

*eurofenix* – spring 2004 edition

## Jurisdictional survey 1: directors' liabilities

Please click on a jurisdiction to read the full response to the *eurofenix* survey. The original feature article summarising the respondents' replies appears in the spring 2004 edition of *eurofenix*. Please contact INSOL Europe for more information.

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## Denmark

**In Denmark directors' liabilities in limited companies (A/S and ApS) are defined in the 'A/S Act' section 54 subsection 2 (daily management) and 3 (supervisory board) and the 'ApS Act' section 19.**

The liabilities are in practice identical, but whereas an 'A/S' according to the 'A/S Act' has a supervisory board (normally (a majority of) non-executive board members – and with special regulation regarding publicly listed companies) and a daily management, an 'ApS' is only required by the 'ApS Act' to have 'a management' having the combined responsibilities and liabilities as the supervisory board and the daily management in an 'A/S' unless otherwise decided in the individual bi laws.

In the following reference is made to the rules set out in the 'A/S Act'.

### **1. Obligation to file?**

In Denmark there is no explicit legal/mandatory obligation for a director or the supervisory board to file for suspension of payment (a 'chapter 11 like institute ') or bankruptcy.

Such situation is handled in accordance with Corporate Governance and best practise recommendations in the legal gap between regulation in the 'A/S Act' and the bankruptcy Act as regulation is not given directly or defined explicitly in the 'A/S Act'.

However, according to the 'A/S Act' section 54 subsection 3 the supervisory board is obliged to secure that the company's capital readiness at any time is sufficient with regard to the ongoing business and known debt.

If the capital readiness is not sufficient the supervisory board shall establish such by the use of any relevant measures, i.e. new agreements of terms of payment with known creditors, raise of new equity capital, loans etc.

This obligation is parallel to the board's obligation to arrange a shareholders' meeting no later than 6 months after deciding that the company has lost 50% of its registered equity capital.

Should these measures be insufficient or even rejected by creditors or investors the supervisory board should voluntarily file for suspension of payment or bankruptcy.

If the supervisory board doesn't file and continues business regardless of the known financial situation the responsible supervisory board puts it self at risk for being rightfully charged with damages suffered by the creditors provided that the board has not acted responsibly/negligently according to the law after being aware of the financial situation. Danish legal counsel is recommended in such situations.

### **2. Who can be held liable?**

Chapter 16 of the Danish 'A/S Act' (section 140 – 145) describes 'lex specialis' rules for liability for founders, board members and directors, shareholders, auditors and other organs instituted by the 'A/S Act' regarding damages caused by the said persons/organs through negligence and suffered by the company or a third party.

Chapter 16 also contains rules of procedure regarding the company's decision – mandatory decision taking on a shareholders meeting (Section 144) - to claim liability towards a liable director and a time limit of 6 months to be counted from the date of decision on a shareholders' meeting to file in court (Section 145).

### **3. Sanctions?**

Sanctions according to Chapter 16 of the 'A/S Act' are purely financial, i.e. payment of damages.

The 'A/S Act' section 160 and 161 contain rules to punish violation of a number of sections of the 'A/S Act' with a fine provided that more severe punishment should not be suffered in accordance with the Danish criminal code.

In practise fines are never or only very seldom given with reference to the 'A/S Act' section 160 – 161.

In neither case sanctions are imposed automatically – the company, a creditor or the Danish Authorities must file individually to the Police Authority.

### **4. Proceedings against the directors?**

If a Danish company is solvent or in solvent liquidation an external legal or physical person can bring proceedings against directors or an appointed liquidator.

If a Danish company is solvent or in solvent liquidation the company itself can only bring procedures against directors if a general shareholders' meeting decides to do so, re. the 'A/S Act' Section 144 above.

If bankruptcy procedures are brought to the estate of a Danish company the appointed receiver of the estate has the sole and full authority to bring proceedings against any creditor including claims against directors.

However, should the receiver decide to give up a claim, the receiver is obliged to inform the creditors of the estate of such decision.

The Probate Court can then decide a time limit for the creditors to decide to conduct the case on behalf of the estate and pay all related costs. If the trial is won damages and legal costs should be paid to the estate and the creditor who has conducted the case on behalf of the estate will on demand be reimbursed reasonable costs – and not necessarily all costs – incurred during the trial.

