with directors' duties (points (1) to (5) as set out in §15.03) and the enforcement of duties. For example, it is not clear how a low DCI/high EI combination compares with a high DCI/low EI combination. It is therefore sensible to treat both as separate variables.

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director faces a substantial likelihood of liability on any of the claims that would be the subject of the litigation demand; and (iii) whether the director lacks independence from someone who received a material personal benefit from the alleged misconduct that would be the subject of the litigation demand or who would face a substantial likelihood of liability on any of the claims that are the subject of the litigation demand. If the answer to any of the questions is 'yes' for at least half of the members of the demand board, then demand is excused as futile.' *United Food & Commer. Workers Union v. Zuckerberg*, 262 A.3d 1034, 1059 (Del. 2021).

139. Pinto and Branson, *supra* n. 70, § 14.08[B], [C].



Figure 15.1 Duty of Care-Enforcement Interdependence

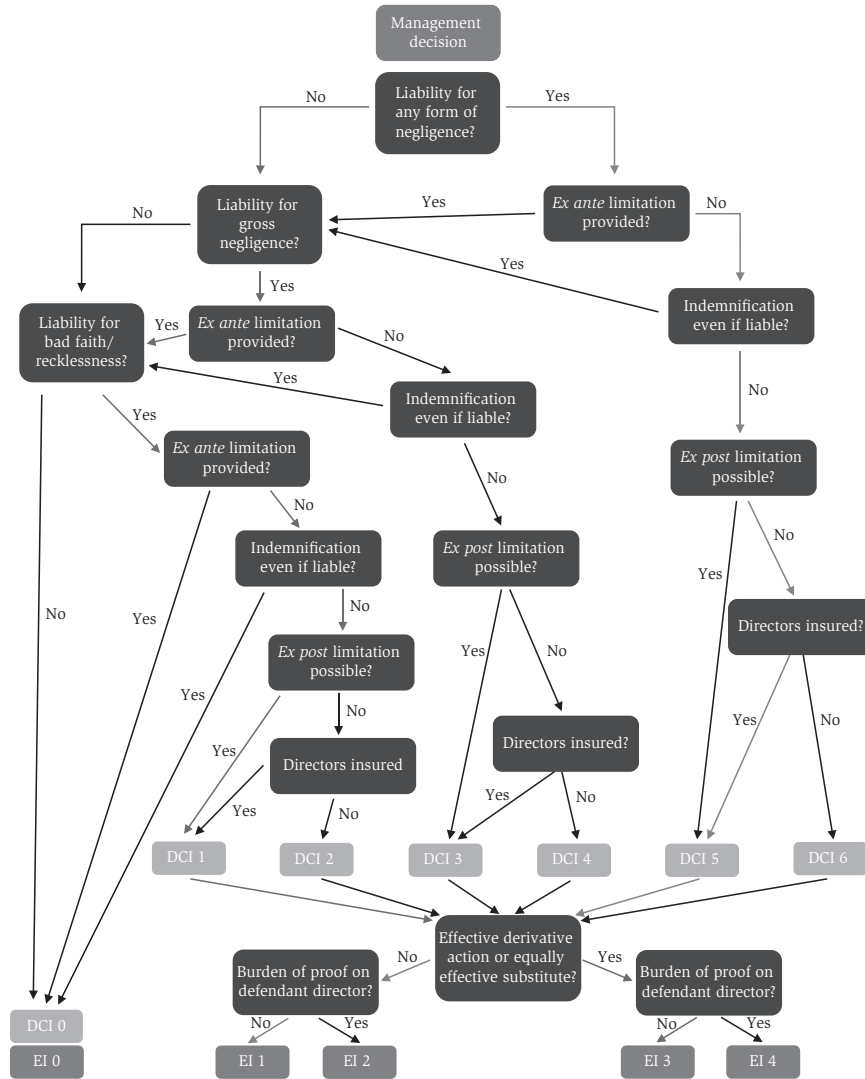


Figure 15.1 first outlines three broad standards of care that cover the spectrum of conceivable standards: a negligence standard, a gross negligence standard, and a bad faith/recklessness standard. Then, it makes allowance for the possibility that legal systems permit an *ex ante* modification of the applicable standard of care by limiting liability to conduct that amounts to the most demanding standard (such as Delaware) or excluding liability for conduct not exceeding the least demanding standard. If liability can be excluded even for bad faith or reckless behaviour (which is not the case

in any of the legal systems analysed here), directors face no liability, and the DCI thus equals zero. Likewise, if directors have a right to be indemnified fully for certain types of conduct (e.g., negligence), even if they are found liable, they face no threat of liability for that type of conduct, and Figure 15.1 shifts the analysis to the next standard of care.<sup>140</sup>

