Vilnius University Faculty of Law
Department of Private Law

Brigita Šimkutė
II study year, LL.M International and European Law programme,
Business Law track student

Master's Thesis

Exemption of Company Directors from Civil Liability with Respect to the Company and its shareholders: a Comparative Analysis

Supervisor: assoc. prof. dr. Paulius Miliauskas
Reviewer: assoc. professor of practice Gintautas Bartkus

Vilnius
2022

ABSTRACT AND KEY WORDS

This Master's thesis analyses the exemption of a company's director from civil liability towards the company and its shareholders in Lithuania, Germany and the United Kingdom (UK). The study reveals the differences and similarities in the regulatory framework of these jurisdictions in relation to the exemption from liability, limits of the exemption and the protected good. The analysis also unveils the problems of practical implementation of the theoretical possibility of exempting a company's manager from civil liability in the Lithuanian legal system, as well as proposes the alternatives to the director's exemption from civil liability.

Keywords: civil liability, exemption, director, shareholders, company.

TABLE OF CONTENTS

MAIN ABBREVIATIONS 2

INTRODUCTION 4

1. CONCEPT OF CIVIL LIABILITY OF A COMPANY DIRECTOR 10

1.1. General concept and purpose of the civil liability of the company's director 10

1.1.1. Director's duties to company and shareholders 11

1.1.2. Basis and conditions for civil liability of the company's director 14

1.2. Limitations of civil liability 19

1.2.1. Limitation based on the fault type 19

1.2.2. Application of Business Judgment Rule 22

2. EXEMPTION OF COMPANY DIRECTOR FROM CIVIL LIABILITY 26

2.1. Exemption in Articles of Association 26

2.2. Exemption by the shareholders 31

2.2.1. *Ex ante* authorisation 32

2.2.2. *Ex post* ratification 38

2.3. Exemption on behalf of the company 44

2.4. Boundaries of exemption from civil liability in the case of insolvency 51

3. ALTERNATIVES TO EXEMPTION FROM CIVIL LIABILITY 59

3.1. D&O insurance 59

3.2. Indemnification 65

CONCLUSIONS 68

LIST OF REFERENCES 71

SUMMARY 81

ANNEX 1 82

ANNEX 2 89

MAIN ABBREVIATIONS

AB	Public limited liability company in the Republic of Lithuania (abbreviation from Lithuanian *akcinė bendrovė*).
ABI	Law on Companies of the Republic of Lithuania (abbreviation from Lithuanian *Akcinių bendrovių įstatymas*)
AktG	German Stock Corporation Act (abbreviation from German *Aktiengesetz*).
AVB-AVG	General insurance conditions for financial loss liability insurance for supervisory board members, board members and managing directors (abbreviation from German *Allgemeine Versicherungsbedingungen für die Vermögensschaden-Haftpflichtversicherung von Aufsichtsräten, Vorständen und Geschäftsführern*)
BGB	German Civil Code (abbreviation from German *Bürgerliches Gesetzbuch*).
BGH	The Federal Court of Justice (abbreviation from German *Bundesgerichtshof*)
CA	Companies Act 2006 of the United Kingdom.
CC	Civil Code of the Republic of Lithuania (in Lithuania *Civilinis kodeksas*).
CCP	Code of Civil Procedure of the Republic of Lithuania (in Lithuania *Civilinio proceso kodeksas*).
Constitution	Constitution of the Republic of Lithuania
EU	European Union
GmbHG	German Limited Liability Companies Act (abbreviation from German *Gesellschaft mit beschränkter Haftung).*
InsO	German Insolvency Code (abbreviation from German *Insolvenzordnung*)
LAT	Supreme Court of Lithuania (abbreviation from Lithuanian *Lietuvos Aukščiausiasis Teismas*)
M&A	Mergers and acquisitions
UAB	Private limited liability company in the Republic of Lithuania (abbreviation from Lithuanian *uždaroji akcinė bendrovė*).

JANI	Republic of Lithuania Law on Insolvency of Legal Persons (abbreviation from Lithuanian *Juridinių asmenų nemokumo įstatymas*)
SPA	Share purchase agreement
VVG	Insurance Contract Act (abbreviation from German *Versicherungsvertragsgesetz*)

INTRODUCTION

The relevance of the topic. The specificity of a legal entity as a subject of legal relations derives from the fact that the legal entity participates in legal relations through natural persons, thereby making the legal person a derivative subject of legal relations (Abramavičius Mikelėnas, 1999, p. 228). Therefore, the management body of a legal person, whatever its nature, whether single-member or collegial, is the principal body of the legal person, through which the legal person acquires civil rights, assumes civil obligations and exercises them (Mikelėnas *et al.*, 2002, p. 183). Nevertheless, the civil liability of the legal entity is distinct in law from the civil liability of a management body (Kraakman *et al.*, 2009, p. 1), i.e. from the company director.

Laws and incorporation documents of the company provide the company director with broad powers to manage the company's activities, use its assets and represent the company in relations with third parties. In addition, the current economic situation is forcing companies to take sudden but not always fully informed decisions. On the one hand, this entails risks: a company's director may take decisions which, in the short or long term, may cause damage to the company, its shareholders or third parties, and may waive the immunity which the separate legal personality of the company grants. It is therefore necessary to analyse when and how the civil liability of a company's director arises. On the other hand, however, sudden and/or risky decisions may sometimes fall within the managerial discretion, which is granted to the directors in order to promote the company's performance. It is therefore also necessary to analyse whether there are possibilities to exempt the company's director from civil liability or in any other way protect him and his personal assets.

The legal framework governing the director's liability must be clear and defined (Ruling of the Constitutional Court of 30 May 2003). While the regulation may seem mostly clear when a company operates in a single country and the company's director and/or the legal team can properly analyse legal regime, clarity of the legal framework becomes particularly problematic nowadays when more and more companies are looking to expand into Europe. European company law is partially codified in Directive (EU) 2017/1132, however there is no clear legal framework regarding the director's liability. Member States continue to operate separate company acts, which are amended from time to time to comply with EU directives and regulations. A comparative analysis of the regulation of exemptions from civil liability in European civil and common law countries is therefore necessary to have a clearer framework.

It is undeniable that a clear legal framework is important for the company and the company's directors to know what standards of conduct apply to the company's directors, what duties they have, to whom these duties are owed, and the consequences of non-compliance with these duties. However, the practical application of the theoretical possibility of imposing or avoiding civil liability is equally important in order to ensure the protection of the company and of the entities to which the company director owes duties, as well as of the public interest. Since the regulation of the exemption of the company's manager from civil liability in Lithuania is at a relatively early stage and there is no case law on the matter, a practical analysis of the provisions on the exemption of the company's manager from civil liability is necessary to ascertain whether the company's manager only has a theoretical possibility of limiting his/her civil liability, whether the provisions are properly applied in practice and whether the provisions would be enforceable in the case at hand.

Aim. The main aim of the master's thesis is to analyse the regulation of the exemption of a company's director from civil liability towards the company and its shareholders in Lithuania, Germany and the UK in order to find out whether the exemption is possible at all, and, if so, whether it is subject to any limitations. The thesis also aims to analyse the alternatives to the exemption from civil liability and the practical implementation of the theoretical possibility of exempting a director from civil liability in SPAs concluded in Lithuania.

Tasks. To achieve the aim of the master's thesis, the following objectives are set:

1. Analyse the duties of a director towards the company and its shareholders;
2. Analyse the basis and conditions for civil liability of a director;
3. Examine the possibility of limiting the civil liability of a company director based on the fault type;
4. Research the operation of the business judgment rule, whether it would operate as a limitation of civil liability;
5. Analyse the possibility to exempt company’s director in the articles of association of a company;
6. Examine the *ex ante* authorisation and *ex post* ratification of director’s actions as a way to exempt company director from liability;
7. Examine whether the rules governing the exemption from civil liability vary depending on the solvency of the company;

8. Analyse Directors' and Officers' (D&O) liability insurance and indemnification of company director in M&A transactions as alternatives to the exemption from civil liability.

Object of the thesis. The object of this master's thesis is determined by the aim and tasks set for the analysis of the topic. The main object of the study is comparative analysis of legal acts and case-law of Lithuania, Germany and the UK on the exemption of company's director from civil liability. The thesis focuses exclusively on the analysis of the regulation of private limited liability companies, but it also includes an analysis of the legislation applicable to public limited companies, where the regulation can be applied *mutatis mutandis* to private limited companies.

