DIRECTORS' LIABILITY UNDER LUXEMBOURG LAW

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The liability of directors of a Luxembourg-based company is mainly based on provisions of the law of 10 August 1915 on commercial companies, as amended (the '**Companies Act**') (in particular Articles 441-8 to 441-10 of the Companies Act) as well as the general provisions of the Civil Code on tort that provide for civil liability. In addition, directors could face criminal charges for certain inappropriate acts. Finally, under certain circumstances, special liability could apply, most often in case of involuntary liquidation (bankruptcy) of the company. **As the provisions concerning the liability of directors are provisions of mandatory law, contractual derogations are not possible.**

1. CIVIL LIABILITY

Under the Companies Act, as well as under the general tort law principles of the Civil Code, directors can be held liable under civil law. Three situations are to be distinguished:

1. Civil liability (towards the Company **only**) for wrongful acts ("faute") committed by the directors in the execution of their duties, on the basis of Article 441-9, first sentence, of the Companies Act;
2. A stricter form of civil liability (towards the company **as well as** towards third parties) for faults arising from the violation of the Companies Act or the articles of association of the Company, on the basis of Article 441-9, second sentence, of the Companies Act; and
3. Special civil liability in certain defined cases as well as civil liability on the basis of the general principles of tort law of the Civil Code.

1.1. Civil liability based on Article 441-9, first sentence, of the Companies Act

Directors of a Luxembourg-based company can be held liable for wrongful acts committed in the execution of their duties for the company. An action based on the assumption of such fault can be enforced only by the company, as it is considered a breach of the 'internal' duty of care which every director has towards the company (and thus, such a duty does not exist towards third parties). The action (also called *actio mandati*) will be of a contractual nature, considering the director as a representative of the company and therefore, under this clause, liable only for his/her own actions, not those of fellow directors (subject to the exceptions set out below).

For an action under this heading to be successful, the plaintiff must convince the court that the following three elements have been satisfied:

1. The director has committed a 'fault' (faute).
Any fault committed by a director of a company is judged severely. It can be committed by a positive as well as a negative action. Therefore, not only positive acts against how a *bonus pater familias* (*bon père de famille*), a prudent, diligent and active person, should behave come within the scope of this notion, but also for instance the omission to notify the company (*i.e.* the shareholders' meeting) of such acts, committed by other persons, at the earliest possible stage. Also, if the disputed acts have been committed together with other directors of the company, they can be held collectively liable (*in solidum*).

The (positive) action must, furthermore, have been committed in a flagrant manner and be unreasonable. A director cannot claim lack of knowledge of a certain subject; such a claim does not release him/her from his/her responsibilities under law.

In any event, the judge will have to take account of the situation at the time when the disputed action(s) were committed by the director or manager and the facts that were known then.

It is important to bear in mind that not every action in the execution of the directors' duties amounts to a fault. Such a fault must amount to a 'general deficiency of prudence' (*manquement général à la prudence*), which is imposed on everyone.

In addition, it is important to stress that a director's resignation does not release him/her from the aforementioned liabilities.

Finally, it is not possible to successfully sue a director who was instructed by the general meeting to engage in the disputed acts, as this would be contrary to the basic principles of law. However, this last statement does not imply that the directors of a

Luxembourg *société anonyme* would be, broadly speaking, instructed by the shareholders for the matters that fall within the scope of the powers of the board of directors. The board of directors can indeed take any action necessary or useful to realise the company's object, except if reserved by law or the articles to the general meeting of shareholders. It has the broadest managerial powers, including the definition of the firm's strategy and general policy as well as day-to-day management, which the board of directors can delegate to a day-to-day director. Therefore, should the shareholders give instructions to the board of directors regarding matters that fall within the scope of the powers of such board of directors, the shareholders could be considered acting as *de facto* directors of the Luxembourg company and therefore be held liable towards third parties (such as the creditors of the company for instance) if such third parties could successfully demonstrate that the shareholder(s) and the company should be considered as one and the same party.

Thus, should it be required for the purpose of a particular restructuring that the shareholders of a Luxembourg company give instructions to the board of directors regarding certain specified matters, the board of directors would still always be under the obligation to act in the corporate interest of the company, rather than in the interest of its shareholders.

An alternative would be to construct the corporate governance of the company from another angle so that, for certain specified matters, the board of directors should request the prior approval of the general meeting of shareholders by convening such meeting or by asking for a particular item to be put on the agenda of a meeting already scheduled as the board of directors is entitled to do so pursuant to the Companies Act. The shareholders would thus have a veto right over certain decisions to be taken by the board of directors and the board of directors would not be allowed to act without the consent of the general meeting of shareholders.