Figure 15.1 then asks whether the liability exposure of directors can be limited *ex post*, through ratification of an act amounting to either a breach of the duty of care or a waiver of the company's claim. Some legal systems, for example, Delaware and the UK, allow ratification by a vote of disinterested shareholders. Others do so only with significant hurdles (Germany<sup>141</sup>), and yet others prohibit any *ex post* waiver of liability (France).<sup>142</sup> The liability exposure of directors is higher than in the case of an *ex ante* limitation of liability, even if ratification results in directors being regarded as not having committed a breach of duty,<sup>143</sup> because the *ex ante* threat of liability conditions the behaviour of directors, and there is no guarantee that disinterested shareholders will ratify a breach in a particular case. In addition, a legal system may provide that some acts are non-ratifiable, or ratification does not extinguish liability, but may instead result in the activation of a review standard that is more favourable to directors. Notably, this is the case under Delaware law, where acts amounting, for example, to a waste of corporate assets cannot be ratified, and shareholder ratification of other acts reinstates the business judgment rule standard, rather than fully exculpating directors.<sup>144</sup>

D&O insurance, likewise, does not offer full protection against personal liability. Some legal systems provide for a legally mandated excess (for example, pursuant to German law, at least 10% of the damage with a cap of not less than 1.5 times the director's fixed annual remuneration<sup>145</sup>) or exclude coverage for certain types of conduct (for example, under French law, a company cannot insure its directors against liability arising from intentional or fraudulent conduct<sup>146</sup>). Even where no deductible is legally required, insurance policies will only offer limited coverage.<sup>147</sup> Furthermore, insurance undertakings are responsive to changes in the probability of a director being held liable, which may be a result of either legal changes or an updated assessment of

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140. Again, full indemnification is not permitted in any of the legal systems analysed here. See, for example, the UK Companies Act 2006, ss. 232(2) and 234(b)(ii), which provide that the articles of association or other contractual arrangements must not provide any indemnity against liability incurred by a director in proceedings brought by the director's company in which judgment is given against the director.

141. Claims can only be waived three years after they arose and only if no objection is registered by minority shareholders holding at least 10% of the share capital, German Stock Corporation Act, § 93(4).

142. See Table 15.2.

143. On the meaning and consequences of ratification and waiver, see Davies, Worthington, and Hare, *supra* n. 116, 10–112.

144. See the references in Table 15.2.

145. German Stock Corporation Act, § 93(2) sentence 3.

146. French Insurance Code, Art L113–1(2).

147. See the references *supra* n. 114.

the probability of future non-compliant behaviour by a director.<sup>148</sup> Directors may therefore face monetary consequences for a breach of duty even if they are insured. For purposes of the DCI, this means that if insurance is in place, the index should be lower than without insurance, but higher than in cases where liability is excluded *ex ante*. However, it is difficult to see how the incentive difference (if any) between the possibility of an *ex post* ratification of a breach of duty or waiver of the company's claim and the partial protection against monetary liability from insurance can be quantified in a rationally defensible manner. The DCI therefore treats both identically (DCI 1, 3, and 5).

To illustrate the operation of the DCI, assume that a company is incorporated under Delaware law and has made use of all possibilities granted under the law of Delaware to limit the liability exposure of directors. Pursuant to the Delaware duty of care, directors face no liability unless plaintiffs can show that the defendants acted in bad faith, disregarded material information reasonably available to them, or sought to derive a personal benefit from a transaction, for example, by engaging in self-dealing.<sup>149</sup> Whether directors availed themselves of all material information and then acted with the requisite care is assessed against a gross negligence standard.<sup>150</sup> However, Delaware law allows companies to exclude liability for monetary damages for a breach of the duty of care in the certificate of incorporation, except for acts in bad faith.<sup>151</sup> Such acts are also non-indemnifiable,<sup>152</sup> but shareholders have the possibility to ratify them (provided directors have not acted fraudulently<sup>153</sup>). Insurance policies, on the other hand, are unlikely to cover bad faith conduct. This sequence of considerations is depicted by red arrows in Figure 15.1. The resulting DCI equals 1.