The thesis first analyses the general concept and purpose of the civil liability of a company's director, its basis in the law of different jurisdictions, followed by the limitation of civil liability according to the type of fault and the application of the business judgment rule. Further the comparative analysis focuses on the possibility to exempt company director in articles of association, by the authorisation and ratification of shareholders' meeting and the contractual exemption on behalf of the company. In order to assess the practical application of the theoretical possibility of exempting the director of a company from civil liability on behalf of the company in Lithuania, the results of an analysis of the provisions of SPAs exempting the director of a target company from civil liability is presented. Finally, the thesis analyses the limitation of the exemption from civil liability in the event of insolvency of the company and discusses alternatives to the director's exemption from civil liability. Due to the inconsistent regulation in the jurisdictions in question and the scope of the thesis, a detailed comparative analysis of indemnification is not undertaken. Moreover, the question of whether an exemption can also be made in settlement agreements is also outside the scope of this master's thesis.

Research methods. The following research methods are used in this master's thesis:

1. Linguistic – this method is used to analyse the meaning of words used in the text of legislation of the jurisdictions in question.
2. Comparative – this method is the main research method of the master thesis and is used constantly throughout the thesis. The comparative analysis *inter alia* includes comparison of civil codes of Lithuania and Germany (CC and BGB), regulation regarding the exemption of company's director in company law acts (ABI, CA, AktG and GmbH), business judgment rules, acts dealing with insolvency (JANI, IsO and Insolvency Act 2015) and D&O insurance application as an alternative to exemption from civil liability. The comparative analysis is not detailed in respect of

indemnification. The countries for the comparative analysis have been chosen on the basis of the legal system to which they belong and the fact that they are all affected by EU regulation. In this respect, it should be noted that Lithuania and Germany were chosen as belonging to the same continental (Romano-Germanic, civil law) tradition, while the UK was chosen as belonging to the common law tradition. Although the UK is no longer a member of the EU, as a former member of the EU it has adopted EU regulation and can therefore be compared with the other two EU countries.

3. Systematic – this method is seen in the systematic interpretation of legislative provisions and case-law on the exemption of company director from civil liability, e.g. linking the possibility of exemption from civil liability to the director's duties to the company, shareholders and creditors, as well as linking the possibility of exemption from civil liability to the limitation of liability on the basis of fault or the business judgment rule. Also, a systematic method is used in the analysis of the alternatives to exemption from civil liability, indicating in which cases these alternatives would be effective.
4. Precedential – this method is used in the analysis of regulation in the UK since it is common law tradition, which is based on the precedents established by the courts.
5. Teleological – this method is used to provide an overview of the main objectives of limiting the liability of a company's directors and of setting limits on the exemptions from liability.
6. Logical - this approach is mainly used to summarise the differences/similarities between Lithuanian, German and UK regulation and the final conclusions.

Originality. The civil liability of a director for damage caused to the company is not a new topic. However, in scholar works analysing the manager's liability, the focus is usually on the director's duties and the breach thereof, which results in civil liability (e.g. R. Greičius "Privataus juridinio asmens fiduciarinės pareigos", R. Jokubauskas and M. Kirkutis "Įmonės vadovo civilinė atsakomybė dėl laiku neinicijuoto nemokumo proceso", A. Tikniūtė "Juridinio asmens valdymo organų pareigos kreditoriams problema" etc.). The legal doctrine lacks a detailed analysis of the director's exemption from civil liability, and moreover a comparison of the regulation of exemption from civil liability in different jurisdictions. The depth of the analysis of the managerial exemption from civil liability varies across the three jurisdictions. While the UK regulation is analysed in detail in S. Mortimore's (ed.) "Company Directors: Duties, Liabilities, and Remedies" and is based on case law, and the German regulation is discussed quite extensively in the commentaries on the law, the issue of directors' exemption from civil liability in Lithuania has not been studied at the academic level to any great extent (with the exception of chapter in A. Ambramavičius and V. Mikelėnas' “Įmonių vadovų atsakomybė”, which was published in 1999 and, accordingly, does not correctly reflect today's regulation in all respects). However, notwithstanding the extent to which the concept of director’s exemption from civil liability has been studied in different jurisdictions, the study is carried out in each jurisdiction mainly in isolation rather than by comparing the regulations with each other.

A narrow analysis of the regulation of the director’s exemption from civil liability in Lithuania and UK has been carried out only in the master's thesis “Bendrovės vadovo civilinė atsakomybė” by Ramunė Balkauskaitė, a student of the Faculty of Law of Mykolas Romeris University. However, this thesis only highlighted the general possibility of exempting or not exempting a company's director from liability, without analysing in detail the procedure of exemption, the limitations related to the company's insolvency, and the alternatives to exempting the director from civil liability. The exemption from civil liability is also briefly analysed in the master's thesis of Ieva Matonytė, a student of the Faculty of Law of Vilnius University, entitled “Įmonės, įstaigos, organizacijos vadovo atsakomybė pagal darbo ir civilinę teisę”. Again, although the later thesis mentions all the methods of exemption, including alternatives to exemption, that will be analysed in this master's thesis, neither a detailed analysis of them nor a comparative analysis of the regulation in different jurisdictions is carried out.

Finally, no thesis or scholarly work has analysed the practical implementation of theoretical possibility of exempting a company director from civil liability.

The most important sources. The most important sources for this master's thesis are the legal acts regulating company law in the compared countries: in Lithuania - CC, ABI, JANI, as well as the CCP and the Constitution, when it comes to the practical implementation of the theoretical possibility of exempting the company's director from civil liability, in Germany - BGB, AktG, GmbH, InsO, and in the UK - the CA. The case law of all three jurisdictions and commentaries of Lithuanian CC and German AktG are also relevant for the interpretation of the statutory provisions.

Regarding the works of scholars, the most important ones for the analysis of the Lithuanian legal regulation are A. Abramavičius and V. Mikelėnas “Įmonių vadovų teisinė atsakomybė”, R. Greičius “Privataus juridinio asmens fiduciarinės pareigos”, D. Ambrasienė *et al.* “Civilinė teisė. Prievolių teisė”, V. Mikelėnas “Civilinės atsakomybės problemos: Lyginamieji aspektai”. The analysis of the UK regulation is mainly based on S. Mortimore (ed.) "Company Directors: Duties, Liabilities, and Remedies", S. Deakin *et al.* “Directors and Officers (d and o) Liability” and A. Cahn and C. D. Donald's “Comparative

Company Law Text and Cases on the Laws Governing Corporations in Germany, UK and USA. Comparative Company Law Text and Cases on the Laws Governing Corporations in Germany, UK and USA". Two later sources are also relevant for the analysis of German regulation. The analysis of all three jurisdictions includes other scholarly works, but these are not considered to be the most important to the thesis as a whole because they are relevant to the specific question of exemption from civil liability.

1. CONCEPT OF CIVIL LIABILITY OF A COMPANY DIRECTOR

1.1. General concept and purpose of the civil liability of the company's director

Generally, civil liability is understood as new obligation that arises from the non-performance or improper performance of a legal or contractual obligation, or the unauthorised exercise of one's rights in an unauthorised manner or by unauthorised means, i.e. abuse of rights. The acts or omissions based on which civil liability arises usually infringe a person's pecuniary interests, therefore civil liability is a pecuniary obligation, one party to which has the right to claim compensation for the damage suffered (Mikelėnas, 1995, p. 30).

The compensatory nature of civil liability indicates that it is invoked not to punish the person who caused the damage, but rather to restore the *status quo* – restore the financial situation of a victim to the situation that was before the damage was caused (Abramavičius, Mikelėnas, 1999, p. 231). The legal framework must ensure that the injured parties are given a realistic opportunity to enforce their right to claim (Ruling of the Constitutional Court of the Republic of Lithuania of 19 August 2006) and that the person responsible for the damage (director of the company) does not escape liability under the guise of the limited liability of a legal person. Consequently, when we talk about the civil liability of a company director, we refer to a negative reaction to a director's behaviour that violates the private interests of either the company, shareholders or third parties (Abramavičius, Mikelėnas, 1999, p. 231), i.e. claim to fully compensate the damage incurred. In this respect it should be noted that the protection of interests is not limited to the company as a company's director has an obligation to safeguard the interests not only of the company he or she manages, but also of shareholders, creditors, employees, customers, suppliers and the public (Greičius, 2007, p. 84).

Besides the compensatory nature, the civil liability of a company director also has two other functions – informational and stimulation of business (Abramavičius, Mikelėnas, 1999, p. 235). Imposing civil liability on a company's director is a serious signal of incompetence or dishonesty. It does not matter whether it would be the point of view of the management of the company, shareholders, business partners or other stakeholders, the imposition of civil liability would be seen as a “red flag” discrediting the status of the director. It is a huge risk to directors’ careers because it will become harder to be appointed as a director in other places once civil liability is imposed.

Talking about stimulation of business, just merely having civil liability enshrined in the legal acts and imposing it effectively stimulates company directors to act with due care in performing their obligations, thereby providing companies, shareholders and other stakeholders with certainty that their interests are protected and growing trust between interested parties. Nevertheless, since the two latter functions are more of preventative nature, the further focus in this thesis will be on the compensative function of civil liability and how the civil liability is imposed on company directors in different jurisdictions.