2. The fault caused damage to the Company.
The director must repair all foreseeable damage (plus possible interest) caused by his/her faulty action(s) to the Company. Unforeseeable damage can thus not be claimed under the provisions of Article 441-9, first sentence, of the Companies Act.

3. The damage has been caused because of the fault.
The damage caused to the Company by the director must have emanated from that fault. In other words, the judge will have to investigate whether without the fault the damage arisen, would have arisen anyway. If so, the director cannot be held liable. If not, then the damage will be presumed to have arisen as a consequence of the fault committed by the director, and he/she will have to indemnify the company accordingly.

4. Special provision as concerns the express discharge of a director
It is possible for the general meeting to grant a director express discharge under Luxembourg law (which would consequently release him/her from any liability under Article 441-9, first sentence, of the Companies Act), but only as far as the approval of the financial statements is concerned (Article 461-7 of the Companies Act). Furthermore, such discharge will be valid only for as long as the accounts were presented free of omissions or false information about the true situation of the company, and, if any acts were carried out not provided for by the articles, they were specifically stated in the convening notice.

1.2. Stricter Civil liability based on Article 441-9, second sentence, of the Companies Act

Collective liability for damage caused to either the company or third parties as a result of a breach of the company's bylaws or the Companies Act applies to all directors of a Luxembourg company. The shareholders of the Company cannot start an action against a director, except if they can demonstrate that the latter's breach prejudiced them independently and personally. It should also be noted that the discharge, as mentioned above, does not eliminate liability of a director for damage resulting from his/her actions under this heading, except if these actions were known to the general meeting because they were specifically mentioned in the prior convening notice (see 1.2.4. above).

Under Article 441-9, second sentence, of the Companies Act, a director can incur liability for a fault committed in the following two circumstances:

1. Liability for the breach of (a) provision(s) of the Companies Act
Breaches of the provisions of the Companies Act include:

a. The failure to convene the annual general meeting of the company;
b. The failure to publish the financial statements or to do so late financial statements;
c. The refusal to convene a general meeting if at least a fifth of the share capital has requested such meeting;
d. The failure to convene a general meeting when losses incurred for the financial year are equal to half of the share capital.

Furthermore, case law contains the following examples of breaches in the sense of Article 441-9, second sentence of the Companies Act:

e. In accounting matters, the general meeting's failure to discuss several items on the agenda;
f. The fictitious acceptance of a mandate, and the failure to draw up the financial statements.

Finally, the Court has held the following practices to be not only in grave breach of the Companies Act, but also of the articles of association of any Luxembourg company:

g. The director's apparent complete disinterest in the company by the director, evidenced by the

delegation of all management powers to a proxy who is not asked to drawup the company's financial statements.

2. Liability for the breach of (a) provision(s) of the bylaws of the Company

The most common faults arising under this heading are those that result from operations performed outside the objects of the company, but any other breach of the bylaws of the company also falls within the scope of this notion.

The establishment will suffice to establish a fault, regardless of whether it arose out of imprudence or not. Only in cases in which a legitimate interest, an act of God or the like played a role could a claim under this heading be successfully countered.

3. The collective liability of the directors of the company

The directors of the company are collectively liable under Article 441-9, second sentence, of the Companies Act. This collective liability has been introduced because breaches under this heading are considered particularly grave and therefore, if it is suspected that such breaches have been committed, the directors are presumed responsible. Nevertheless, this presumption can be reversed if the directors can establish that:

a. They did not participate in the breach;
b. They did not commit any fault; and
c. They have denounced the breach(es) at the next general meeting following the point in time when they learned of the breach(es).

It is not sufficient for a director to resign in order to escape the provisions of Article 441-9, second sentence of the Companies Act.

4. Damage and causal link

The Companies Act imposes a reinforced liability under Article 441-9, second sentence, of the Companies Act and therefore, in case the directors are found to have been in breach, they can be ordered to pay both foreseeable **and** unforeseeable damage as well as interest thereon, to the claimant.

As is the case under Article 441-9, first sentence of the Companies Act, there should be a causal link between the fault and the damage that has arisen. If not, no liability will be incurred by the directors of the company involved (see 1.1.3. for more on this subject).

1.3. Special Civil Liability based on provisions of general law

Under the principles of general law, in our specific case the provisions concerning civil liability of Articles 1382 and 1383 of the Luxembourg Civil Code, a director may be held liable for damage caused by a fault to the company or a third party, but which fall outside the scope of Article 441-9 of the Companies Act.

