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VASSIL BRESKOVSKI*

Directors' Duty of Care in Eastern Europe

As privatization speeds up in the countries of Central and Eastern Europe, many state-owned enterprises are being transformed into public limited companies.[1] Their shares are already being traded on the new or resurrected stock exchanges in Warsaw, Prague, Moscow, Budapest, and Sofia.[2] And it is clear that in the future public limited companies, or joint stock companies, or companies limited by shares—the latter comparable to U.S. publicly held corporations, English public limited companies, or German *Aktiengesellschaft* (AktG)—will be

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1. For an extensive legal and economic background on privatization in Eastern Europe, see THE PRIVATIZATION PROCESS IN CENTRAL EUROPE (Roman Frydman et al. eds., 1993).

2. Poland: *Warsaw Stock Exchange Set Up*, FIN. TIMES, Apr. 1991, *available in* LEXIS, Europe Library, EEBLAW File; *Warsaw Stock Exchange: Back in the Game*, WARSAW VOICE, Nov. 8, 1992, *available in* LEXIS, Europe Library, WRSAWV File.

Hungary: Zsuzsa Ban, *A Look at the History of Bond and Securities Trading in Hungary*, HUNGARIAN OBSERVER, Sept. 1990, *available in* LEXIS, Europe Library, HUNOBS File; Peter Torday, *Capitalism Returns to Hungary After 42 years*, THE INDEPENDENT, June 22, 1990, *available* in LEXIS, Europe Library, INDPNT File; Bandy, *Eastern Europe's First Stock Exchange Opens in Budapest*, AP, June 22, 1990, *available in* LEXIS, Nexis Library, AP File.

Czech Republic & The Republic of Slovakia: *France's Sociétés des Bourses Françaises Wins Contract for Stock Exchanges*, EBRD WATCH, May 11, 1992, *available in* LEXIS, Europe Library, HUNGAR File.

Russia and the Commonwealth of Independent States: *Russia: US Model for Russian Stock Exchange?*, REUTER MONEY REP., Dec. 1, 1992, *available in* LEXIS, Europe Library, MONRPT File; *Opportunities in the Russian Securities Market*, BUS. E. EUR., Mar. 9, 1992, *available in* LEXIS, Europe Library, BUEEUR File.

the most important forms of business organization both in terms of capital and number of employees.

At the same time, after more than four decades the countries of Eastern Europe have enacted or reenacted commercial and corporate laws.[3] The latter closely follow American and Western European models of corporate governance.[4] It will be interesting to see how these inchoate provisions related to the administration of the corporation and the duties of corporate bodies will be implemented and interpreted by the judiciary.

The European Communities, now the European Union (EU), have been striving for years to harmonize their company laws.[5] Moreover, harmonization

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3. The article will focus on the commercial and corporate laws of:

Bulgaria: Turgovski Zakon [Law on Commerce], DURZHAVEN VESTNIK No. 48 (1991), *translated in* 1 CENTRAL AND EASTERN EUROPEAN LEGAL MATERIALS (Vratislav Pechota ed., 1993) [hereinafter Bulgarian Law on Commerce].

The Czech Republic & the Republic of Slovakia: Obchodni Zakonik [Czechoslovak Commercial Code of 1991)] [hereinafter Czechoslovak Commercial Code], *translated in* 2 DAVID E. BIRENBAUM, BUSINESS VENTURES IN EASTERN EUROPE AND RUSSIA (2d ed. 1992) [hereinafter BUSINESS VENTURES IN EASTERN EUROPE AND RUSSIA]. The Commercial Code continues to be effective in the territories of the Czech Republic and the Republic of Slovakia as long as it is not repealed by the National Councils. *See infra* note 27.

Hungary: Torveny a Gazdasagi Tarsasagokrol [Act VI of 1988 on Business Organizations], *translated in* 3 HUNGARIAN RULES OF LAW IN FORCE No. 3-4 (Feb. 1-15, 1992), *reprinted in* BUSINESS VENTURES IN EASTERN EUROPE AND RUSSIA, *supra* [hereinafter Hungarian Company Act].

Poland: Decree of the President of the Republic, June 27, 1934, DZIENNIK USTAW [Dz.U.] (1934) 57/502, *amended by* Dz.U. (1946) 57/321, (1950) 34/312, (1964) 16/94, (1969) 13/95, (1988) 41/326, (1990) 17/98 [hereinafter Commercial Code of Poland] (unofficial translation available from William K. Sievers of the law firm of Weil, Gotshal & Manges, New York and Warsaw).

4. *See, e.g.*, George Glos, *The New Czechoslovak Commercial Code*, 18 REV. CENT. & E. EUR. L. 555 (1992); Boris Landjev, *The New Bulgarian Commercial Code*, 18 REV. CENT. & E. EUR. L. 367 (1992); BUSINESS VENTURES IN EASTERN EUROPE AND RUSSIA, *supra* note 3, at 3-38, 4-49 & 5-33.

5. The European Community was founded on the ideal that through harmonization and coordination the states of Europe could be brought together into a political union as well as a single common market. To achieve this goal, the founders of the EC realized that divergent company laws must be realigned so as to provide individuals with essentially the same safeguards and protection of interests within the Community. Harmonization is carried out by directives based on article 54(3)(g) of the Treaty of Rome. According to this provision, the Council, acting on a proposal from the Commission and in cooperation with the European Parliament, shall issue directives in order to coordinate "to the necessary extent the safeguards which, for the protection of the interests of members and others, are required by the Member States of companies or firms within the meaning of the second paragraph of Article 58 with a view of making such safeguards equivalent throughout the Community." Treaty of Rome, 1957, art. 54(3)(g).

Company law has been among the more successful areas of harmonization of the laws of Community Member States. The stimulus, however, toward such harmonization has slackened somewhat in recent years, the stumbling blocks being worker participation and takeovers. The goals laid down in the Commission's White Paper, COM(85)310 final, for creating a 1992 internal market have not been achieved. The measures now being contemplated are aimed at a lesser degree of detailed regulation in the field of company law.

For a comprehensive discussion of the notions of integration and harmonization in the field of company law, see ERIC STEIN, HARMONIZATION OF EUROPEAN COMPANY LAWS (1971); RICHARD BUXBAUM & KLAUS HOPT, LEGAL HARMONIZATION AND THE BUSINESS ENTERPRISE (1988); EUROPEAN BUSINESS LAW, LEGAL AND ECONOMIC ANALYSES ON INTEGRATION AND HARMONIZATION 199-226 (Richard

is needed and is pending with respect to the fiduciary duties of corporate directors.[6]

Following the sweeping political changes, most of the Eastern European countries signed association agreements with the EU, setting forth the principles and mechanics of future political and economic integration into the Common Market.[7] One of the goals to be pursued by the Eastern European countries during the term of these association agreements is harmonization and the bringing of their laws into compliance with the standards set by the Union.[8] This endeavor will encompass their commercial and company laws, including the fiduciary duties of directors.