1.1.1. Director's duties to company and shareholders

A status of a company director automatically indicates that a person, who is running the company, must act in the best interest of the company, do not violate duties imposed on him by the law or internal company documents. Since the duties imposed are aimed at protecting interests of the company, shareholders and other third parties, the violation of them triggers the negative reaction of interested parties and, as already discussed, gives rise for company director's civil liability. Consequently, when analysing civil liability of a company director, it is necessary to start from the basis of it – the duties owed by the director and compare them across the jurisdictions.

Lithuania

According to Article 37(1) of ABI, the director of a company is a single-person management body of the company, which owes duties to both company and shareholders. According to the general rule enshrined in Article 2.87 str. of the CC, director should, in relation to the legal person and other members of the bodies of the legal person, act honestly and reasonably, and not breach his/her fiduciary duties (duty of care, loyalty) to the legal person. The general rule that the duty is owed to the company is supplemented by Article 19(8) of ABI, where it is established that the management bodies must act in the best interests of the company and its shareholders, comply with laws and regulations, and comply with the company's statutes. Each of the duties has its peculiarities but all together oblige company directors to act with due care, attention, and diligence. If the company director acts with due care and skill and does his utmost to ensure that the company of which he is the director operates in accordance with the law and regulations, comply with the law and comply with the restrictions imposed on his activities he is automatically protecting the interests of the shareholders, as it is required by law.

Germany

Analysing German legal framework, we encounter the key notion that director's duties of care and loyalty run directly to the company (Cahn, Donald, 2018, p. 396). This is reflected through codification of duties towards the company – duty to exercise the diligence of a prudent manager (duty of care), non-disclosure duty, prohibition of competition (duty of loyalty (§ 93(1) and § 88(1) of AktG). German law does not have a certain provision, as it is in Lithuania, that the duties owed by the director are not limited to the company and extend to the shareholders. Nevertheless, it still imposes a duty on the director to convene a shareholders' meeting when 1) it is an annual ordinary shareholders' meeting, 2) the shareholders' meeting is necessary for the company's interest or 3) it is clear from the annual financial statements or the balance sheet prepared in the course of the financial year that half of the share capital has been lost (§ 49 of GmbHG). Also, according to § 51a(1) of GmbHG, a director owes shareholders obligation to disclose, upon the request of the shareholder, information on the company's affairs, and allow to inspect the books and company documents). Mentioned duties imposed by different sections of GmbHG and AktG therefore confirm that the duties of the director, although run directly to the company, are no way limited to the company and extends to shareholders. Consequently, it may be concluded that although the key notion in German company law is that the directors must serve the interest of the company, the concept of "serving the interest of the company" is meant to mediate the differing partial interests of various constituencies and includes at a minimum the interests of the employees, the creditors and the shareholders, and this is indeed the reason why mentioned obligations of the company director are enshrined in the German law.

United Kingdom

Directors' duties, as many other legal norms and regulations in the UK, had been developed over the years in common law and were later codified in the statutory law, namely in Sections 170-181 of CA. The fundamental principle of common law was that generally, director's duties are owed to the company as a whole and not to individual members (*Percival v Wright*; *Peskin v Anderson*[1]). Especially, in common law jurisdictions, it was common practice that a director owes the company a fiduciary duty and a duty of care, which are now replaced by the statutory norms (Bruce FCIS, 2011, p. 67). Although the common law duties were codified, they are still of particular importance in interpreting the

[1] [2001] 1 BCLC 372

general duties enshrined in CA. Section 170(1) of the CA specifically indicates that general duties, meaning duty to duty to act within powers, duty to promote the success of the company, duty to exercise independent judgment, duty to exercise reasonable care, skill and diligence, duty to avoid conflicts of interest, duty not to accept benefits from third parties and duty to declare interest in proposed transaction or arrangement (Sections 171 – 177 of the CA), are owed by a director of the company to the company. There is no reference to shareholders or other third parties. This reflects the position of common law that a director owes fiduciary duties and a duty to exercise reasonable care, skill, and diligence to the company, and in the absence of special circumstances, to the company alone (Arnold QC, 2017, p. 245).

Mentioned presence of special circumstances indicates that although the key notion in UK law is that duties are owed to the company, company director may still owe a duty to or be liable against other parties, for instance, the shareholders. In *Peskin v Anderson*[2] the Court of Appeal has affirmed that although the fiduciary duties form the foundation of the fiduciary relationship between the company director and its company and therefore fiduciary duties owed by the director to the shareholders do not arise from that relationship, certain circumstances may bring the director of a company to direct and close contact with the shareholders in a manner capable of generating fiduciary obligations. Circumstances may include a duty to disclose material facts to the shareholders, obligation to use confidential information, which has been acquired by the director in the office, for the benefit of the shareholders, and not to promote director's interests at the expense of the shareholders. Consequently, we may conclude that in the UK, similarly as Germany, although the key notion is that the duties of company director generally run to the company and not to individual members as it is in Lithuania, the shareholders' interests are still protected via other duties which arise in particular circumstances.

Conclusion

Considering the afore-mentioned, we can conclude that, generally, in all three jurisdictions the duties of company director are not limited to the company and can extend to the shareholders. The difference is that in Lithuania the duties are owed to both company and shareholders and are not limited to certain circumstances, whilst in Germany and the UK the company director owes duties directly to the company and duties to the shareholders only arise in certain circumstances. Notwithstanding the differences, the duties discussed

[2] [2000] EWCA Civ 326

form the fundamentals of the relationship between the director and the company and/or the shareholders. Therefore, the breach of them constitutes violation of private interests of the company or shareholders, and the civil liability shall be imposed as a negative reaction to the director's behaviour, which will be elaborated on further in this thesis.

1.1.2. Basis and conditions for civil liability of the company's director

Since in all three jurisdictions company director in one way or another owes duties to company and shareholders, and therefore should bear a responsibility for violation of these duties, it is essential to analyse when exactly does the liability arise.

Lithuania

According to Article 2.87(7) of the CC, a director who fails to perform or improperly performs any of the duties referred shall be liable to compensate the legal person in full for the damage caused, unless the law, the instruments of incorporation or the contract provide otherwise. Although the law does not specifically state that the shareholders should also be compensated for the damage caused, it should be noted that under Article 6.246 of the CC, civil liability arises from failure to fulfil an obligation imposed by law or contract. Therefore, considering that Article 2.87(1) of the CC, read together with Article 19(8) of ABI, imposes legal obligation on a director to act in good faith and reasonably in the best interest of the legal person and the other members of the bodies of the legal person, which *inter alia* include the shareholders of the company, the compensation for damages that occur due to the breach of duty by the company director cannot be limited to the legal entity as such and extends to the shareholders.

As the civil liability of the company's director is non-contractual (LAT judgment of 20 November 2009 in a civil case No 3K-7-444/2009), LAT has on numerous occasions[3] held that the director is liable only if four conditions for the director's civil liability are present: 1) unlawful acts (Article 6.246 of the CC), 3) causal link between the unlawful acts and the damage (Article 6.247 of the CC), 3) fault (Article 6.248 of the CC), 4) damage (Article 6.249 of the CC).

Civil liability arises from a breach of a duty imposed by law or a contract, an act prohibited by law or a contract, or a breach of a general duty to exercise due care and diligence (Ambrasienė *et al.*, 2004, p. 182). Therefore, when we talk about the unlawful

[3] See, for instance, Judgment of the Supreme Court of Lithuania of 20 November 2009 in a civil case No 3K-7-444/2009; Judgment of the Supreme Court of Lithuania of 25 March 2011 in a civil case No 3K-3-130/2011.

acts of the director, we refer to breach of the afore-mentioned duties, either imposed by law or being fiduciary duties. Nevertheless, the mere breach is not enough. Since in civil law the damage is understandable as a negative effect on a person's property or pecuniary rights, in the form of impairment or total loss of value (Abramavičius, Mikelėnas, 1999, p. 239), the breach of duties by the director will only be held to be unlawful act if the breach resulted in pecuniary damage, i.e. the loss can be expressed in monetary terms.

If the breach results in pecuniary damage, we have two conditions – unlawful acts and damage – fulfilled. Yet, this is not enough. Unlawful acts and damage must have causal link. It is necessary to establish whether the company director's actions were the sole factor causing the damage. If it is established that the actions of the director were the sole cause of the damage, the causal link is constituted. Otherwise, if the occurrence of damage was influenced by more factors than just the actions of the company director, it shall be further determined if the actions of the director were the key factor causing the damage (Abramavičius, Mikelėnas, 1999, p. 249). In such a case, the key aspect in determining the causal link is the impact that the director's actions had on the damage. If the actions increased the likelihood or determined the occurrence of the damage, it will be held that the unlawful actions of the company director resulted in damage and the causal link. In any other case, if the actions by the company director were weaker than the other factors, e.g. the actions by the management board, *force majeure* circumstances, the causal link will not be established as the impact of the director's actions on the occurrence of the damage is not the key one (Abramavičius, Mikelėnas, 1999, p. 249). If the case concerns a transaction, LAT has held that the causal link will only be established if at the time of the conclusion of the deal from which the claimant alleges damage, it was known in advance that they would lead to the company's damage and that the director, notwithstanding that knowledge, would nonetheless have entered into such transactions (LAT judgment of 20 November 2013 in a civil case No 3K-3-581/2013).