In contrast, under French law, directors are liable for any form of negligence. Liability cannot be excluded or limited *ex ante*, directors cannot be indemnified and claims of the company cannot be waived *ex post*.<sup>154</sup> Companies are able to take out D&O insurance, which typically covers negligence. If insurance has indeed been

148. See, e.g., Roberta Romano, *Corporate Governance in the Aftermath of the Insurance Crisis* 39 Emory Law J. 1155, 1157–9 (1990) (explaining that D&O insurance became difficult to obtain in the United States after an explosion of liability actions in the first half of the 1980s that seemed to usher in a substantial increase in the risk of liability for good-faith breaches of the duty of care).

149. *Aronson v Lewis*, 473 A.2d 805, 812 (Del. 1984).

150. *Ibid.* From more recent case law, see also *Brehm v. Eisner*, 746 A.2d 244, 259 (Del. 2000); *Re Walt Disney Co. Derivative Litigation*, 907 A.2d 693, 749 (Del. Ch. 2005).

151. Delaware General Corporation Law, § 102(b)(7).

152. Delaware General Corporation Law, § 145(b).

153. Fraudulent acts constitute acts in bad faith, but whether acts in bad faith amount to fraud is a matter of definition. Under Delaware law, fraud and bad faith are not synonymous. Bad faith is defined as an 'intentional dereliction of duty, a conscious disregard for one's responsibilities', *In re Walt Disney Co. Derivative Litigation*, 906 A.2d 27, 66 (Del. 2006). Fraud, also referred to as subjective bad faith, is a narrower category that also requires 'an actual intent to do harm', *ibid.*, 64.

154. See Table 15.2.

purchased, the DCI therefore equals 5.<sup>155</sup> The relevant analytical steps are depicted by blue arrows in Figure 15.1.

Enforcement questions are generally independent of the DCI, except where the DCI equals zero. In other case, it is not clear why a DCI of a particular value (say, a particularly stringently formulated duty of care) should influence the ease of enforcing a breach of the duty (that is, there are no obvious interaction effects between the DCI and EI). It is therefore sensible to compute both variables separately. However, as discussed in §15.03, individual legal elements that determine how a potential breach of duty can be enforced are not independent of one another.

For purposes of the EI, it is assumed that an effective enforcement regime must provide for the possibility of an action being brought by persons or bodies other than the board of directors, which will often be conflicted, or the general meeting, which may suffer from a similar conflict of interest or, if shareholders are dispersed, from coordination problems. Primarily, effective enforcement will therefore require that minority shareholders are able to bring a derivative claim without undue difficulties. If it is correct, as argued in §15.03, that this is only the case if a derivative action mechanism is conducive to minority shareholder litigation along *all* dimensions identified as relevant in that section, the EI should not represent an aggregation of scores assigned to these dimensions (for example, the EI takes the value 3 if all three dimensions are favourable to minority shareholder lawsuits, and the value 2 if one of the three dimensions creates an obstacle to litigation). Rather, it is suggested that the EI operates in a binary fashion at this level: either an effective enforcement mechanism exists that allows an independent body or person to sidestep the potentially conflicted board of directors and general meeting, or it does not exist.

In the absence of an effective derivative action, other legal mechanisms may, in principle, function as substitutes. Whether these are effective depends on the legal mechanism in question. Of those examined in §15.02[A], arguably only the Dutch inquiry proceedings may qualify as an effective substitute. Criminal law is limited to particularly grievous misconduct and has a high evidentiary threshold, and directors' disqualification typically only becomes relevant once a company has been placed into insolvency proceedings.