This article examines the standards of skill and care that should be followed by directors of public limited companies in the United States, the United Kingdom, Germany, and France and compares them with statutory provisions adopted by some Eastern European countries. It begins with a review of the corporate governance structure of the joint stock companies adopted by Bulgaria, the Czech Republic, the Republic of Slovakia, Hungary, and Poland. It then proceeds with an analysis of the director's standard of care in the United States, the United Kingdom, Germany, and France. It concludes with a commentary on the liability of corporate directors for negligence, and the standard of skill and care elaborated in the new commercial codes of the above-mentioned market-oriented economies.

The conclusion contains a proposal for a more detailed and clearer statutory definition of the standard in the codes. Consideration is given to how the standard should be interpreted and enforced in order to provide for both better shareholder protection and the freedom of managers to embrace more risk. Contrary to the

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Buxbaum et al. eds., 1991); FRANK WOOLDRIDGE, COMPANY LAW IN THE UNITED KINGDOM AND THE EUROPEAN COMMUNITY: ITS HARMONIZATION AND UNIFICATION (1991); Alfred Conard, *The European Alternative to Uniformity in Corporation Laws*, 89 MICH. L. REV. 2150 (1991).

For analysis and information on the current status of European Community legislation in relation to company law see 2 GORE-BROWNE ON COMPANIES 38-001 (A. J. Boyle & Richard Sykes eds., 44th ed. 1986). *See also, e.g.*, EUROPEAN COMPANY LAWS (Robert Drury & Peter Xuereb eds., 1991); ROBERT PENNINGTON & FRANK WOOLDRIDGE, COMPANY LAWS IN THE EUROPEAN COMMUNITY (3d ed. 1982).

6. EUROPEAN BUSINESS LAW, LEGAL AND ECONOMIC ANALYSES ON INTEGRATION AND HARMONIZATION, *supra* note 5, at 211-12.

7. Poland, Hungary, the Czech Republic, and the Republic of Slovakia were first to sign association agreements with the European Union (EU) on December 16, 1991. For a general discussion of the EU association agreements, see *EU Association Agreements with Poland, Hungary, and the CSFR*, 3 PARKER SCHOOL SURVEY OF EAST EUROPEAN LAW 1 (June 1992); Frank Benyon, *Les "accords européens" avec la Hongrie, la Pologne et la Tchécoslovaquie*, 2 REVUE DU MARCHE UNIQUE EUROPÉEN 25 (1992). *See* COM(92)511 final. The Europe Agreements with Hungary and Poland entered into force after ratification by all EU Member States on February 1, 1994, and were published in 1994 O.J. (L 347) (Hungary) and 1994 O.J. (L 349) (Poland). Bulgaria signed a similar accord on March 9, 1993. *See European Association Agreement Signed with Bulgaria*, AGENCE EUROPE, Mar. 9, 1993, *available in* LEXIS, Europe Library, LBYRPT File; *see* COM(93)45 final.

8. The Europe agreements provide for cooperation on approximation of legislation. Eastern European countries recognize that compatibility with the EU legislation will stimulate foreign investment into their markets. *See* Towards a Closer Association with the Countries of Central and Eastern Europe: Report by the Commission to the European Council, COM(92)2301 final at 6.

common sentiment in Eastern Europe that less regulation and more managerial freedom are acceptable when a country is moving toward a market economy, a proposal for a stricter standard is made. This recommendation recalls the legal environment in Eastern Europe and the ultimate end of encouraging both foreign and domestic investment. In this respect the Draft Fifth Directive[9] is examined, and the provisions of German, French, and U.S. laws are analyzed and used as a standard of comparison.

I. The Standard of Skill and Care for Corporate Directors—A Comparative Analysis

The standard duty of care of corporate directors can generally be considered as consisting of two duties: the duty to monitor and the duty to make reasonable decisions.[10] The standard varies in different legal systems and the liability for breach of the duty ranges from mere negligence (France and Germany) to gross negligence amounting to fraud (the United Kingdom and, to a lesser extent, the United States). Likewise, the scope of discretion given to directors to make decisions varies from jurisdiction to jurisdiction, with the broadest scope probably being granted by the "business judgment rule" in the United States.

It is very difficult, if not impossible, to evaluate fairly which law sets a higher standard in relation to directors' duties of skill and care. Indeed, this standard is not only a function of substantive law but also, perhaps to a greater extent, a function of the applicable rules of procedure.[11] In both respects, the standard

9. Proposal for a Fifth Directive to Coordinate the Safeguards Which, for the Protection of the Interests of Members and Others, Are Required by Member States of Companies Within the Meaning of the Second Paragraph of Article 58 of the EEC Treaty, as Regards the Structure of Sociétés Anonymes and the Powers and Obligations of their Organs, 1972 J.O. (C 131); Amended Proposal for a Fifth Directive Founded on Article 54(3)(g) of the EEC Treaty Concerning the Structure of Public Limited Companies and the Powers and Obligations of Their Organs, 1983 O.J. (C 240); Second Amendment to the Proposal for a Fifth Council Directive Based on Article 54 of the EEC Treaty Concerning the Structure of the Public Limited Companies and the Powers and Obligations of Their Organs, 1991 O.J. (C 7).

The scope of the Draft Directive encompasses workers' participation in the management of companies and touches upon the governing structure of companies, the role of the directors, and the rights of shareholders. The Draft Directive is supposed to apply only to public limited companies.

For an analysis and discussion of the various drafts of the Fifth Directive, see J. Temple Lang, *The Fifth EEC Directive on the Harmonization of Company Law*, 12 COMMON MKT. L. REV. 155-70 (1975); Thomas Conlon, *Industrial Democracy and EEC Company Law: A Review of the Draft Fifth Directive*, 24 INT'L & COMP. L.Q. 348-59 (1975); Jane Welch, *The Fifth Draft Directive—A False Dawn?*, 8 EUR. L. REV. 83-102 (1983); Janet Dine, *Implications for the United Kingdom of the EC Fifth Directive*, 38 INT'L & COMP. L.Q. 547-59 (1989); Frank Wooldridge, *The Fifth Draft Directive on the Harmonization of the Company Law*, L. SOC'Y GAZETTE 2783-87 (Oct. 10, 1984); Clive Schmitthoff, *Amendments to the Fifth Draft Directive and to Vredeling*, J. BUS. L. 453, 456-58 (Nov. 1983).

10. *See, e.g.*, Melvin Eisenberg, *The Duty of Care of Corporate Directors and Officers*, 51 U. PITT. L. REV. 948, 951, 956 (1990).

11. Bernard Grossfeld, *Management and Control of Marketable Share Companies*, *in* 13 INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW, BUSINESS AND PRIVATE ORGANIZATIONS 4-113 (Alfred Conard ed., 1971).

is arguably higher in the United States and France and lower in the United Kingdom. The German standard is best viewed as intermediary.

In terms of the substantive provision of law, the standards could be ranked in the following manner: the strictest standards are imposed in France and Germany, followed by the United States, and finally by the United Kingdom. Although the trend is toward imposing a higher standard and increasing investor protection in Europe, the European Union Draft Fifth Directive and the proposal for the European Corporation do not articulate any standard for skill and care of corporate directors. Similarly, the standard remains inchoate in the jurisprudence of most Member States. Nevertheless, bearing in mind the U.S. experience with legal integration, it might be expected that harmonization will occur in Europe first through case law and only later by codification.[12] Nevertheless, the dilemma posed is whether the Member States should wait and leave the development of similar case law through jurisprudence or whether they should expedite codification through directives.