**Jesper Trommer Volf, Accura Advokataktieselskab.**

## Netherlands

### 1. Obligation to file

- i) Is there an obligation on directors to file for formal insolvency proceedings?

Under Dutch law there is no formal obligation for managing directors or supervisory board members<sup>1</sup> to file for insolvency proceedings. In fact bankruptcy proceedings may only be initiated after a decision by the general meeting of shareholders. However, the managing board is normally speaking - and in some circumstances subject to prior approval of the supervisory board - entitled to file for a suspension of payments.

Dutch law does provide that in *Naamloze Vennootschappen*<sup>2</sup> a general meeting of shareholders must be convened when the managing directors may reasonably assume that the net asset value of the company is less than 50% of the paid and called up capital (article 2:108a NCC<sup>3</sup>).

Although no formal obligation to file for bankruptcy or moratorium proceedings exists, it is generally accepted, both in doctrine and in case law, that a managing director should not enter into obligations which he knows, or should know, that the company will be unable to fulfil. This means that if the managing board has reason to believe that the company is or will become insolvent, the company must in fact cease doing business.

- ii) If so when does this arise

Not applicable.

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<sup>1</sup> In the Netherlands companies either have a managing board with only executive members (the normal situation in smaller companies) or a managing board with only executive members and a supervisory board ("*Raad van Commissarissen*") with only non-executive members (the normal situation in larger companies). Only in extraordinary situations may the supervisory board empower one of its members with executive authority.

<sup>2</sup> In the Netherlands there are two widely used forms of companies: "*besloten vennootschap met beperkte aansprakelijkheid*" normally abbreviated as "*B.V.*" which is the common form for smaller privately held companies with limited liability, and the "*naamloze vennootschap*", normally abbreviated as "*N.V.*" which is the common form for larger and publicly held companies.

<sup>3</sup> Netherlands Civil Code ("*Burgerlijk Wetboek*")

## 2. Who can be held liable

A managing director may be held personally liable on several grounds *inter alia* the following:

- a. by the company (and in a bankruptcy by the trustee in bankruptcy of the company) if he did not fulfil his tasks as managing director properly (article 2:9 NCC)
- b. by the company or a creditor on the basis of tort (article 6:162 NCC)
- c. by the trustee in bankruptcy on the basis of mismanagement that was an important cause of the bankruptcy (article 2:138 NCC and 2:248 NCC)
- d. by the tax authorities, the social security authorities and pension funds in the event of mismanagement<sup>4</sup>
- e. by any third party in case of misleading financial figures (articles 2:139 NCC ad 2:249 NCC)

Generally speaking, a de facto director, meaning any director who has acted as if he were a managing director and has thus (co-)managed the company, may be held personally liable in the same manner as formal managing directors in all the abovementioned situations.

A member of the supervisory board may be held personally liable on more or less the same grounds as a managing director may be held personally liable. However, since the supervisory board is charged only with the supervision of the management and the general state of affairs of the company (article 2:140 NCC), such liability is normally less likely than personal liability of a managing director.

## 3. Sanctions

- i) What are the possible sanctions against directors of insolvent companies?

In the event of mismanagement, the directors of insolvent companies may be jointly and severally liable (see above under 2) towards the bankruptcy estate for the full deficit in the bankruptcy. In the event of fraud, there may also be criminal law sanctions.

The Ministry of Justice keeps a register of directors of companies that went bankrupt. In some cases this may mean that they will not be able to form new companies for a certain period of time.

- ii) Are there sanctions/restrictions that are imposed automatically

The registration by the Ministry of Justice is automatic. None of the sanctions are imposed automatically.

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<sup>4</sup> In the event of liability based on mismanagement, the NCC, the tax laws and social security laws work with a number of assumptions of mismanagement and liability. Especially if the books and records of a company are not kept in (perfect) order and/or the annual accounts are not filed and published in due time, mismanagement is a fact, and it is assumed that this mismanagement is an important cause of the bankruptcy or the non payment of the taxes. Management that is unable to undo such assumption will be held personally liable for the deficit of the bankruptcy estate or, as the case may be, those unpaid taxes.