Turning to the last condition for the company director's civil liability, determination of fault assists in drawing the lines of civil liability, therefore, when we analyse whether the company director is liable for damage caused, the focus is on the analysis of his actions that presumably have led to the damage. Since a company director, representing a legal person, has an obligation to act diligently, honestly and competently, and do his or her utmost to ensure that the company he or she manages operates in accordance with the law and other legal acts (LAT judgment of 30 November 2009 in a civil case No 3K-3-528/2009), once it is established that the prudent business person, being in the same situation as the company director, would have acted differently to prevent the damage occurring, the company director will be held liable for the damage caused (Abramavičius, Mikelėnas, 1999, p. 250). Director's fault may be expressed by intention or negligence (Article 6.248(2) of the CC). The latter fault type is subdivided into ordinary and gross negligence (Ambrasienė *et al.,* 2008, p. 189). However, here it must be mentioned that once it is held that the director of the company has acted unlawfully and caused the damage (loss), director's fault is presumed (Article 6.248(1) of the CC, Judgment of LAT of 3 June 2016 in a civil case No 3K-3-298-701/2016) and the claimant is not required to prove that the director of the company is guilty. The burden of rebutting fault presumption rests with the company's director (LAT judgment of 22 September 2015 in a civil case No 3K-3-470-969/2015). In other words, the form of fault does not usually affect the liability. However, the type of fault, and especially its subdivision, is particularly important for application of and exemption from liability. This will be analysed in more detail further in this thesis.

Germany

Discussed legal regulation of Lithuania does not differ much from the regulation in Germany. Since Lithuania and Germany belong to the same continental law system, civil liability in Germany arises once the civil liability conditions mentioned before are met (Mikelėnas, 1995, pp. 98. 106, 125, 141). The liability for damages presupposes fault, i.e. an intentional or negligent breach of the due diligence of a prudent and conscientious manager, which, similarly to Lithuania, is presumed within the framework of § 93(2) of AktG (Schmidt, Lutter, 2015, p. 1456). The presumption implements a standard of care expected of a director, so that he could not exonerate himself with the objection that he lacked the necessary skills (BGH, judgment of October 28, 1971 – II ZR 49/70). BGB generally links the creation of civil non-contractual liability to the existence of a specific delict (Mikelėnas, 1995, p. 125). A delict is not any act or omission that causes damage, but only one that is unlawful and culpable, and in the German case, just as in Lithuanian case, this would be breach of duties contained in § 93(1) of AktG. Having a breach of duty and therefore all conditions of civil liability present, the liability of a company director in Germany would arise under § 93(2) of AktG the same way as it would arise under Article 2.87(7) of the CC.

Although the basis of civil liability and its conditions of it are the same in Germany and Lithuania, in Germany, differently than in Lithuania – the liability of a director is concentrated and mainly focused on restoring the *status quo* of the company's property. As far as the shareholders' private interests, i.e. the potential damage to the shareholders by the breach of duty, is concerned, the underlying idea in German law is that, to the extent that the damages payments by the director fill up the corporate purse, shareholders and creditors suffer no loss at all (Wagner, Klein, 2018, p. 171). Thus, there is neither need nor reason to compensate third parties, including but not limited to the shareholders. This indeed reflects the importance of relationship between the company director and the shareholders in Germany, about which we have talked before, and the view that once the director serves the interest of the company, he mediates the interests of other interested parties, including but not limited to the shareholders. Therefore, should the breach occur, and the shareholders together suffer damage, the payment to the company is in a sense deemed to be compensation to other possibly affected parties.

Nevertheless, it should be mentioned that since Germany, just like Lithuania, is continental law tradition country, if the obligor breaches a duty arising from the obligation, the obligee may demand damages for the damage caused thereby (§ 280(1) of BGB). Therefore, here we may draw a parallel to CC and say that in Germany civil liability arises not only in relation to the company but also before the shareholders if the duties mentioned in § 49 of GmbHG are breached.

United Kingdom

Turning on to the civil liability concept in the UK, first of all, it should be noted that when talking about common law countries, we do not refer to civil liability conditions and instead talk about the cause of action (Mikelėnas, 1995, p. 98). Under UK law, the cause of action exists if there is damage, failure to perform duty and a causal link between them, whereas the attention to fault is only drawn up when talking about non-contractual liability for civil wrongs (Ambrasienė *et al.*, 2004, p. 181). Since the directors can be subject to non-contractual liability for civil wrongs (Grantham, 2003, p. 17), the regulation is similar to the above-mentioned regulation of the civil law countries.

The similarity of the UK regulation to discussed civil law countries can also be seen in the basis of civil liability. Since in the UK the general duties discussed above are generally not owed to the shareholders of the company, the directors are liable to the company once they breach one or more of these duties.[4] As we can see, the basis of liability is the same as in Lithuania and Germany – breach of duties owed. There is no difference between civil law and common law countries as the common law duties are codified. The different situation is with the remedies available to the company against the director who

[4] Section 179 of CA states that *except otherwise provided, more than one of the general duties may apply in any given case*. Therefore, two or more duties may apply in a certain situation and consequently be breached by the director at the same time.

has committed a breach as the remedies are not codified in the UK (Cabrelli, McAlpine, 2018, p. 677). Therefore, they depend on the type of duty that was breached – fiduciary or not-fiduciary. If the duty breached is not-fiduciary, i.e. codified in Sections 171 – 177 of the CA, the consequences of breach are the same as would apply if the corresponding common law rule or equitable principle applied (Section 178 of the CA). Here we see the interplay of common law principles to negligence claims – should the general duties be breached, the director would be liable to pay for the breach, and the award of damages would be regulated by the rules relating to causation, foreseeability and quantification of damages (*South Australia Asset Management Corporation v York Montague Ltd*; *Dorchester Finance v Stebbing*). The different situation is with breach of fiduciary duties, i.e. duty of care and duty of loyalty. Since the actual control of property beneficially belongs to the company and causes the law to treat directors in the UK analogous to trustees, although they are not trustees (*Re Lands Allotment Company*), directors are under a duty not to misapply the company's property and therefore abide by the fiduciary duties. Consequently, once the fiduciary duties are breached, the fiduciary remedies, which are more focused on the disgorgement of the director's wrongly obtained gain (*Regal (Hastings) Ltd v Gulliver*) rather than the compensation to the company for director's negligence (Hood, 2000, p. 308), are available.

Conclusion

Each of the jurisdictions imposes strict standards of due care and loyalty towards the company directors, which in one way or another safeguards the interests of the company and its shareholders. In all three countries civil liability arises once certain conditions, in civil law countries named as conditions of civil liability and in common law countries named as cause of action, are met. Also, the research has shown that the civil law countries Lithuania and Germany focus on civil liability and enforce remedies provided for by the law (compensation for damage), whereas in the common law country the remedies extend to the common law tradition when the breach of fiduciary duty occurs.

1.2. Limitations of civil liability

Although it is necessary to safeguard the interests of the company and shareholders against irrational decisions made by the director of the company, the directors shall also be allowed a certain degree of management discretion and have their interests protected. Therefore, it is essential to discuss whether the civil liability of a company director has the potential of being limited in relevant jurisdictions and if yes, what are the basis, rationale, and boundaries of limitation, as well as how does the limitation, if any, mitigate the interests of all – company, shareholders and the company director itself.

1.2.1. Limitation based on the fault type

Lithuania

As already discussed, one of the conditions of the civil liability is the fault, which is presumed but can be rebutted by the company's director. The possibility to rebut the presumption is tightly connected with the limitation of liability based on the fault type because LAT has stated that a manager shall not be liable for any breach of the duties assigned to him, but only for his gross fault, i.e. intention or gross negligence manifested by clear and unjustifiable negligence in the performance of his duties (LAT judgment of 1 February 2012 in a civil case No 3K-3-19/2012). Therefore, the presumption is rebutted if a company has been acting other than with gross fault.