Faced with this impasse, the Eastern European states had no choice. The recently enacted commercial codes closely copied the existing provisions of the EU regulations. As a result, the current East European statutory standards are rather obscure and do not serve to protect investors sufficiently. Furthermore, the delicate condition of these new market economies, combined with the lack of experience and the unified EU standard, rules out any adoption of a more rigorous approach or prescription of a precise duty of skill and care. Accordingly, in order to fill the void, the courts of Eastern Europe should look to the rich experience and voluminous case law of the United States when formulating guidelines for promoting investor protection, while avoiding oppressive obligations on directors.

II. The Governing Structure of Public Limited Companies in Eastern Europe

The structure of corporate governance may do more to control negligence than the threat of possible court action. The Draft Fifth Directive tried to build on this notion by offering a choice between two systems.[13] One consists of a two-tiered structure of corporate governance in which a management board would be responsible for implementing the company's goals and policies on a day-to-day basis, and the supervisory board would select and remove management and have the

Thus, for example, in France creditors have a direct right of action. Shareholders in Germany and France have a right of statutory action in the company's name, i.e., derivative suit, against the director, though there is a requirement that shareholders hold 10% and 5% respectively. *See* P. MEINHARD, COMPANY LAW IN EUROPE F-14A(iii) (1981); Vanessa Finch, *Who Cares About Skill and Care?*, 55 MOD. L. REV. 179, 204 (1992).

12. BUXBAUM & HOPT, *supra* note 5, at 272-73. The authors argue that the convergence of the case law related to the duty of care has started in some of the Member States.

13. 1983 O.J. (C 240), *supra* note 9, art. 2(1).

overall responsibility for supervising management's leadership.[14] The other system would consist of a unitary board of directors comprising executive and nonexecutive directors.[15] The supervisory directors in a two-tier system and the nonexecutive directors in a one-tier system of corporate governance would have the same rights and duties with respect to monitoring the behavior of management.[16] But in the two-tier system the supervisory directors would have absolute veto power over closure, transfer, extension, or termination of a substantial part of the business, as well as veto power over any organizational changes or long-term cooperative undertakings.[17]

All the countries of Eastern Europe, except Bulgaria, which offers a choice between the two systems, have opted for the two-tier board structure.

A. Bulgaria

The Bulgarian Law on Commerce is the only one of the new codes that gives discretion to the founders of the joint stock company in setting up the structure of its corporate governance. They can choose between a one-tier system (board of directors and executive officer) or a two-tier system (management board and supervisory board).[18] Thus, the provisions of law repeat the Draft Fifth Directive,[19] which in this aspect was influenced by the French law.[20] Members of the management board are appointed and dismissed by the supervisory board in the two-tier system[21] or by the general meeting of shareholders in the one-tier system. The number of management board members may vary from one to nine,[22] while the number of supervisory board members must be between three and nine.[23]

The function of the management board is to manage the company and represent it in dealings with outsiders. In the case of the one-tier system, the board of directors must appoint one or more of its members to be executive officers of the corporation.[24]

The supervisory board is obliged to exercise monitoring powers and can employ outside experts for this purpose.[25] The supervisory board is not involved in the management of the company.[26]

14. *Id.* art. 3.
15. *Id.* art. 21a.
16. *Id.* arts. 11, 21.
17. *Id.* art. 12.
18. *See* Bulgarian Law on Commerce, *supra* note 3, arts. 241, 244.
19. Landjev, *supra* note 4, at 364; *see* 1983 O.J. (C 240), *supra* note 9, art. 2.
20. Wooldridge, *supra* note 5, at 82; Corporate Governance and Directors' Liabilities, Legal, Economic and Sociological Analyses on Corporate Social Responsibility 234 (Klaus Hopt & Gunther Teubner eds., 1985); Buxbaum & Hopt, *supra* note 5, at 178-79.
21. *See* Bulgarian Law on Commerce, *supra* note 3, art. 241(2).
22. *Id.* arts. 241(4), 244(1).
23. *Id.* art. 242(2).
24. *Id.* art. 244(3).
25. *Id.* art. 243(1), (4).
26. *See* The Privatization Process in Central Europe, *supra* note 1, at 19.

B. THE CZECH REPUBLIC AND THE REPUBLIC OF SLOVAKIA

According to the Czechoslovak Commercial Code, in force since January 1, 1992, the public limited company is governed by three organs: the shareholders (through a general assembly), the board of directors, and the oversight (supervisory) council.[27] The powers of the board of directors are stipulated in articles 191-195. The board must have at least three members, who represent the corporation in dealings with the outside world in addition to directing the company. The board also draws up the annual financial statements, proposes the distribution of profits, prepares annual reports, and is responsible for keeping the company's books and records.[28] It decides on all matters except those reserved for the general meeting by law or by the corporate charter.[29]

The oversight council, or supervisory board, which must have at least three members, exercises a general oversight role, functioning similarly to the outside directors of a U.S. public corporation.[30] In particular, it reviews the financial statements and submits its findings to the general meeting. Only natural persons who are neither on the board of directors nor authorized to act in the name of the corporation can be members of the oversight council.[31] If the company employees number more than fifty, two-thirds of the members of the council are elected by the general meeting and one-third by the employees.

C. HUNGARY

Similarly, under the Hungarian Company Act, the corporate governing structure of the public limited company is two-tiered. The board of directors is subject to oversight by a supervisory board.[32] The members of both bodies are elected by the general meeting of shareholders.[33] The structure is mandatory, and the company should have at least one auditor.[34] The board of directors represents the company. It "shall establish the company and supervise the company personnel and shall exercise employer rights."[35] Nevertheless, the founders possess some discretion in the allocation of decision-making power within the company, because the powers of the supervisory board and the board of directors can be largely determined in the by-laws. If company employees number more than 200, one-third of the seats on the supervisory board are reserved for employee representatives.

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27. BUSINESS VENTURES IN EASTERN EUROPE AND RUSSIA, *supra* note 3, at 5-41. When Czechoslovakia split into the Czech Republic and the Republic of Slovakia on January 1, 1993, both states agreed to adopt all legislation and honor all treaties of the former Czechoslovakia.