#### **4. Proceedings against directors**

Actions against directors based on tort may be brought by any damaged party. The same is true for actions based on the publication of misleading prospectuses and financial figures. Actions based on the directors not performing properly may in general only be brought by the company or, as the case may be, the trustee in bankruptcy of the company. Actions based on mismanagement as meant in the articles 2:138 NCC and 2:248 NCC may only be brought by the trustee in bankruptcy.

The specific actions mentioned in the various tax and security laws and regulations may only be brought by the relevant tax and social security authorities.

**Eddie Meijer, Houthoff Buruma.**

## Italy

### 1. Obligation to file?

- i) Is there an obligation on directors to file for formal insolvency proceedings?

According to article 6 of Royal Decree dated March 16, 1942 no. 267 (Bankruptcy Act), the declaration of bankruptcy can be submitted in the following ways: a) by a petition of one or more creditors; b) by means of a demand by the debtor him/herself; c) by a petition of the Public Prosecutor; d) by the Court of its own motion. Therefore, should the entity to be declared bankrupt be a company, the legal representative must file the petition with the competent Tribunal.

Moreover, together with the petition, the legal representative must file with the Court the accounts, balance sheets, the management accounts of the previous two years, a report on the company's state of affairs and a list of creditors (article 14 Bankruptcy Act).

- ii) If so, when does this arise?

The legal representative of the company must file the petition if the bankruptcy is the only mean to limit the damages of creditors as a consequence of the state of insolvency. As a matter of fact, the Bankruptcy Act envisages a criminal sanction for the entrepreneur (i.e. in case of companies, the legal representative) who has increased the state of insolvency by abstaining from filing the petition for bankruptcy or has carried out incautious activities to delay the adjudication of bankruptcy.

### 2. Who can be held liable?

- i) In addition to directors, which other persons involved in a company's affairs may be held personally liable for their acts, eg, shadow directors, de facto directors, non-executive directors?

The adjudication of bankruptcy may determine criminal sanctions for the so-called bankruptcy crimes. Although the Bankruptcy Act regards the personal liability of directors involved in the daily business of the company, according to case-law also the de-facto directors may be prosecuted.

Moreover, article 147 of the Bankruptcy Act provides for the extension of the bankruptcy of the company with unlimited liability to the shareholders with unlimited liability. This provision applies mainly to partnerships (limited partnership with share capital, limited partnership and general partnership), where the shareholders may carry out the management of the company.

### 3. Sanctions?

- i) What are the possible sanctions/restrictions against directors of insolvent companies?

The directors must file the accounts and balance sheet within 24 hours from the adjudication of bankruptcy. Moreover, they have to fulfil the duty of residence and the limitations to their right to stay and move. This means that they cannot move without the judge consent and must appear before the trustee, the judge or the creditor's committee when convened for the needs of the procedure. Such duties are provided by article 146 of the Bankruptcy Act.

Moreover, directors may be personally prosecuted for those bankruptcy crimes committed prior to or during the procedure such as fraudulent or straight bankruptcy. For instance, articles 223 and 224 of the Bankruptcy Act provide for sanctions for those directors who have caused, either directly by infringing law or indirectly for instance by means of fraudulent deals, the insolvency of the company.

ii) Are any of these sanctions/restrictions imposed automatically?

A part the criminal sanctions, the other restrictions constitute effects determined by the judgement adjudicating the bankruptcy. The criminal sanction for fraudulent bankruptcy is imprisonment for between five years and ten years, depending on the gravity of the crime as determined by the competent court. Those directors condemned for one of the bankruptcy crimes are also disqualified for ten years.

#### **4. Proceedings against directors?**

i) Who can bring the proceedings against the directors?

Generally speaking, according to the Civil Code directors may be held liable to the company, to the company's creditors and to third parties. Directors are liable to the company if they negligently fail to fulfil duties imposed upon them by the law or the by-laws or to supervise the general conduct of the company or if, being aware of prejudicial acts, they did not do what they could to prevent them from occurring.

Directors are also liable to the company's creditors when the company's assets are insufficient to satisfy their claims, if directors fail to preserve the company's assets. Such actions do not prevent single shareholders or third parties bringing claims for damages if they are directly damaged by the director's conduct.