In fact, the latter provision simply imposes an even stricter regime upon the director of a company (introducing, as outlined above, a *presumption* of fault), whilst upholding the general law concerning civil liability for negligence. Thus, if the negligent behaviour of a director would not fall within the scope of Article 441-9of the Companies Act, the regulations under the general principles of law operate as a safety net for the claimant (be it the company or a third party).[1]

2. CRIMINAL LIABILITY

In certain cases, acts of directors, acting alone or collectively, which would amount to civil liability, can also fall within the scope of the rules set out in the Luxembourg Criminal Code (*Code Pénal*). Examples are forgery of (company) documents, misappropriation (of company funds) or breach of trust.
In addition, the Companies Act contains certain specific criminal offences for directors who:[2]

a. Fail to submit within six months the approved financial statements to the general meeting as well as those who fail to publish such documents as required by law (Article 1500-2 – subject to a fine of up to EUR 125,000);
b. Distribute 'fictitious' dividends, *i.e.* dividends which do not originate from real profits (Article 1500-6 – subject to up to two years' imprisonment and a fine of up to EUR 125,000);
c. Fail to submit the documents referred to under a) with fraudulent intent (Article 1500-5, second paragraph – subject to a jail term of up to two years and a fine of up to 125,000 Euros);
d. Commit forgery with fraudulent intent or the intent to cause damage in the balance sheet or the financial statements of the company (Article 1500-8 – subject to up to ten years' imprisonment and a fine of up to EUR 250,000);
e. In bad faith, misappropriate company assets or credit for personal gain or for the benefit of another company in which they have a direct or indirect interest whilst knowing that this is contrary to the company's interest. This provision applies to so-called de facto directors as well (Article 1500-11 – subject to up to five years' imprisonment and a fine of up to EUR 25,000).

3. LIABILITY IN CASE OF BANKRUPTCY

In case of bankruptcy of a company, a distinction should be made between the possible civil and criminal consequences for a director.

3.1. Civil liability

Civil liability in bankruptcy cases underlies the regulations set out in:

- the Companies Act, more specifically Article 441-9, first sentence (see 1.1. above for more details);
- the general principles of tort law, more specifically Articles 1382 and 1383 of the Civil Code (see 1.3. above); and
- the rules contained in the Luxembourg Commercial Code (*Code de Commerce*), which will be discussed below

3.2. Liability for directors under the Commercial Code

Article 495-1 of the Commercial Code

If, upon insolvency, it turns out that the assets of the company do not suffice to pay all legitimate creditors, the directors can be held liable, individually or collectively, for all or part of the outstanding debts if it is proven that the directors have committed serious faults that contributed to the company's bankruptcy. Such action is subject to a limitation period of three years, effective as of the date of the final verification of all the creditors' claims by the competent court.

Article 495 of the Commercial Code

A director of a company that goes bankrupt can even be declared personally bankrupt, if:

- under the cover of the company, he/she has committed commercial acts in his personal interest; or
- deliberately pursued a loss-making activity, in his/her personal interest, which could only lead to the insolvency of the company;

The director's liability of the director will comprise of, apart from his/her personal liability, that of the company. Article 495 thus imposes a strict regime of liability on any director who makes a company go bankrupt for his/her personal gain.

Article 444-1 of the Commercial Code

If the directors of a company have contributed to its insolvency by way of a severe fault, they can be prohibited to pursue a commercial activity for a period of one to twenty years. They can also be deprived of the right to act as a director, manager or internal auditor of a company for that same period.

The prohibition described above is obligatorily imposed on those directors who have been sentenced for simple or fraudulent bankruptcy.

The request for such a prohibition must be made within three years of the date when the company was declared insolvent by a court, by either the curator of the Company or the Public Prosecutor.

Any prohibition, imposed on a director of an insolvent company by a court, will be entered into the company file at the Trade and Companies Register in Luxembourg. It will be deleted after expiry of the period for which the prohibition applies, or if, following an appeal, the prohibition order has been withdrawn.

Note on Article 489 of the Criminal Code

Directors of a company who are found guilty of simple or fraudulent bankruptcy, risk (on top of the prohibition to carry out the activities mentioned in Article 444-1 of the Commercial Code) imprisonment of one month to two years for simple bankruptcy, and imprisonment of five to ten years for fraudulent bankruptcy.

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[1] In fact,under this heading, nothing distinguishes a director from an "ordinary" individual who is prosecuted.

[2] Please note that not all possible offences are listed in this memo. For more specific information, please refer to Section XV of the Companies Act.

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