28. Czechoslovak Commercial Code, *supra* note 3, art. 192.

29. Glos, *supra* note 4, at 562.

30. BUSINESS VENTURES IN EASTERN EUROPE AND RUSSIA, *supra* note 3, at 5-42.

31. Czechoslovak Commercial Code, *supra* note 3, art. 200(1), (4).

32. BUSINESS VENTURES IN EASTERN EUROPE AND RUSSIA, *supra* note 3, at 3-47.

33. Hungarian Company Act, *supra* note 3, arts. 285(2), 291(1).

34. Gyula Gayer, *Changes in Hungarian Corporate Law*, DE DROIT DES AFFAIRES INTERNATIONALES 526 (No. 4/5, 1990).

35. Hungarian Company Act, *supra* note 3, art. 285(1).

D. Poland

The joint stock company governance structure under Polish law consists of the general meeting of shareholders, the management board, and the supervisory board or audit commission.[36] If the initial capital exceeds five billion zlotys (US$290,000) the corporation has to have a supervisory board, and the latter cannot be replaced by an audit board.[37] The supervisory board consists of at least five members, who are normally appointed by the general meeting of shareholders. However, the company bylaws can specify alternative means for their appointment.[38] The board of directors is also elected by the general meeting, unless the corporate charter stipulates otherwise.[39] Under Article 378, a member of the supervisory board cannot hold an appointment with the board of directors, and no member of the supervisory board can be on the board of directors. The powers of the board of directors are generally specified as management of the affairs of the company.[40]

The function of the members of the supervisory board is defined as the "exercise of permanent (constant) supervision over company activities encompassing all branches of the enterprise."[41] The directors' duties include: examination of the balance sheet and profit-and-loss accounts; examination of the company's books and documents (including determination that such books and documents are consistent with the actual condition of the company; examination of the report of the management board and of the management board's decisions regarding distribution of profits and covering losses; and submission of the annual report to shareholders describing the results of these examinations.[42] The members of the supervisory board are expected to perform their duties collectively. Under article 386(1) the board may delegate to a member the exercise of specific monitoring duties.

The bylaws may extend the duties and powers of the supervisory board. In particular the bylaws could require that the management board receive directors' permission prior to undertaking certain activities.[43]

To summarize, most of the Eastern European countries have adopted a two-tiered governing structure for their public limited companies, thus maintaining general consistency with the German legal system.[44] Bulgaria resorts to the alternative of the one-tiered system following the Draft Fifth Directive and the French model. Though the codes lay down most of the powers of the different organs, these powers can largely be defined in the bylaws.

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36. William Sievers & Andre Spark, *Directors' Duties in Selected Markets: Poland*, 8 Int'l Company & Com. L. Rev. 311 (Aug. 1993); Business Ventures in Eastern Europe and Russia, *supra* note 3, at 4-55.
37. *See* Commercial Code of Poland, *supra* note 3, art. 377(2).
38. Business Ventures in Eastern Europe and Russia, *supra* note 3, at 4-57.
39. *See* Commercial Code of Poland, *supra* note 3, art. 366(3).
40. Business Ventures in Eastern Europe and Russia, *supra* note 3, at 4-57.
41. *See* Commercial Code of Poland, *supra* note 3, art. 382.
42. *Id.* art. 382(2).
43. *Id.* art. 213.
44. Conlon, *supra* note 9, at 348, 350-51.

The two-tiered board system is a German innovation.[45] A characteristic feature of the German economy is that most German companies are financed not through equity but through bank loans. Thus, banks wishing to supervise the use of their investments and to exercise general control over the direction of the companies in which they have invested advocated the establishment of a supervisory board.[46] The classic board system consisting of outside and inside directors is typical for a system of equity financing, such as in the United States and the United Kingdom.[47]

Although the dual board system has proved to be successful in German law and the achievements of the German economy have added to its appeal within the European Union, the system emphasizes creditor protection. At the same time, German industries are dominated by a few banks and the capital market is thin and narrow. The predominant corporate forms are the limited partnership or the closed corporation.[48] The current developments in Eastern Europe for mass privatization and for establishing capital markets will eventually create diffused ownership, a situation similar to that in the United States and the United Kingdom. Thus, it is questionable whether a two-tiered board system in Eastern European countries will have the same effect as in Germany.[49]

III. The Duty of Care—A Country-by-Country Analysis

A. The United States[50]

Under U.S. common law corporate directors' duty of care has been drawn partly from tort law.[51] Several formulations elaborate on the standard of care. Generally, directors are required to exercise the same degree of care that an ordinary, prudent person would exercise under similar conditions.[52] Some courts

45. *Id.* at 348-49.

46. *Id.* at 348-50.

47. *See* Dine, *supra* note 9, at 547; Conlon, *supra* note 9, at 350-51.

48. Friedrich K. Kubler, *Tensions Between Institutional Owners and Corporate Managers: An International Perspective: Institutional Owners and Corporate Managers: A German Dilemma*, 57 Brook. L. Rev. 97, 102-07 (1991).

49. *See, e.g.*, Alfred F. Conard, *The Supervision of Corporate Management: A Comparison of Development in Eastern European Community and United States*, 82 Mich. L. Rev. 1469-70 (1984).

50. For a general and extensive discussion of the directors' duty of care in the United States, see Edward Brodsky & M. Patricia Adamsky, Law of Corporate Officers and Directors, Rights and Liabilities (1992); William E. Knepper & Dan Bailey, Liability of Corporate Officers and Directors (4th ed. 1988); Dennis J. Block et al., The Business Judgement Rule, Fiduciary Duties of Corporate Directors and Officers (1987); Melvin Eisenberg, *The Duty of Care of Corporate Directors and Officers*, 51 U. Pitt. L. Rev. 948 (1990); Bayless Manning, *The Business Judgment Rule and the Director's Duty of Attention: Time for Reality*, 39 Bus. Law. 1477 (1984).

51. Norwood Beveridge, Jr., *The Corporate Director's Duty of Care: Riddles Wisely Expounded*, 41 Def. L.J. 519-49 (1992); Richard B. Dyson, *The Director's Liability for Negligence*, 40 Ind. L.J. 341 (1965).

52. The test is an objective one. *See* Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125, 130 (Del. 1963).

have enunciated that "under the business judgment rule director liability is predicated upon gross negligence."[53] As of today, thirty-seven states have codified the common law duty of care.[54]

Section 8.30(a) of the Revised Model Business Corporation Act of 1985 states:

> A director shall discharge his duties as a director, including his duties as a member of a committee: (1) in good faith; (2) with the care of an ordinary person in a like position would exercise under similar circumstances; and (3) in a manner he reasonably believes to be in the best interest of the corporation.

The American Law Institute, in its proposed final draft of March 31, 1992, of Principles of Corporate Governance: Analysis and Recommendations,[55] compels directors to exercise the care that an ordinarily prudent person reasonably would be expected to exercise under similar conditions.

The duty of care might be considered as the aggregate of four relatively distinct duties:[56] the duty of inquiry, that is, the duty to follow up reasonably on information that should raise concern;[57] the duty to employ a reasonable decision-making process;[58] the duty to make reasonable decisions;[59] and the duty to supervise or monitor the conduct of the corporation's business.[60]

Courts rarely hold corporate directors liable for mere negligence because of the existence of the business judgment rule. The latter 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

53. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984); Smith v. Van Gorkom, 488 A.2d 858, 873 (Del. 1985). For analysis of the common law standard of care, see KNEPPER & BAILEY, *supra* note 50, at 43.

54. *See* BLOCK, *supra* note 50, at 26; KNEPPER & BAILEY, *supra* note 50, at 38.

55. ALI PRINCIPLES OF CORPORATE GOVERNANCE § 4.01 (Proposed Final Draft, Mar. 31, 1992).

56. *See* Eisenberg, *supra* note 50, at 948.