Should the company be declared bankrupt, article 146 of the Bankruptcy Act empowers the liquidator to bring the fraudulent and wrongful action against the directors in the place of the company itself or the company's creditors. In such a case, the judge, when authorizing the liquidator to bring the action, may also dispose precautionary measures.

**Giorgio Cherubini & Fabrizio Losco, Pirola Pennuto Zei & Associati.**

## Germany

### 1. Obligation to file?

- i) Is there an obligation on directors to file for formal insolvency proceedings ?

Insolvency proceedings are never instituted ex officio, but always upon application filed by the debtor or creditor. This disposition principle, i.e., the right to file, is defined in the Insolvency Code (§ 13 Section 1 InsO). If a creditor files for insolvency proceedings, he must prove that he has a legal interest in the commencement of the insolvency proceedings and furnish prima facie evidence of his claims and his reason for commencement. The director's duty to file for insolvency exists in the event of inability to pay and over-indebtedness for incorporated firms and for unincorporated firms in which no personally liable partner is a natural person. This is stipulated in the appropriate special laws, i.e., in § 64 Section 1 GmbHG (Law on Limited Liability Companies), § 92 Section 2 AktG (Stock Corporation Law), § 130a Section 1 HGB (Commercial Code) and § 177a HGB. If a GmbH is expected in the long run to be incapable of repaying its due debts from ready funds, we talk of inability to pay. Over-indebtedness, on the other hand, prevails if the liabilities are no longer covered by the company's assets.

- ii) If so, when does this arise?

If the duty to file for insolvency applies, the management must immediately – at the latest within three weeks after the reason for the insolvency arises – file for insolvency. In the event of inability to pay, the three-week period commences upon its occurrence. Knowledge is, however, a pertinent factor when it comes to over-indebtedness. This duty attaches to each and every person responsible, irrespective of any representation provisions stipulated in the articles.

### 2. Who can be held liable?

- i) In addition to directors, which other persons involved in a company's affairs may be held personally liable for their acts, e.g., shadow directors, de facto directors, non executive directors?

Anyone who holds the power of representation in terms of controlling/controlled companies and in legal relations may be designated as a person responsible. This means, first and foremost, the following natural persons: in the "Aktiengesellschaft" (stock corporation), the "Genossenschaft" (co-operative) and the "rechtsfähiger Verein" (association having legal capacity), it is the Vorstand (board), in the GmbH (and therefore also in the GmbH & Co. KG), it is the Geschäftsführer (managing director). An internal allocation of duties does not release the person responsible from its filing duty. The person appointed as the agent (Organ) of the company is not exonerated by the fact that he/she is merely nominally shown to be the person responsible, with, in truth, another person managing the business transactions. A distinction is drawn at this point between "factual agent position" and the "nominee or straw-man position". Factual directors are persons who have not been effectively appointed to their office, although they, in fact, perform the functions of their office, whereas, vice versa, the appointed agents will also be considered to be liable if they are straw-men. The role of the person responsible is to be seen as a

straw-man position if the business partners are clearly aware that the director is merely acting as an extended arm of the person behind the scenes. The insolvency filing duty and the liability when infringing this duty also attaches to the person who, without being appointed as a person responsible, in fact manages the business transactions of the company similar to a person responsible or as a co-responsible person. The total elimination of the persons responsible in law is not required.

### **3. Sanctions?**

- i) What are the possible sanctions/restrictions against directors of insolvent companies?

Delayed filing for insolvency carries substantial dangers and risks for the person responsible, both in terms of criminal law and in civil law.

#### **Aspects of criminal law**

If the person responsible fails in its insolvency filing duty, he renders himself liable to prosecution (§ 84 Section 1 No.2 GmbHG, § 401 I No.2 AktG, §§ 130b, 177a HGB). A criminal offence is also deemed to have been committed if the director fails to file for insolvency within the 3-week period. In this context, anyone acting negligently is also under threat of prosecution.