Although Lithuanian law does not have a legal norm which would directly codify what has been held by LAT, the attention needs to be drawn to Article 6.252(1) of the CC, which stipulates that an agreement of the parties upon exclusion of civil liability for damage sustained by the reason of the debtor's intentional fault or gross negligence shall be null and void, thereby drawing boundaries of limiting civil liability. This provision includes two fault "types" – intentional fault and gross negligence, which can be said to be determining factor in deciding whether the civil liability shall apply or whether it could be limited. As already mentioned, Article 6.248(2) stipulates that fault may be expressed by intention or negligence, the latter being divided into simple and gross negligence. Therefore, it is essential to understand the difference between two negligence subtypes and how they affect the exemption from liability. Selenionytė – Drukteinienė and Norkūnas (2008) defines gross negligence as actions that a person, exercising at least a minimum degree of care and attention, would not have done, whereas simple negligence is defined as a failure to exercise caution and care when performing by non-specific instructions of general nature. As we can see, it may be hard to distinguish between these two types of negligence. The situation is arguably even more complicated with the case of exemption of director from civil liability. Since the director must act with the utmost care and diligence to safeguard the best interests of the undertaking under his direction (Abramavičius, Mikelėnas, 1999, p. 286), one may argue that nearly everything can be included in the notion of "gross negligence". Here it should be noted that Lithuanian legislator has granted director discretion relating to reasonable managerial decisions, which is the basis of business judgment rule that will be later discussed in this thesis. Discretion in managing business means that simple negligence related to the risk of the company's commercial activities should not be the basis of the director's civil liability (LAT judgment of 13 April 2017 in a civil case No e3K-3-180-378/2017). As a result, the objective *bonus pater familias* principle must be applied to distinguish between gross and mere negligence. It is clear that every case is different and what may seem as normal commercial risk in one case, it would be seen as grossly negligent director's conduct in another case. However, for the purposes of this thesis, it may generally be argued that simple negligence is related to normal commercial risk, which is understandable as regular individual activities for profit (Mikelėnas *et al.*, 2002, p. 23), whereas gross negligence relates to negligence and carelessness in performing certain actions, which other person, exercising at least a minimum degree of care and attention, would not have done. Gross negligence would be constituted in such cases: setting excessive remuneration for the company's employees when the company's financial situation is poor, insufficient analysis of available information before taking a decision, failure to comply with basic standards of business administration etc.

As it can be seen, it may be hard to distinguish between simple and gross negligence. Only general conclusions can be drawn at this point therefore every case should be evaluated individually. Nevertheless, for the purposes of this thesis it is clear that causing damage with intentional fault and gross negligence would indeed be seen as a direct breach of mandatory duties imposed on the director by Article 2.87(1) of the CC and Article 19(8) of ABI. Therefore, limiting the liability of a director acting with intentional fault and gross negligence would simply breach mandatory provisions of law and therefore is not legally allowed.

Germany

German regulation considerably differs from Lithuanian regulation. Neither BGB nor AktG or GmbHG contain provisions that would allow limiting the director's liability once it is established that the director was not acting with intentional fault or gross negligence as it is in Lithuania. Here we see that German regulation is very strict about abiding by the standard of care applicable to the company director as defined by § 93(1) of AktG, and therefore it is impossible to modify the standard or derogate from it by justifying the breach of standard if it was not committed intentionally or with gross negligence. According to German law, fault types are not categorized, the breach is simply seen as breach, and the director's liability for damage to a corporation under § 93(2) of AktG is seen as mandatory law, thereby making it impossible to impose limits or exclusions to it (Wagner, Klein, 2018, p. 177).

United Kingdom

Comparing three jurisdictions, UK regulation may seem to be similar to Lithuanian regulation but, in reality, is similar to German regulation. Section 232 of the CA sets out the general prohibition on the exemption and indemnification of directors in relation to their negligence, default, breach of duty, or breach of trust in relation to the company, nevertheless contains some exemption to the general prohibition on indemnification (Section 232(2)), which will be analysed later in this thesis, and preserves the effectiveness of provisions in a company's articles dealing with conflict of interests (Section 232(4)).

Although it may seem that by listing circumstances in which the liability cannot be limited, UK legislator allows the limitation or exclusion of liability for the damage in any other circumstances, arguably there are no other circumstances left. Differently from Lithuanian law, Section 232(1) of the CA does not distinguish between simple negligence, gross negligence or intentional fault. Until the 1929 Companies Act it was common to allow exemption of directors from loss except when it was due to their wilful neglect or default, or in some cases, due to actual dishonesty (*Re Brazilian Rubber Plantations and Estates Ltd; Re Home and Colonial Insurance Co Ltd*). If this regulation was applicable now, we could say that UK regulation is similar to Lithuanian regulation. However, now Section 232(1) is wide enough to include any misconduct of a company director. As a result, the exemption of liability cannot be said to be possible based on the fault type as all fault types seem to fall within the prohibition of exemption contained in Section 232(1) of the CA.

Conclusion

Considering what has been said, Germany and UK have a very strict approach towards limitation of liability based on the fault type. In mentioned jurisdictions it is generally impossible to impose limits or exclusions to liability before the relevant conduct has occurred. Different situation is with Lithuania. Lithuanian regulation distinguishes between fault types and leaves a possibility to exempt a director from civil liability that would attach to him in connection with simple negligence.

1.2.2. Application of Business Judgment Rule

The company law structure is based on two fundamental principles – limited civil liability of shareholders, where in most cases shareholders risk only their personal contributions and do not incur any significant risk (Girasa, 2013, p. 14; Easterbrook, Fischel, 1991, p. 40-41) and limited civil liability of the members of the management body (Jarusevičius, 2019, p. 85). Therefore, central management (Cahn, Donald. 2018, p. 444) combined with limited liability of management bodies can become the key to the success of the company. Management authority is delegated to directors because it is believed that they are experts, who better than shareholders, can professionally control company‘s assets (Cahn, Donald. 2018, p. 444) and make decisions in the best interest of the company and its shareholders, thereby abiding by the statutory duties imposed on them. However, what if the decision made is ill-founded or does not have the outcome it was supposed to have? Does it always mean that the previously discussed civil liability arises and the liability cannot be limited as the bad result is deemed to be not in the best interest of the company and therefore a breach of duties owed to the company?

It is now well recognised practice that directors can escape liability for business errors when the courts apply business judgment rule. Ever since it was introduced in the U.S., business judgment rule has been labelled as a “safe harbour” that makes both directors and their actions unassailable if certain prerequisites have been met (Branson, 2002, p. 636). Essentially, the application of business judgment rule shelters directors’ from civil liability for mere business judgment errors – the managers are not held liable for unlucky business decisions that did not turn out the way they should have if a person (either it would be company or a shareholder) cannot prove that the director has not acted on an informed basis, in the best interests of the company lacking any conflict of interest (Radin, 2009). Therefore, the risk that is attached to managerial discretion slightly reduces as the liability turns out to have a possibility of being limited.

Although the exact copy of the business judgment rule introduced in the U.S. cannot be found in the company laws of the EU Member States and the UK (Dotevall, 2016, p. 291), a similar rule is found in most of the European countries (Gerner-Beuerle, Schuster, 2014, p. 204), thereby providing possible limitation of civil liability.

Lithuania

The concept of a business judgment rule is not directly enshrined in any legal act of Lithuania, however LAT has been interpreting and developing this concept since 2014.[5] According to the consistent case law of LAT, under the business judgment rule manager is presumed to act in the best interests of the company he or she manages. This presumption is intended to protect the director from liability for business decisions made in good faith and following the standards of the duty of care. In this respect LAT notes that the civil liability of a director is not for business failure but for making a business decision in breach of fiduciary duties and/or in excess of authority, therefore, it is not sufficient for the person seeking compensation to prove the fact of the damage caused, but it is also necessary to prove a breach of the manager's fiduciary duties of loyalty, honesty, reasonableness, etc., a manifest exceeding of reasonable commercial risk, clear negligence or an exceeding of the authority conferred (LAT judgment of 9 January 2014 in a civil case No 3K-7-124/2014). Since the rule is not codified in the legal acts, it is essential to understand why the case law regarding the application of business judgment rule develops the discussed way. Contrary to what it may seem, the practice of applying the rule is developed by the courts not to increase the “risk appetite” of the directors but rather to ensure that the case-law, together with the legal acts, not only protects the rights and interests of creditors of companies but also inhibits reasonable risk-taking on the part of the directors of the companies, which is essential for the development of business (LAT judgment of 2 May 2014 in a civil case No 3K-3-252/2014).

Although the case law related to the application of the business judgment rule is still developing in Lithuania,[6] we can already conclude that company directors’ civil liability can be limited by applying business judgment rule as directors are allowed to take risks without being exposed to the threat of full personal civil liability for their decisions, when they are made in good faith and with due care.

Germany

When talking about the limitation of liability under the business judgment rule, German regulation is a bit more developed than Lithuanian. Although the German business

[5] See, for instance, LAT judgment of 9 January 2014 in a civil case No 3K-7-124/2014; LAT judgment of 5 May 2014 in a civil case No 3K-3-244/2014; LAT judgment of 4 November 2019 in a civil case No e3K-3-320-916/2019.