57. *See* Bates v. Dresser, 251 U.S. 524 (1920). The court held that a teller's flamboyant lifestyle should have prompted the bank's president to inquire whether shrinkages in the bank's deposits were the result of the teller's embezzlements. Nevertheless, the bank's directors not being similarly on notice, were held not to have breached their fiduciary duties.

58. The directors and officers must use reasonable care and properly inform themselves when making a decision. The test used by most states is a "gross negligence" test. *See* Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985). The Delaware Supreme Court held that outside directors breached their duty of care in approving the sale of Trans Union Corporation. The sale was approved by the board of directors at a meeting that lasted only two hours. The presentation was completely oral; no written drafts of the agreement were circulated. The board's approval can best be described as uncritical acceptance of management's recommendation.

59. This duty concerns the quality of business decisions. The business judgment rule provides that a substantively unwise decision by a director or an officer will not by itself constitute a lack of due care.

60. *See* Francis v. United Jersey Bank, 432 A.2d 814 (N.J. 1981). The court held liable a director who failed to discover misappropriation of trust funds because she knew nothing of the corporate affairs of the company, visited the corporate offices only once, and never read or obtained the annual financial statements. The court stated that directors were "under a continuing obligation to keep informed about the activities of the corporation," had to maintain familiarity with the financial situation of the company, and should have performed general monitoring of the corporate affairs and policies. *Id.*

the company."[61] Some recent statutes have even restricted liability of directors for breaches of the duty of care. The statutes vary in their approach. For example, they limit the money damages that may be recovered against the officer or a director, or they have relaxed the standard, so that only more outrageous behavior will be covered. Nevertheless, the amendments that occurred in the Delaware statute have had the most significant impact. Under section 102(b)(7), the certificate of incorporation may contain a provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breaches of the duty of due care.[62] Interestingly enough, the American Professors Bradley and Schipani, in an article published in 1989, showed that the enactment of section 102(b)(7) of the Delaware statute was associated with a negative effect on the value of the corporations incorporated in Delaware.[63]

In conclusion, the U.S. system of corporate governance, which combines minimal government intervention with accountability, has combined the notions that directors should have all germane protections against the liability for decisions involving risk, and that they are under a moral and legal obligation to perform their role with due care.[64]

B. The United Kingdom[65]

Although directors' duty of care is a cornerstone of U.K. law,[66] the standard of care epitomized by English case law has been recognized as both unsatisfactory and inappropriate for the requirements of the modern business world.[67] In a 1925 case the court emphasized the relative nature of the duty of care. Thus, a director need not exhibit, in performing his duties, "a greater degree of skill than may reasonably be expected from a person of his knowledge and experience."[68] With regard to diligence, "[a] director is not bound to give continuous attention to the affairs of his company," but is simply obliged to attend all meetings he reasonably can.[69] It should be mentioned that the obligation to give continuous

61. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984); *see, e.g.*, ALI, PRINCIPLES OF CORPORATE GOVERNANCE § 4.01(c)(3) (Proposed Final Draft, Mar. 31, 1992).

62. *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (1991); *see also* Michael Bradley & Cindy A. Schipani, *The Relevance of the Duty of Care Standard in Corporate Governance*, 75 IOWA L. REV. 1 (1989); Eisenberg, *supra* note 50, at 969-723.

63. *See* Bradley & Schipani, *supra* note 62, at 48, 60-65.

64. Eisenberg, *supra* note 50, at 972.

65. *See* DIRECTORS' DUTIES AND RESPONSIBILITIES IN THE EUROPEAN COMMUNITY, A COUNTRY BY COUNTRY GUIDE 204 (Alex Roney ed., 1992) [hereinafter DIRECTORS' DUTIES]; ROBERT PENNINGTON, COMPANY LAW 676-78 (5th ed. 1985); Vanessa Finch, *Company Directors: Who Cares About Skill and Care?*, 55 MOD. L. REV. 179 (1992).

66. EUROPEAN BUSINESS LAW, LEGAL AND ECONOMIC ANALYSES ON INTEGRATION AND HARMONIZATION, *supra* note 5, at 211.

67. A.J. Boyle, *Draft Fifth Directive: Implications for Directors' Duties, Board Structure and Employee Participation*, 13 COMPANY LAW. No. 1, at 6 (1992).

68. In re City Equitable Fire Ins. Co. Ltd., 1925 Ch. 407, 428 (Eng. C.A.).

69. *Id.* at 429.

attention to the affairs of the company may nevertheless be required in his service contract.[70] Third, a director, in the absence of grounds for suspicion, is permitted to trust officials to perform their duties honestly, as long as the director has allocated such duties properly.

Directors' negligence can take the following forms: first, dishonest behavior, which is often pleaded as negligence; second, failure to detect or prevent fraudulent behavior; and third, carelessly misjudged business decision.[71] At the moment, the prevailing opinion is that since directors are endowed with different degrees of experience and care, the only realistic duty of care that can be imposed is a subjective one.[72]

Section 727 of the Companies Act of 1985 grants judges "discretion to relieve negligent directors of liability where they are considered to have acted 'honestly and reasonably' and, in all the circumstances, 'ought fairly to be excused for the negligence, default, [and] breach of duty.' "[73] On the other hand, section 214 of the Insolvency Act (the wrongful trading section) imposes a civil remedy against directors based on a tough standard of care.[74] The director has to persuade the court that after becoming aware of the approaching insolvency, he or she took every step to minimize potential loss to the company. If he or she cannot do that, the court may order a personal contribution to the assets of the company. The standard of care is twofold, comprising both subjective and objective criteria. The director's actions or conclusions are judged by those of a reasonably diligent person who has the general knowledge, skill, and experience expected of a person carrying out the same functions as that director and the general knowledge, experience, and skill that director has. However, this type of liability arises from insolvent liquidation and does not relate to the company's whole trading life.[75]

In conclusion, the standard of care in the United Kingdom is rather lenient. As a result, there is a call both for legal reform and for imposition of an objective standard, as well as for developing an effective control mechanism over directors' competence and behavior.[76]

C. Germany

Under sections 93 and 116 of the German Stock Corporation Act (*Aktiengesetz (AktG)*),[77] managers and directors should apply the care of an orderly and prudent

70. *See* DIRECTORS' DUTIES, *supra* note 65, at 204.
71. Boyle, *supra* note 67, at 7.
72. *Id.*
73. Finch, *supra* note 65, at 201.
74. DIRECTORS' DUTIES, *supra* note 65, at 204.
75. Grossfeld, *supra* note 11, at 4-121.
76. *See* Finch, *supra* note 65, at 214.
77. For a most recent version of the *Aktiengesetz* (AktG) of September 6, 1965, see NIRK ET AL., HANDBUCH DER AKTIENGESELLSCHAFT (1992), *translated in* 24 COMMERCIAL LAWS OF THE WORLD: WEST GERMANY (1990). For a commentary of the AktG, see KARSTEN SCHMIDT, GESELLSCHAFTSRECHT [CORPORATE LAW] 637-816 (1991).