There are also other criminal offences which are often realised by directors in connection with insolvency proceedings:

- Bankruptcy offences pursuant to § 283 ff StGB (criminal code)
- Retaining and misappropriation of pay pursuant to § 266 a) StGB
- Tax offences pursuant to §§ 370 ff. AO (Fiscal Code)

#### **Aspects of civil law**

For delayed insolvency filing, the person responsible is liable under civil law in external relations from tort pursuant to § 823 Section 2 BGB (Civil Code) in conjunction with the appropriate special law (§ 64 Section 1 GmbHG, § 92 Section 2 AktG, § 130a Section 1 HGB), both in relation to the company and to the company's creditors. The entities deemed to be creditors are both those persons who have acquired claims even before the insolvency (so-called "old creditor") and those persons who have become creditors after the occurrence of the insolvency ("new creditors"). Regarding both the objective precondition of the infringed insolvency filing duty and fault, the onus of proof is reversed, i.e., the person responsible must exculpate itself. As to the amount, the "old creditor" receives only the differential damage, whereas the new creditor is compensated for his entire damage/losses. Differential damage is the difference between the quota which the "old creditor" would receive in case the manager has fulfilled his obligations to what he receives now without this fulfillment. However, in practice, it is very seldom that the person responsible must pay because of this claim.

There are also other special rules and regulations which define the capital liability of the persons responsible. For instance, they are personally liable to the company for payments which have been made without equivalent consideration after the occurrence of the inability to pay or after over-indebtedness has been determined. The liability of the person responsible for failing to pay the employees' share of the social insurance contributions results from § 823 Section 1 BGB in conjunction

with § 266a StGB. Pursuant to § 69 of the Fiscal Code, these persons are liable to the extent that claims from the fiscal relations resulting from the duties incumbent upon them have not been determined or not been determined in good time.

ii) Are any of these sanctions/restrictions imposed automatically?

By virtue of the principle according to which the prosecution of an offence is mandatory (§ 152 Section 2 StPO; Code of Criminal Proceedings), the public prosecutor's office is obliged ex officio to intervene in case of any punishable offences for which reasonable factual aspects or facts are available, unless the law stipulates otherwise. The public prosecutor's office must therefore act ex officio if it gains knowledge of a criminal offence. Beyond its wording, the above principle not only applies to the public prosecutor's office, but also to the judiciary and the police. It prevails throughout the entire proceedings, from their inception and commencement to the completion of execution.

#### **4. Proceedings against the directors?**

i) Who can bring the proceedings against the directors?

New creditors can assert their claims against the person responsible directly and outside the insolvency proceedings for reasons of failing to file for insolvency. On the other hand, the assignor's claims is asserted by the insolvency administrator for the estate in insolvency as total losses (§ 92 InsO). If, in spite of the occurrence of the inability to pay or over-indebtedness, a person responsible makes payments from the subsequent assets/estate, the company itself and, during the insolvency, the insolvency administrator asserts these claims pursuant to § 92 InsO. The claims regarding the withholding of social contributions are pursued and asserted by the health insurance funds themselves.

**Alexander Schork, Schultze & Braun.**

## France

### 1. Obligation to file ?

- i) Yes
- ii) 15 days from the company is insolvent. The company is insolvent when it is unable to pay its debts as they fall due with its realisable assets.

### 2. Who can be held liable ?

- Director in law
- Director shadow / de facto : any person who, even if he is not formally appointed as director, has an effective power of direction. It is an individual or business entity who interferes in the management of a company, not as an adviser to the real directors, but as a shadow director

### 3. Sanctions ?

Possible sanctions/restrictions :

#### Civil sanctions

- ♦ Wrongful trading proceeding and extension of the proceedings. Directors and officers (whether officially appointed directors or de facto directors) of an insolvent company will be personally liable for the debts of the company if they are found guilty of misconduct in the management of the company's business (*'faute de gestion'*) or if they use the company's credit in their own interests. In such cases, the directors may be obliged to pay all or part of the company's debt, either as a result of separate proceedings against them (*'action en comblement de passif'*), or by way of an extension of the insolvency proceedings to their personal assets in the proceedings against the debtor.

The sanction is optional, even if all the conditions exist.

- ♦ Prohibition on management (*'faillite personnelle' / 'interdiction de gérer'*). The sanction carries with it a prohibition on managing, administrating and controlling a commercial enterprise or any form of company which conducts economic activity.

The sanctions are not imposed automatically. The court which decides to convict the director has discretion over the duration of the sanction, although the minimum period in any case is five years.