[6] From 2014, LAT has applied business judgment rule only in 15 cases (3K-7-124/2014, 3K-3-252/2014, 3K-3-244/2014, 3K-3-152-686/2015, 3K-3-210-611/2015, 3K-3-220-916/2015, 3K-3-298-701/2016, 3K-3-452-415/2016, 3K-3-485-421/2016, e3K-3-472-313/2018, e3K-3-526-219/2018, e3K-3-320-916/2019, e3K-3-236-611/2021, e3K-3-307-421/2021).

judgment rule was originally introduced and developed in company law by the German Federal High Court of Justice (BGH judgment of 21 April 21 1997 – II ZR 175/95), it is now codified, however not superseded (Mertens, Cahn, 2010). § 93(1) of AktG mentions it within the duties of the members of the management board, setting out that *no dereliction of duties will be given in those instances in which the member of the management board, in taking an entrepreneurial decision, was within their rights to reasonably assume that they were acting on the basis of adequate information and in the best interests of the company*. Mentioned section does not expressly state elements of the German business judgment rule, however it is widely accepted that there are five of them - the director is taking an entrepreneurial decision, thereby reasonably assuming that he or she is (secondly), acting based on adequate information, and (thirdly), for the benefit of the company, and (fourthly), in good faith, and (fifthly), avoiding conflict of interests (Schmidt, Lutter, 2015). Once all of them are met, company director escapes liability.

Although German business judgment rule is codified and more developed, we can see that by its content it is similar to the rule being developed in Lithuania. The main purpose of it is the same - to protect company directors from damage claims if the decision that gave a rise to the claim was made in good faith and the best interest of the company. However, German regulation is silent about the presumption that company director always acts *bona fide* and does not switch the burden of proof to the claimant (Deipendbrock, 2016, p. 204), as it is in Lithuania. According to § 93(2) of AktG, in the event of a dispute as to whether or not the director has employed the care of a diligent and conscientious manager, director shall bear the burden of proof. It is upon the director to show that it was only a business error, and not his or her intentional fault to make a decision that may be contrary to the interest of the company and therefore violating the interests of third parties, including, but not limited, to the shareholders.

Also, it shall be noted that differently than in Lithuania, German business judgment rule is mainly seen as a tool to limit the liability of management bodies of a public limited company (*Aktiengesellschaft (AG)*). Since the application of Lithuanian business judgment rule is relatively at the early stage, there is no specific guidance by the Lithuanian courts as to whether the business judgment rule shall be applied more to private limited companies (UAB) or public limited companies (AB). Nevertheless, Lithuanian business judgment rule is already applied in the cases where liability of a director of AB is concerned.[7] Therefore, there is a possibility that in the future the Supreme Court of Lithuania will draw more

[7] See, for instance: LAT judgment of 3 December 2021 in a civil case No e3K-3-307-421/2021.

precise boundaries for the application of business judgment rule and possibly clarify in which type of disputes – disputes involving AB director or disputes involving UAB director, the application of business rule has stronger rationale.

United Kingdom

Moving on to the application of the business judgment rule in the UK, it essentially does not differ from the application in UK or Lithuania. Similarly to Germany (§ 93(1) of AktG), the duty of care set in Section 175 of the CA obliges the director to exercise such care, skill and diligence that would be exercised by a reasonably diligent person with the general knowledge, skill and experience that may reasonably be expected of a person carrying out such functions. Therefore, similarly to Lithuania, UK courts presume that disinterested directors making business decisions in good faith have met their duty of care absent egregious mismanagement (Cahn, Donald, 2018, p. 444). They are usually reluctant to engage in analysis of merits of commercial decisions made by a director in good faith.[8] The burden of proof is on the claimant to rebut the presumption that there was a mere error and not a breach of the duty of care (Gerner-Beuerle *et al.*, 2019, p. 99). Consequently, we can conclude that just like in Lithuania, liability of directors in the UK requires the intentional or negligent breach of director's duties, and if the claimant cannot prove this – civil liability for mere business failure is not imposed.

Conclusion

All three jurisdictions have different views towards limitations. Whilst Lithuania provides for possible limitation if the damage was not caused intentionally or with gross negligence, the limitation based on the fault type is not available in the UK and Germany, where director's liability for damage to a corporation is seen as mandatory law. Nevertheless, the limitation which applies in all three jurisdictions is business judgment rule. In all three jurisdictions managers are protected in making entrepreneurial decisions, provided they act *bona fide* in making those decisions. However, the difference between jurisdiction is that in Lithuania and the UK the good faith of director is presumed whilst in Germany the burden of proving that the director exercised care of a diligent and conscientious manager is on the director.

---

[8] See, for instance, *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 at 832.

2. EXEMPTION OF COMPANY DIRECTOR FROM CIVIL LIABILITY

Having concluded that the civil liability of company directors can be limited, the further focus will be on the exemption of the company director from civil liability. The exemption possibilities in the relevant jurisdictions will be analysed from different angles – exemption in articles of association, *ex ante* and *ex post* exemption by the shareholders, as well as exemption on behalf of the company. Considering that the director has an obligation to mitigate the interests of all – himself, as his liability can be limited, company, shareholders, creditors etc., the discussion in this chapter will finish with the analysis of the exemption boundaries in relevant jurisdictions, as far as it is related to company's insolvency.

2.1. Exemption in Articles of Association

Company's articles of association - document of incorporation that applies throughout the company's lifetime, often regarded as the constitution of the company (Mikalonienė, 2011, p. 268). According to Mikalonienė (2011), considering that the company acquires rights and obligations, and therefore participates in legal relations, through natural persons, articles of association simultaneously reflect the expression of the will of both the participants of the company and the company as independent entities to create, modify or amend civil rights and obligations, which *inter alia* include the rights, obligations and liabilities of the company director. But can the articles of association exempt company director from liability? There is no one general answer, therefore, it must be assessed and answered in accordance with national law.

Lithuania

Lithuanian company law does not provide for specific limitations on the director's exemption from civil liability in the articles of association. The possibility to exempt company director from civil liability in articles of association is enshrined in Article 2.87(7) of the CC, where it is stated that the director shall only compensate legal entity in full for the damage caused if *inter alia* incorporation documents do not provide otherwise. However, the possibility to provide otherwise, i.e. to exempt director from civil liability in articles of association, is not absolute. Since it is not only the company itself that has an interest in efficient functioning of the company, but also its shareholders, employees and creditors, the compensation for the damage caused to the company, and hence the exemption of the company's director from civil liability, cannot be treated as a purely private matter for the company (Abramavičius, Mikelėnas, 1999, p. 303). For this reason, to protect the public interest, the legislator has narrowed the discretion of company founders in drafting articles of association to the extent that the articles of association cannot conflict with mandatory statutory provisions (Article 2.46(2) of the CC and Article 4(6) of ABI). The exemption in articles of association can be deemed to be prior agreement between the company and its participants because they are drawn before the incorporation of the company, therefore, when talking about the mandatory norms applicable to it, we refer to Article 6.252(1) of the CC. The norm consists of two parts: fault type and the object of the damage (Mikelėnas *et al.*, 2002, p. 348). Regarding the fault type, as it was already concluded, the liability of a company director may be limited if he does not act intentionally or with gross negligence. This limitation is supplemented by the limitation regarding the object of the damage. Since Lithuanian law (Article 1.114(1) of the CC) protects business professional reputation, business name, trademarks of goods (services) and other values with which the arising of certain legal effects is linked by the laws, the limitation of liability of a director is not possible for non-pecuniary damage that results from the violation of mentioned values.

Consequently, when talking about the boundaries of exemption in articles of association, we may conclude that Lithuanian legal framework generally allows the exemption of company director from civil liability in articles of association, except for the cases when director is acting with intentional fault, gross negligence, or have caused non-pecuniary damage resulting from the violation moral values and rights preserved by Article 1.114(1) of the CC. If the exemption would be allowed without boundaries, mandatory legal norms would be violated, thereby allowing director to act in his own interest instead of promoting the success of the company. As a result, private interests of the company, shareholders, and public interest of all other stakeholders could be violated.

Germany

As we can see, the main restriction on the exemption in articles of association in Lithuania relates to compliance with mandatory legal norms. The same but even more stringent regulation can be found in Germany. Although the description of mandatory legal norms cannot be found neither in Lithuanian law nor in German law, it is a subject of legal doctrine. According to it, mandatory norms are generally binding rules, which determine the rights and obligations of the participants in a legal relationship (Baublys *et al.*, 2012, p. 316). Vaišvila (2004) defines mandatory legal norms as legal norms that impose a mandatory duty to perform certain positive actions. This perception of mandatory norms is particularly important when analysing German approach towards the exemption of company directors in articles of association. As it was already mentioned in the first chapter of this thesis, pursuant to German law, director's liability for breach of duties under § 93(2) of AktG is seen as mandatory law, thereby making it impossible to impose limits or exclusions to it. The rules of exemption in articles of association are therefore not complicated. Since the law stipulates that the directors shall be jointly and severally liable to their company for any resulting damage, there is a positive obligation on the directors to compensate the damage caused to ensure protection of company's interests and thus director cannot be exempted from this obligation in articles of association.