business manager ("*haben bei ihrer Geschäftsführung die Sorgfalt eines ordentlichen und gewissenhaften Geschäftsleiters anzuwenden*").[78] Therefore, the standard is that of a person in a responsible position of authority as a manager of other people's money in a particular enterprise.[79] The member's individual abilities are not taken into account. The test is purely objective, and the courts will not accept unfitness or inexperience as an excuse.[80] If managers and directors fail in their defined duties, they are "jointly and severally [liable] for . . . [the] damages arising therefrom."[81]

The burden of proof is on the directors and managers, that is, they have to show that they have adhered to the duty of due care.[82] The due care requirement is absolute and any negligence, however slight, can give rise to damages. Thus, the burden imposed on the directors is reduced by the fact that while they have certain discretion in the exercise of their judgment, the scope of their discretion is probably narrower than under the business judgment rule in the United States. Directors can be held liable not only for their own acts but for failure to control the activities of their colleagues.[83]

The *Aktiengesetz* expressly lays down provisions stating that the standard of diligence is equally applicable both to the management board and to the members of the supervisory board.[84] Accordingly, section 93, para. 3 of the AktG, amplifies the circumstances under which the members of the board are specially liable if they deviate from the provisions of the AktG: if they pay investments, interest, or dividends to shareholders; if the stocks of the company or of another company are subscribed, acquired, taken or received as pledge, or reduced; if shares are issued prior to the full payment of the nominal value or of the higher issue value; if the company property is divided up; if payments are made after the inability to pay has been discovered or its involvement in debt has been indicated; if credit is granted; if delivery shares have been issued in the case of conditional increases in capital beyond the purpose established or prior to the complete payment of equivalent value.[85] To establish liability damages must have occurred.[86] Directors' duty of care cannot be decreased by the corporate charter.[87]

The shareholders' subsequent ratification of directors' actions will waive direc-

78. Section 93, para. 1, sent. 1 of AktG, *supra* note 77; *see* SCHMIDT, *supra* note 77, at 684.

79. Grossfeld, *supra* note 11, at 4-113; *see also* SCHMIDT, *supra* note 77, at 684.

80. NIRK ET AL., *supra* note 77, at 273.

81. COMMERCIAL LAWS OF THE WORLD: WEST GERMANY, *supra* note 77, § 93(2).

82. Section 93, para. 2, sent. 2 of AktG, *supra* note 77; *see* SCHMIDT, *supra* note 77, at 685; Grossfeld, *supra* note 11, at 4-113. In contrast, the U.S. burden of proof lies with the plaintiff.

83. Grossfeld, *supra* note 11, at 4-113.

84. BUSINESS LAW IN EUROPE: LEGAL, TAX, AND LABOUR ASPECTS OF BUSINESS OPERATIONS IN THE TEN EUROPEAN COMMUNITY COUNTRIES AND SWITZERLAND 222 (Maarten J. Ellis & Paul M. Storm eds., 1982); *see also* SCHMIDT, *supra* note 77, at 693.

85. SCHMIDT, *supra* note 77, at 685.

86. NIRK ET AL., *supra* note 77, at 279.

87. Grossfeld, *supra* note 11, at 4-115.

tors' liability for damages, provided that they correctly informed the meeting.[88] Nevertheless, the current opinion is that a following ratification of a breached duty does not relieve the directors from their liability.[89] At the same time, liability is not curbed by the supervisory council's approval of the transaction.[90]

In conclusion, Germany imposes a much more rigorous standard of care for directors than the United Kingdom and the United States.

D. FRANCE[91]

Directors have a duty to manage the corporation like *bons pères de famille* (good fathers of families). The standard of negligence differs depending on whether the director is paid or not. The former, as a rule, is held liable even for slight negligence. The director will not be excused because of old age, deafness, sickness, or insufficient ability.[92]

Directors are liable for acts they have committed in their personal capacity.[93] Articles 244 and 249 of the Commercial Law impose liability in three main areas: (1) failure of the directors to respect statutory law, for example, provisions governing company procedures such as calling shareholder meetings, preparation of annual accounts, or modification of articles of association; (2) failure to respect articles of association and, in particular, the restrictions they place on directors, transfer of shares, and use of the company's assets; and (3) failure through negligence or irregular accounts, and failure to deal properly with employees to ensure correct management of the company. Director liability only arises if the company or shareholders have suffered damage or loss. Directors can also be held liable under the general provisions of the law of torts set out in the Civil Code. Thus, as a general principle every fault causing damage is a source of liability.[94]

Moreover, the president of the company is liable for all acts of deputies. Courts have imposed on every director a duty of control and supervision over the activities of the board. Thus, a director who wants to escape joint liability must expressly disapprove of the board's decision.[95] Directors will not be held responsible if

88. Section 93, para. 4, sent. 1 of AktG, *supra* note 77; SCHMIDT, *supra* note 77, at 685.

89. *See, e.g.*, NIRK ET AL., *supra* note 77, at 281. *Contra* DIRECTORS' DUTIES, *supra* note 65, at 78.

90. Section 93, para. 4, sent. 1 of AktG, *supra* note 77; SCHMIDT, *supra* note 77, at 685.

91. Loi No. 66-537 of July 24, 1966 (Commercial Act); *see also* Decret No. 67-236 of Mar. 23, 1967 (1967 Decree). For the original French texts, see CODE DE COMMERCE [COMMERCIAL CODE] 1155-1375 (1991-92). The Commercial Law is translated in 8 COMMERCIAL LAWS OF THE WORLD: FRANCE (1992). *See also* Andre Tunc, *The Judge and the Businessman*, 102 LAW. Q. REV. 549, 554-57 (1986).

92. Grossfeld, *supra* note 11, at 4-115.

93. DIRECTORS' DUTIES, *supra* note 65, at 55.

94. Tunc, *supra* note 91, at 555. It is hardly possible to find a court decision in which an error in judgment is not necessarily a fault, or in which due to the difficulties of conducting a business, a director's decision should be regarded with some leniency. *Id.*

95. Grossfeld, *supra* note 11, at 4-115, -116.

they can prove that they were unaware of any wrongdoing because of fraud. The court has to examine whether a director of normal diligence could have discovered the wrongful act.[96]

Under article 246, para. 2, no decision of the shareholders' meeting can relieve directors of liability to which they are otherwise subject.[97]

The founders of the public limited company may choose between the one-tiered or two-tiered system of corporate governance.[98] However, most of the *sociétés anonymes* (incorporated companies) are organized under a unitary board structure.[99] Under article 249, para. 1, of the French Commercial Law, members of the executive board in a two-tiered system are subject to the same liability as is imposed upon directors. Members of the supervisory council are liable for any personal misconduct in the course of their duties, but are not responsible for acts of the management.[100] The supervisory board, however, will be held liable if its members do not report offenses committed by the executive board, if they have knowledge of such offenses, to the general meeting of the shareholders.[101]

The French Commercial Law also provides for a derivative suit, which can be filed by 5 percent of shareholders against a member of the board on behalf of the company.[102] The charter cannot contain a provision that makes the bringing of the suit subject to authorization by the general meeting of the shareholders.[103]

To summarize, of the four legal systems discussed here, French law imposes the strictest standard of duties and liabilities upon directors and provides for the best investor protection.