#### Criminal sanctions

- ♦ Penal Bankruptcy (*'banqueroute'*). It is a criminal offence punished by imprisonment, fine and other punishments (prohibition on management, etc.).

Like any criminal offence, Court has a large discretion to instigate the proceeding and to decide the nature of the sanction.

#### 4. Proceeding against directors ?

i) Who can bring the proceedings against the directors ?

- Wrongful trading proceeding and extension of the proceedings: the Court itself, the Court-appointed administrator, the Court-appointed creditors' representative/liquidator or the prosecutor.
- Prohibition on management (*'faillite personnelle' / 'interdiction de gérer'*): the Court itself, the Court-appointed administrator, the Court-appointed creditors' representative/liquidator or the prosecutor.
- Penal Bankruptcy (*'banqueroute'*): the prosecutor, the Court-appointed administrator, the Court-appointed creditors' representative/liquidator, or the employees' representative.

**Cécille Dupoux, SCP Sonier et Associés.**

## England & Wales

### iii) **Obligation to file?**

- i) Is there an obligation on directors to file for formal insolvency proceedings?

There is no formal statutory obligation on a director of an insolvent company to file for formal insolvency proceedings. However, under section 214 of the Insolvency Act 1986 ('IA 1986') a director of a company that has gone into insolvent liquidation and at some time before the commencement of the winding up of the company, knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation may be made liable to make such a contribution to the company's assets as the court thinks fit. The court will not make such a declaration if it is satisfied that the director in question took every step with a view to minimising the potential loss to the company's creditors. One step further than this, a director may be held liable for fraudulent trading under section 213 of the IA 1986, if it appears he has carried on the business of the company with an intent to defraud its creditors. In addition, a director of a company liable under these sections may be disqualified from acting as a director or being concerned with the management of any company for a period of up to 15 years under the Company Directors Disqualification Act 1986.

### 1. **Who can be held liable?**

- i) In addition to directors, which other persons involved in a company's affairs may be held personally liable for their acts, eg, shadow directors, de facto directors, non-executive directors?

Any person who was knowingly a party to the carrying on a business with intent to defraud creditors may be held liable for fraudulent trading under section 213 of the IA 1986. Liability for wrongful trading under section 214 of the IA 1985 is restricted to persons who have been directors and shadow directors of the company. A director includes any person occupying the position of director, by whatever name called. A shadow director, in relation to a company, means a person in accordance with whose directions or instructions the directors of a company are accustomed to act. However, a person is not deemed to be a shadow director by reason only that the directors act on advice given by him in his personal capacity.

### 2. **Sanctions?**

What are the possible sanctions/restrictions against directors of insolvent companies?

In addition to the personal liability a director of an insolvent company may face under section 213 and 214 of the IA 1986, a director of a company who is found by the court to be unfit to be concerned in the management of a company which has become insolvent will be disqualified from acting as a director or being concerned with the management of any company for a period of between two and fifteen years.

Are any of these sanctions/restrictions imposed automatically?

Under section 6 of the Company Directors Disqualification Act 1986 disqualification for a minimum period of two years is mandatory where it is established to the satisfaction of the court that the director is unfit to be concerned in the management of a company.

#### **4. Proceedings against directors?**

- i) Who can bring the proceedings against the directors?

Under section 7 of the Company Directors Disqualification Act 1986 the Secretary of State (or the Official Receiver in the case of a company being wound up by the court) may apply to the court to have a director or shadow director of an insolvent company disqualified on the grounds of unfitness. Under the IA 1986 actions against directors personally for fraudulent and wrongful trading may only be brought by the liquidator of the insolvent company. Prior to the IA 1986 an individual creditor or contributory could bring an application for fraudulent trading. However, this was removed as it was thought it may encourage creditors to put improper pressure on directors to settle claims personally.

**Marcus Haywood, 3/4 South Square.**

## Sweden

### 1. Obligation to file?

- i) Is there an obligation on directors to file for formal insolvency proceedings?

In Sweden, the company's directors are under no express obligation to file a winding up petition. On the other hand, the actions or omissions of the directors when the company is insolvent may become the subject of a separate assessment if the company is placed into insolvent liquidation.