Discussed German regulation, although formally stricter, arguably has the same effect as Lithuanian regulation. Although German law, unlike Article 6.252(1) of the CC, does not provide for any circumstances when the liability could be limited and the director could be exempted from liability in articles of association, directors may not be found to have acted in breach of duties to the company if they been merely guilty of errors of judgment and mistakes (Wooldridge, 2010), which is essentially the same as simple negligence that is a permitted ground for exemption in Lithuanian law. It may therefore be argued that mandatory nature of obligation to compensate company for damage caused in Germany can arguably be related to wilful misconduct, gross negligence, which are prohibited to be ground for exemption in Lithuanian law as well. Both jurisdictions preserve mandatory legal norms, but one specifically allows the exemption in articles of association based on simple negligence, while the other one prohibits all types of exemption in articles of association but allows exemption based on simple negligence through the operation of business judgment rule. Even if Article 6.252(1) did not allow an exemption in articles of association based on simple negligence, such an exemption, based on current LAT case law, would be allowed under business judgment rule. It can therefore be concluded that the formal rules on the exemption from liability in the articles of association differ between Lithuania and Germany. However, more broadly, the possibility of exemption is the same in both jurisdictions - a director cannot escape liability if he acts in a totally unjustifiable manner, in gross breach of his duties to the company or by taking unjustifiable risks in contravention of mandatory rules of law.

United Kingdom

Continuing the analysis of the exemption in articles of association in different jurisdictions, more detailed analysis is needed for legal framework in the UK. Without making a comparison with German regulation as it does not allow exemption in articles of association at all, it should first be noted that the regulation in UK is more developed and specific than the regulation in Lithuania. Although Section 232 of the CA sets the general restriction on the exemption of company director, which is already wider than the restriction codified in Article 6.252(1) of the CC and barely leaves possibility to exempt company director from liability, UK legislator sets a possibility to limit director's liability for breach of one of the general duties – duty to avoid a conflict of interest set in Section 175 of the CA. Section 232(4) of the CA directs that a company is not prevented from making such provision *as has previously been lawful* for dealing with conflicts of interest in its articles, thereby allowing to exempt director from civil liability for a breach of the Section 175 duty to avoid a conflict of interest. Essentially, Section 232(4) of the CA suggests that the company could enter into a contract, or insert provisions in its articles of association, duly carving or limiting the content of the statutory duty to avoid a conflict of interest and duty laid down in Section 175 of the CA.

The exemption from liability for breach of duty to avoid a conflict of interest is no way absolute. Up until the CA came into force, the view in the UK case law was that it is not strictly accurate to state that a director owes a fiduciary duty to his company not to put himself in a position where his duty to the company may conflict with his personal interest, and therefore that a liability should automatically arise once a company director puts himself in such a situation. Instead, it was considered that the true principle is that if a company director finds himself in a situation of conflict of interests, unless the articles of association contain a provision entitling him to do so, the transaction will be void and other customary sanctions for voidability will follow (*Movitex Ltd. v Bulfield & Ors.*). The exemption however was not seen as a way to release director from the consequences for the breach of duty to avoid conflict of interest. The possibility to exempt a director from liability in articles of association was directly linked to the requirements with which a director must comply to make the transaction, possibly involving conflict of interests, valid and not render it voidable (Hayton, 1987). The requirements which the company had a competence to lay in the articles included duty to disclose interest in the transaction, abstain from voting in the board meeting etc. It was common practice to exempt the director from liability arising from the situations of conflict of interests and in many cases self-dealing transactions, provided other requirements in articles of association are met. Although this may seem as a hole in the legislation because there are no specific boundaries, requirements for the exemption of company directors in conflict of interest cases, and when talking about the UK, we refer to previous case law, which initially says that the company has the competence to set the conditions in which the liability will not apply, a "patch" to cover this hole is arguably wider than the hole. Although it is only a metaphor used by Vinelott J. in *Movitex Ltd. v Bulfield & Ors.,* it is meaningful when talking about Section 232(4) of the CA and its actual meaning.

Dr. Finn (1978) has noted that although a company may release a director from liability arising from self-dealing and conflict of interests, no provision can release him from the overall duty to act in the best interests of the company. Considering that the duty to act in the best interest of the company is reflected in the general duties codified in Sections 171-177 of the CA, it may be argued that although a director can be exempted from the duty laid down in Section 175, he is still subject to all the other duties and therefore the exemption of company director in articles of association is only possible if the other general duties are abided by. As a result, should the company want to exempt a director from liability arising from the conflict of interests' situation, it should at least mention that the exemption is subject to the compliance with general duties listen in Sections 171-174 and Sections 176-177 of the CA. The compliance with one duty – duty to disclose interest in proposed transaction may nevertheless raise questions for companies that do not have a board of directors, to which director discloses his interest, and instead has only one director. What should the director do in such a case? Is it possible to disclose information to himself? Lightman J. in *Neptune (Vehicle Washing Equipment) Ltd. v. Fitzgerald* held that a meeting of one director for disclosure is possible, providing it is expressly noted in the minutes of the meeting. However, the better solution was offered by A.G. Steinfeld Q.C, sitting in that case as a deputy judge, who held that since the director must be acting *bona fide*, the duty of disclosure will only be abided by if the director seeks the shareholders' approval for the transaction instead of just relying on disclosure to himself as noted in the minutes of the meeting. This is indeed a valid conclusion because once the shareholders approve the transaction, it is confirmed that the director acts *bona fide* and therefore the exemption from liability arising out of conflict of interests' situation is possible. Nevertheless, the further analysis of the ratification of company director's decisions by the shareholders will be done further in this thesis.

Concluding with the UK, generally, should the transaction involving conflict of interests involve any other breach of general duties, the transaction would be void and liability will follow although the director was exempted from it in the articles of association. Consequently, although the possibility to exempt the director from the liability arising out of the conflict of interests may seem a hole in the legislation, allowing company director to eventually act in his own interest instead of the interest of the company, the practice embedded in the case law safeguards the interests of the company and shareholders by making director subject to all other duties, which run directly to the company, but in certain cases, mentioned in the first chapter of this thesis, extend to the shareholders, thereby placing a “patch” on the hole.

Conclusion

Analysed jurisdictions do not have a uniformed approach towards the exemption of company director from civil liability in the articles of association. Whilst the regulation in Lithuania and Germany are similar in a sense that they base their restrictions on mandatory legal norms, regulations differ because Lithuania generally allows the exemption of company director from civil liability in articles of association, except for the cases when director is acting with gross fault or have caused non-pecuniary damage, and Germany does not allow the exemption in articles of association at all. The most developed and at the same time complex regulation is found in the UK. The legislator sets the general prohibition on the exemption in articles of association but leaves a possibility for company director to be exempted from liability for breach of duty to avoid conflict of interest. However, possibility to not be liable for breach of duty to avoid conflict of interests is not absolute – company director must abide by other general duties enshrined in the CA, thereby safeguarding the interests of the company and in special circumstances the shareholders.

2.2. Exemption by the shareholders

The research has already shown that the company laws of jurisdictions in question are not uniformed. However, a uniform approach is seen in one area – meeting of shareholders in all three jurisdictions is considered a supreme body of a company (Wagner and Klein, 2018, pp. 160, 703; Article 19(1) of ABI). Being the supreme body of a company, it has the power to influence corporate decision-making, instruct director to act in a certain way by adopting decisions that fall under its competence. However, the boundaries of instruction and their relationship with company director’s liability for decisions made remain unclear. To clarify this, further analysis will focus on the possibility provided for shareholders in different jurisdictions to exempt company director from civil liability by authorising his decision *ex ante* and ratifying it *ex post*, thereby waiving the liability that already arose.

2.2.1. *Ex ante* authorisation

According to Longman Dictionary, word authorisation means *official permission to do something*. Consequently, it indicates that if someone has the official permission to do something, he or she could arguably escape liability for consequences that follow. But is it really the case in company law? Does the authorisation by shareholders meeting exempt company director from civil liability that could arise from a prospective breach of director's duty? Since there is no uniform company law among the three jurisdictions in question, answers to later questions can only be found analysing *ex ante* authorisation on a jurisdiction-by-jurisdiction basis.