E. The Draft Fifth Directive and the European Company Statute[104]

The Draft Fifth Directive and the European Statute do not articulate a standard of care and skill for board members.[105] Nevertheless, both regulations provide for

96. Commercial Act, *supra* note 91, art. 244; Grossfeld, *supra* note 11, at 4-116.

97. Commercial Laws of the World: France, *supra* note 91, art. 246; article 240, para. 1 of the Commercial Law, *supra* note 91.

98. Pennington & Wooldridge, *supra* note 5, at 49.

99. Meinhardt, *supra* note 11, at F-14(i).

100. Article 250, sent. 1 of the Commercial Law, *supra* note 91.

101. Article 250, sent. 3 of the Commercial Law, *supra* note 91.

102. Meinhardt, *supra* note 11, at F-14A(iii).

103. Article 246, sent. 1 of the Commercial Law, *supra* note 91.

104. The European Company Statute, 1989 O.J. (C 263) 41. The new Draft Directive, 1991 O.J. (C 138) at 8 and 1991 O.J. (C 176) at 1, is a proposal by the EC Commission for a creation of a new business organization, which will be governed by the statute and by the domestic legislation of the Member States. For discussion of the regulation, see 2 Gore-Browne on Companies, *supra* note 5, at 39-001. The provisions of the Statute follow exactly the Draft Directive. For that reason the discussion is limited only to the Draft Fifth Directive, though it should be remembered that the Statute has similar provisions.

The Draft Fifth Directive and the Statute have not been implemented mainly because of political opposition from the United Kingdom. The latter contests the provisions related to employee participation in management. *See, e.g.*, Wooldridge, *supra* note 5, at 86-90.

105. Welch, *supra* note 9, at 91.

civil liability of members of management and supervisory boards for "breaches of . . . [duty] in carrying out their [functions]."[106] It may be inferred that provisions scattered throughout the Draft Directive bear upon the so-mentioned duties and functions. As far as the one-tiered board is concerned, all management members have the same basic duty. According to article 21q(2) they shall "carry out their functions in the interest of the company having regard [in particular] to the interest of the shareholders and the employees." We may conclude that by this wording article 21q(2) includes the use of due care in making business decisions.[107]

Liability is joint and several without limit, but individual directors can escape liability if they prove that no fault is personally attributable to them. "Fault" seems to be equivalent to the meaning and use of "negligence" in the U.K. and U.S. law. This minimum liability presumably covers any damages sustained by the company as a result of a breach of duty by members of the governing organs in performing their functions.[108]

The authorization of a transaction by the supervisory organ (or presumably by the nonmanagement members of the administrative organ) shall not of itself exempt the management directors from liability.[109] Similarly, under article 14(5) of the Draft Directive the authorization by the general meeting of the shareholders of a transaction that causes damages to the company does not itself exempt any members of the board or boards of directors from liability.[110] Article 18(1) implies that the general meeting of shareholders can renounce the right to bring proceedings on behalf of the company to enforce the joint and several liability without limit. Nevertheless, such a refusal is ineffective against any shareholder entitled to maintain a suit to enforce article 14 liability, that is, a shareholder who holds shares of 10 percent or more of subscribed capital.[111] Finally, advance renunciation is prohibited, since article 18(2) provides that damage to the company must have occurred in order for the renunciation to be effective.[112]

The provisions of the Draft Directive and the European Statute clearly impose a much more severe standard than the existing U.K. and U.S. law and one similar to German and French statutory law. Nevertheless, the provisions in the Draft Directive and the European Company Statute are problematic.[113]

One difficulty is the absence of a definition of the duty of care as well as what

106. 1983 O.J. (C 240), *supra* note 9, art. 14.

107. *Id.* art. 21q(2).

108. *See, e.g.*, 2 GORE-BROWNE ON COMPANIES, *supra* note 5, at 39-007, -024; M. Raaijmakers, *European Harmonization: Quo Vadis?*, *in* HARMONIZATION OF COMPANY AND SECURITIES LAW 64, 85 (1989).

109. 1983 O.J. (C 240), *supra* note 9, art. 14(4).

110. *Id.* art. 14(1), (5).

111. *Id.* art. 16(1), (2).

112. *Id.* art. 18(1), (2).

113. 2 GORE-BROWNE ON COMPANIES, *supra* note 5, at 39-026.

constitutes a breach of that duty. Therefore, it is certainly necessary to extend harmonization in respect to directors' duty of diligence.[114]

Second, several provisions relating to the directors' duties are ambiguous. For example, article 21q(1) provides that all "members of the administrative organ shall have the same rights and duties, without prejudice to" delegation of the conduct of management of the company or to allocation of functions among the members of that organ.[115] This nebulous provision might be interpreted to the effect that no difference exists between the rights and duties of management and nonmanagement directors other than those arising from the delegation of management functions.

F. Eastern Europe

1. *Bulgaria*

The Bulgarian Law on Commerce, which follows closely the Draft Directive, does not contain any distinct provisions that elaborate the standard of care to be followed by the directors and management of the public limited company. Nevertheless, under article 240(2), members of the management board and the supervisory board are jointly liable for any damages caused by their fault.[116] A member of the board will not be held liable if the court finds that the board member has no fault connected to the damage.[117] Interestingly enough, the board members have to deposit security for their potential liability in an amount specified by the general meeting but not less than their remuneration for a three-month period. This indemnity may be in stocks or in bonds.[118]

2. *The Czech Republic and the Republic of Slovakia*

As already mentioned, under the law of the Czech Republic and the Republic of Slovakia the administration of public limited companies (joint stock companies) is based on a two-tiered system. Members of the board of directors and the supervisory board are obliged to fulfill their duties with due care and to maintain confidentiality of information and facts, the disclosure of which to third parties could cause the corporation to suffer damage.[119] As far as liability is concerned, section 66 of the Commercial Code states that the relations between the corporation and the members of its corporate bodies are primarily ruled by provisions on mandated contracts.

114. European Business Law, Legal and Economic Analyses on Integration and Harmonization, *supra* note 5, at 212.
115. 1883 O.J. (C 240), *supra* note 9, art. 21q(1).
116. Bulgarian Law on Commerce, *supra* note 3.
117. Article 240(3), sent. 1 of the Law on Commerce, *supra* note 3.
118. Article 240(3), sent. 2 of the Law on Commerce, *supra* note 3.
119. *See* Czechoslovak Commercial Code, *supra* note 3, § 194(5).