However, according to the Swedish Companies Act the company's directors are under an express obligation to prepare a special balance sheet to determine whether the company should be wound up i.e. if there is reason to believe that the company's equity is less than half of its registered share capital. Such a balance sheet must report assets at market value less sales costs, and liabilities in accordance with certain principles. If, according to the balance sheet for insolvency purposes, it proves to be the case that the equity is less than half the registered share capital, the issue of liquidation of the company must be put before the general meeting of the company. If the general meeting does not adopt a resolution regarding liquidation, the company has eight months to restore the registered share capital. If the company does not succeed, the company must be liquidated. If the company fails to commence liquidation proceedings notwithstanding an obligation to do so, the company may be the subject of compulsory liquidation. If the company fails to take these measures, the company's directors will be personally liable for new obligations incurred.

In these situations, however, the issue of liquidation of a limited company relates not to solvency but, rather, to sufficiency.

### 2. Who can be held liable?

- i) In addition to directors, which other persons involved in a company's affairs may be held personally liable for their acts, e.g., shadow directors, de facto directors, non-executive directors?

According to Chapter 15 of the Swedish Companies Act, in addition to directors, shareholders and the company's auditors are liable if they have damaged the company intentionally or through negligence in the performance of their duties. As regards shareholders, the obligation to compensate for damage to the company arises where a shareholder or other party, intentionally or through gross negligence, causes the company to incur damage by contributing to a violation of the Companies Act, the applicable Annual Accounts Act, or the company's articles of association.

### 3. Sanctions?

- i) What are the possible sanctions/restrictions against the directors of insolvent companies?

According to the Swedish Criminal Code, the directors of insolvent companies risk fines or imprisonment for, among other things, use of the company's funds without a corresponding benefit, favouring or

disfavouring a particular creditor, or false accounting in the event the company's accounts fails to comply with the requirements of the Swedish Book-keeping Act, etc.

As regards limited companies whose equity is less than one half of the registered share capital, the company's directors may become personally liable for obligations incurred after the obligation to go into liquidation arises.

If certain circumstances exist that render more difficult the directors' management of the insolvent company and, primarily, if the directors previously, in other companies, acted in bad faith towards the creditors, etc., the issue of disqualification of directors may arise. A disqualification entails that the director may not conduct business operations, i.e. he may not serve on the board of directors of a company, as a managing director, or hold any other senior position in any business operations.

ii) Are any of these sanctions/restrictions imposed automatically?

None of these sanctions are imposed automatically. On the other hand, a liquidator is obliged to investigate the directors' liability and, if personal liable is deemed to exist, to make demands on the company's directors. A liquidator is also obligated to notify certain criminal acts to the prosecutor.

#### **4. Proceedings against directors?**

i) Who can bring proceedings against the directors? In England, for example, fraudulent trading and wrongful trading proceedings can only be brought by the liquidator. It may be the case that elsewhere in Europe similar actions could be brought by creditors and contributories as well.

In Sweden, it is primarily the liquidator who brings an action against the company's directors and notifies the prosecutor upon suspicion of any crime. If the liquidator decides not to sue the company's directors for economic compensation, in certain cases the company's creditors have the possibility to bring an action against the directors.

As regards companies that are under an obligation to go into liquidation, i.e. companies whose equity is less than one half of the company's registered share capital, the company's creditors whose claims arise after the date on which the obligation to go into liquidation occurs may also bring an action against the company's directors.

In addition, the company's shareholders may, to a certain extent, bring an action against the company's directors in accordance with the damages rules in the Companies Act as referred to above.

#### **Summary**

In Sweden, directors incur liability primarily in connection with the liquidator's investigation and the claims that the estate in liquidation might possibly have against the directors as a consequence of their behaviour prior to the insolvent liquidation. In addition, after his investigation, the liquidator also initiates the issue of criminal liability by notifying a special authority, the Economic Crimes Bureau, which is especially focused on white-collar crimes and crimes associated with business operations. In addition,

interested parties, specifically the company's creditors, have a possibility to act against the company's directors. However, the insolvency procedure is based on the idea behind that the creditors shall act through the liquidator and that the liquidator takes the initiative in the insolvency-related issues.

**Guy Lofalk, Hellström & Partners Advokatbyrå KB.**