In a second stage, the EI captures how the burden of proof is distributed. This question is again formulated in a binary fashion. A legal rule that shifts the burden on the directors (as, for example, German law<sup>156</sup>) facilitates recovery. It is suggested that the focus of the inquiry at this level should be on the initial allocation of the burden of proof. Legal system may provide that the burden shifts under certain conditions, but if claimant-shareholders need to meet an initial threshold of showing misconduct,

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155. It is worth repeating that the DCI reflects a firm-level assessment. Thus, if insurance was unavailable or had not been purchased by a French company, the DCI for that company would equal 6.

156. German Stock Corporation Act, § 93(2), sentence 2.

recovery is appreciably more difficult than if directors had to show that they complied with their duties.<sup>157</sup>

For the two legal systems used to illustrate the operation of the DCI and EI, Delaware and France, these considerations mean the following. Only Delaware law provides for a derivative action that does not stymie minority shareholder litigation.<sup>158</sup> The French minority shareholder action plays a negligible role in practice because of the financial disincentives that it creates, and French law has not developed an effective substitute mechanism. In both legal systems, claimant-shareholders must show that directors breached their fiduciary duties, although the burden shifts to the directors if the shareholders meet this threshold.<sup>159</sup> In Figure 15.1, these analytical steps are again depicted by red arrows for Delaware and blue arrows for France. The resultant EI equals 3 for Delaware and 1 for France.

It is interesting to note that the scores for the DCI and EI in the two countries are roughly reversed. France scores in the top third in the DCI and the bottom quartile in the EI, and Delaware in the bottom quartile in the DCI and the top half in the EI. Whether this means that the overall environment for a protection of minority shareholders in the two countries is roughly comparable can be doubted. The impact of the EI on minority shareholder protection is likely non-linear. An EI below 3 means that enforcement actions will be rare. An EI of 3 or 4, on the other hand, means that potential breaches of fiduciary duties will be litigated regularly, and shareholders will recover damages in at least some cases even if the DCI is low.<sup>160</sup>

## §15.05 CONCLUSION

This chapter has suggested a theoretical framework to capture and quantify the effects of fiduciary duties and legal mechanisms governing their enforcement. It is for future research to extend the framework in two respects. First, from a theoretical angle, the interdependence of legal rules that address further typical scenarios of managerial conduct should be conceptualised similarly to what this contribution did for the duty of care. In particular, the regulation of related-party transactions between a director and the company and the exploitation of corporate opportunities by directors for their

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157. For example, the Delaware business judgment rule operates as a presumption that the defendant directors acted in good faith, without a conflict of interest, and based on appropriate information. If plaintiff-shareholders rebut the presumption, the burden shifts to the directors to demonstrate that the challenged act or transaction was entirely fair to the corporation, *In re Walt Disney Co. Derivative Litigation*, 906 A.2d 27, 52 (Del. 2006). Similarly, under French law, shareholders bear the burden of proving that a decision of the directors constituted a management mistake. If they meet this burden, it falls on the defendant directors to establish that they exercised the care of a cautious and prudent director, notably by opposing the challenged decision, Cass. Com., 30 March 2010, FP-P+B+R+I, n° 08-17.841, *Fonds de garantie des dépôts (FGD) c/ Sté Caribéenne de conseil et d'audit (Crédit Martiniquais)*, *Revue des sociétés* 2010, 304. For an English translation and analysis of this case, see Gerner-Beuerle and Schillig, *supra* n. 40, 523-26.

158. See the discussion in §15.03.

159. See *supra* n. 157.

160. A high DCI-EI combination may, in any case, not be optimal, see the discussion in §15.02[B].

personal gain are likely to follow patterns partially different from those depicted in Figure 15.1, although many of the considerations that have informed the development of Figure 15.1 (such as the possibility to limit liability exposure *ex ante* or *ex post* through private ordering) will be equally applicable to this context.

In a second step, the legal variables constructed according to the methodology suggested here can be used to investigate several empirical questions that this contribution has touched upon. In particular, it is not well understood how the fiduciary duties-enforcement nexus should be calibrated to improve economic outcomes. A variable capturing enforcement regimes is unlikely to have a linear effect, but this needs to be investigated further. Likewise, it is unclear how substantive rules interact with enforcement mechanisms and whether, for example, strong enforcement rights combined with limited liability exposure are more efficient than strong enforcement rights combined with stringent fiduciary duties.