3. *Hungary*

According to Hungarian law, a member of the board of directors or the supervisory board, or an auditor, "shall be obliged to act with the care generally expected from persons in such positions."[120] If such persons breach their duties, they will be held liable for damages under the general provisions of the civil law. A contract with the company cannot waive liability. The liability of the senior officers is joint and several.[121] However, a director who objects to a decision and reports the objection either to the supervisory board or to the general meeting of shareholders will not be held liable.[122]

4. *Poland*

Polish law requires that directors carry out their duties with the "diligence of a conscientious merchant," but does not precisely define the meaning of the quoted phrase. It is not clear whether this test is objective. If it is, this test implies that directors will be held to no higher standard than an average businessman and are not required to have specific expertise.[123] The liability of the directors is joint and several.[124]

VI. Conclusion

A close look at the statutory provisions related to the directors' duty of care in the commercial laws of the examined Eastern European countries shows that it is either absent, as in Bulgaria, or is sparsely defined. While the drafters have evidently conscientiously copied the main provisions of the Draft Fifth Directive and of the French and German commercial codes, the standards imposed are not as strict as those of France or Germany. In particular, the new laws do not set forth detailed regulation of the cases in which directors will be held liable for violations of duties. Not clear is whether directors will be held liable for mere or gross negligence. Interestingly enough, the Czechoslovak Commercial Code even permits full elimination of directors' liability if provided by the corporate charter. The Czech Republic and the Republic of Slovakia have launched the largest privatization in history by selling vouchers. This process will be completed in a few years and will place about 50 percent of state property in private hands. Hence, an enormous number of private investors will appear on the scene.[125]

Moreover, it has been argued that the enactment of section 102(b)(7) of the Delaware statute in the United States, which states that the corporate charter may contain provisions for eliminating or limiting the personal liability of a

120. Hungarian Company Act, *supra* note 3, art. 32(1).
121. Gayer, *supra* note 34, at 523.
122. Hungarian Company Act, *supra* note 3, art. 32(3).
123. *See, e.g.*, Sievers & Spark, *supra* note 36.
124. Commercial Code of Poland, *supra* note 3, art. 290.
125. *See, e.g.*, THE PRIVATIZATION PROCESS IN CENTRAL EUROPE, *supra* note 1, at 70-90.

director, was associated with a negative effect on the stock prices of the corporations in Delaware.[126] Therefore, it is debatable whether that is the best solution since the Czech Republic, the Republic of Slovakia, and all Eastern European countries need foreign investments more than ever. Next, it is not apparent how these provisions will be interpreted by the courts, which will certainly need guidance in applying them. In this respect, the case law of the United States can be used to guide decisions and to partially replace the lack of experience in corporate and commercial matters.

What kinds of provisions related to the duty of care should be adopted and how should the standard of care be interpreted in Bulgaria, Hungary, the Czech Republic, the Republic of Slovakia, and Poland?

First, one should note that these countries have more similarities than differences in their legal systems. All are civil-law countries and had been heavily influenced by German and French law. Moreover, all are trying to join the European Union. Thus, this effort requires harmonization of their corporate and commercial legislation with the proposed Fifth Directive. However, to the extent the proposed Fifth Directive does not explicitly define the duty of skill and care to be followed by directors and contains some ambiguous provisions, the new democracies should try to fill the void by looking to the states with a long tradition and development of corporate law. Hence, to provide for better investor protection and to create more legal certainty, they should include more detailed statutory provisions related to directors' duty of care and liabilities in their commercial codes following the German, French, and U.S. statutory experience.

What standard of care should be adopted by the new market economies? It may be argued that in an era of full-time directors and rising standards of commercial education, the standards of skill and care required by directors should be high. At the same time, however, directors should be free to take risks so that entrepreneurship will not be restrained. Thus, the Draft Fifth Directive, in article 14, as well as the commercial codes of the Eastern European countries discussed, contain provisions that directors should be collectively liable for damages to the company that result from breaches of duty by one or more of them. The positive aspects of this proposal are that it encourages the responsible monitoring of directors by directors and deters directors from using delegation as a shield for liability for negligence. The negative aspect of the rule is that it may discourage competent persons from engaging in management or supervision of corporations because of the risk of liability for the acts of less competent counterparts.

The need to make duties of skill and care rigorous in Eastern Europe can be argued with conviction. The notion of the corporation comprising interests that include those of shareholders, employees, and creditors calls for an objective standard to measure the directors' duty of care since employees and creditors

126. *See, e.g.*, Bradley & Schipani, *supra* note 62, at 48, 60-65.

have no say in the appointment of directors.[127] A more rigorous standard of directors' duties will be one of the prerequisites to encourage investments in the new privatized joint stock companies.

Next, whether statutory or judicially articulated standards are applied to directors' duties probably will not matter. Statutory tests will inevitably involve a significant measure of discretionary assessment by judges. Nevertheless, it is possible to construct a test that allows judges to consider variations in directorial roles, but which does not ask judges to become involved in the merits of business decisions. Directors should be judged on the functions they undertake, and their qualifications should not prejudice them. Such a test would allow the court to consider the size and nature of the enterprise and the skills reasonably to be expected of directors in the role they have assumed.

In conformity with the Draft Directive, the commercial laws of all Eastern European countries provide for a two-tiered system that involves a management organ and a supervisory organ, with members of the former appointed and dismissed by the latter or the general meeting, and members of the supervisory board appointed by the general meeting of the shareholders. These provisions allow for continuous monitoring of the work of the management board.[128] The supervisory board has substantial powers of inquiry, including the power to investigate, to demand reports from the management board, and to receive a management board report on the state of affairs of the corporation at least every three months. Though the two-tiered system has worked fairly well in Germany,[129] one of the risks is that supervisory directors will start to identify with management directors in a scheme of shared responsibility that protects the executives from close scrutiny by shareholders and creditors. One way to deal with the problem is to allow a certain percentage of the shareholders to demand reports of company affairs to supplement the reporting obligations of the supervisory or unitary board, as defined in articles 32 and 60 of the Draft Directive.

Finally, some thought should be given to protecting the interests of small investors in the new capital markets of Eastern Europe. To achieve such protection shareholders should be given the main enforcement role, that is, they should have the right to file derivative suits.[130] In this respect and in line with the provisions of

127. The Commercial Code of Poland and the Bulgarian Law on Commerce do not contain provisions related to employee participation on the board of directors or the supervisory council.

128. James Cox & Nis Jul Clausen, *The Monitoring Duties of Directors under the EC Directive: A View from the United States Experience*, 2 DUKE J. COMP. & INT'L L. 47-49 (1992).

129. WOOLDRIDGE, *supra* note 5, at 85.

130. So far, only the Commercial Code of Poland provides for a shareholder's statutory action to sue for damages on behalf of the company. *See* Commercial Code of Poland, *supra* note 3, arts. 294, 477; Sievers & Spark, *supra* note 36, at 316. The Draft Fifth Directive in article 16 states that national laws shall provide for statutory actions of shareholders against wrongdoer directors, though the shareholders should hold at least 10 percent of the issued capital. Such derivative suits are provided for in the United States, Germany, and France, but not in the United Kingdom.

the Draft Directive, the ratification power of the general meeting should be limited accordingly.[131]

In conclusion, legislators in Eastern Europe should rethink the duty of skill and care and adopt measures that allow those with interest in a company to counter directorial incompetence and negligence. The creation of credible capital markets requires as a priority measure the encouragement of increased director competence, diligence, and accountability even through imposition of a somewhat onerous liability on directors.

131. *See* 1983 O.J. (C 240), *supra* note 9, art. 18.