Lithuania

Ex ante authorisation of director's actions is not clearly regulated in Lithuania. Authorisation by the shareholders was regulated in Article 3(8) of Companies Act of the Republic of Lithuania enacted on 30 July 1990, where it was stated that a member of the management board and other persons can be exempted from liability by the general meeting of shareholders by 9/10 of the votes cast at the meeting. There was a clear threshold which had to be met to exempt a director from liability, however now, possibility for general meeting of shareholders to authorise certain decision of the director is not specifically enshrined in current version of ABI. Since the law is silent about the possibility as such and the exemption, with several exceptions, can be included in the articles of association, can it be concluded that articles of association may stipulate that *ex ante* approval by the shareholders exempts company director from liability?

The analysis should be started by noting that Lithuanian law does not contain any restrictions on determining in the articles of association, in addition to the specific cases stipulated in ABI,[9] other cases where the decisions taken by the director require the approval of the general meeting of shareholders. However, the approval by the shareholders in Lithuania cannot be understood to be equal to managerial decisions and therefore entail legal consequences the same way as the managerial decision.

In accordance with the provisions of Article 2.82(2) of the CC, meeting of shareholders is a body of the company, but not the company's management body. The competences of director, as management body, and meeting of shareholders are therefore different. The competence of the general meeting of shareholders is to exercise

[9] Article 34(5) of ABI.

shareholders' interests and manage the company, which *inter alia* includes approving director's decisions, whilst the competence of the director is to make business decisions and manage shareholders' assets. This division of competences is particularly important when analysing possibility of *ex ante* authorisation because the provision in the articles of association that the general meeting of shareholders is involved in the adoption of decisions falling within the competence of director, or that the approval of the general meeting of shareholders is required for the adoption of a decision in certain specifically identified cases, does not imply either a limitation of the management body's competence, or an extension of the general meeting of shareholders' competence (LAT judgment of 2 December 2021 in a civil case No e3K-3-300-313/2021). Consequently, when the articles of association list matters that require the approval by the shareholders, it does not mean that competence to decide is transferred to shareholders. Contrary, in such a case, articles of association only set out the procedure needed to make a decision, but the competence to make a decision and therefore bear the consequence that may follow is left for a director. As a result, liability for damages caused by unlawful business decisions is attached to director and the approval of shareholders does not exempt him from it (LAT judgment of 25 November 2016 in a civil case No 3K-3-485-421/2016).

The rationale of the conclusion that *ex ante* authorisation of the director's decision, although included as mandatory procedural step, does not exempt company director from liability can also be found in duties that the director owes to the company and the standard of care applicable to him. As already discussed, every director is obliged to act with care, honesty, skill and do everything within his power to ensure that the company operates in accordance with legal acts. Duties make director subject to higher standard of performance and therefore liability than the participant in a company, such as a shareholder, is. Automatically, this makes us think that director, who has the exclusive right to represent the company, makes business decisions as prudent business manager and avoids making decisions that are unlawful or in general breaches his obligations towards the company. Such an approach should be practiced by all directors, not making their decisions dependent on the approval by the shareholders, which is just the procedural step required by law or articles of association. Since the company director is considered to be subject to higher standards of performance, have more business knowledge and experience (LAT judgment of 30 November 2009 in a civil case No 3K-3-528/2009), he is not expected to always rely on the approval on shareholders and if the decision is potentially risky, entailing damage to the company, still make it.

Although *ex ante* authorisation by the shareholders do not exempt company director from liability, it should be mentioned that LAT clarifications would arguably not apply in the case where shareholders adopt a decision to exempt director from civil liability, not authorising certain action. Since ABI does not mention who has the right to exempt a company's director from civil liability and in what procedure, it may be argued that the shareholders' meeting may exempt company's director from civil liability if such a possibility is addressed in the articles of association. However, in any case, the decision of the shareholders of the company to exempt a director from civil liability may be set aside by a court decision on the claim of individual shareholders or creditors of the company, if such decision has infringed their rights or legitimate interests (Art. 2.82(4) of the CC).

United Kingdom

Just like ABI, the CA stipulates that certain decisions cannot be made without prior authorisation of shareholders by their ordinary or special resolution[10] and articles of association may provide additional circumstances where such an ordinary or special resolution must be passed in advance (Cabrelli, McAlpine, 2018, p. 702). However, unlike in Lithuanian regulation, UK has *ex ante* authorisation specifically enshrined in the law. According to Section 180(4)(a) of the CA, the company, i.e. its participants like shareholders, has the right *to give authority, specifically or generally, for anything to be done (or omitted) by the directors*.

In the UK, the general meeting of shareholders enjoys the right to influence corporate decision-making, which in the UK functions as inherent limitations on directors' powers (Cabrelli, McAlpine, 2018, p. 703), thus indicating that *ex ante* authorisation exempt company director from liability. This is already different than Lithuanian regulation where clear separation of competences exists and therefore liability for decision made cannot be escaped.

Since it appears that in the UK shareholders enjoy the right to exempt company director from liability by approving his decisions, the question arises whether the right to authorise is absolute, and who is liable for damages resulting from the decision. Firstly, it should be noted that it is common practice in the UK for shareholders to assume that they are under no obligation to exercise their right to vote on an ordinary or special resolution and that they are free to vote as they wish (*Northern Counties Securities Ltd v Jackson & Steeple Ltd)*. However, this freedom of vote does not mean voting *mala fide* and not for the

[10] For the need of ordinary resolution or special resolution, please see s. 510(2)(a), s. 168(1), s. 190(1) of the CA; for the need of special resolution please see s. 22(1), s. 77(2)(a), s. 570 and s. 571 of the CA.

proper purpose of the company. Yes, the shareholders are not directly restricted by the law to make authorisations. However, it should be borne in mind that the shareholders have a direct interest in the proper functioning of the company in the first place, as they have invested their own money in the company, and therefore any damage caused by an unjustified decision will jeopardise their interests too. Secondly, acting not in good faith and not for the purpose of the company would mean that a director could be exempted from liability from which he would not be exempted under Section 239 of the CA (ratification of acts of directors). In other words, the company director would avoid liability by having his decision authorised although he would not enjoy such an exemption under Section 239 of the CA (Leahy, Feld, 2017, p. 516), which is a clear violation of law. Therefore, a shareholders' resolution authorising a director to take certain actions and therefore exempting him from liability must be taken *bona fide* and for proper purposes.

What is interesting when talking about the good faith of shareholders in making the authorisation is that normally no liability would attach to them as they are deemed to be a company (Cabrelli, McAlpine, 2018, p. 704) and therefore not expected to do harm to themselves. Shareholders can only be held liable for authorised decision when the court intervenes after being satisfied that no reasonable person could have considered the resolution would benefit the company (*Shuttleworth v Cox Bros & Co (Maidenhead) Ltd*; *Re Charterhouse Capital Ltd*) and the person bringing the claim proves that a certain shareholder(s) cast his(their) vote in bad faith or for an improper purpose (*Peter's American Delicacy Co Ltd v Heath*). In any other scenario, the liability for the shareholders for authorised decision would only arise if the company were to be wound up due to insolvency and the appointed liquidator of the company's assets were to seek to recover a share of the company's losses (Cabrelli, McAlpine, 2018, p. 704). The relationship between the insolvent liquidation and company director's exemption from liability will be analysed further in this chapter.

Germany

In contrast to the limitation of liability based on fault, German law provides for a possibility to limit director's liability based on a shareholders' resolution. Pursuant to § 93(4) of AktG, director‘s liability for a breach of duty of care is excluded if the relevant acts of the director are based on a lawful resolution of the shareholders' meeting. Since the duty of care under German law is understood as an obligation for a director to exercise due care of a prudent manager, a director can only be exempted from liability for conduct which does not meet the standard of a prudent manager. However, is this not incompatible with the notion, referred to earlier in this thesis, that German law does not allow limitation or exclusions of mandatory legal norms, i.e. director's liability to compensate company for damage caused under § 93(2) of AktG?

In Germany, the standard of care to be applied to a director is closely linked to the application of the business judgment rule. As already discussed, a director of a company escapes liability under the German business judgment rule if he or she makes a business decision in the reasonable belief that he or she is acting on the basis of adequate information, in the best interests of the company, in good faith and avoiding a conflict of interest (Schmidt, Lutter, 2015). Essentially, if a company director has exercised the standard of care expected of prudent business managers. This provides us with the primary justification for why the authorisation by the shareholders is allowed under the law as being non-contrary to mandatory legal norms – the authorisation can be equated with recognition of business judgment rule. Even if the authorisation is not exercised, the company's director could still potentially escape liability under the operation of business judgment rule, and this would not be a breach of mandatory legal norms. However, considering the similarity between the business judgment rule and authorisation under § 93(4) of AktG, the question arises whether the authorisation is without boundaries, since it is *ex ante* and the acts have not yet been carried out to be properly assessed in the light of the requirements of business judgment rule.

German law does not contain any specific requirements for the authorisation, so the only requirements may relate to the mandatory nature of duty to compensate company for damage caused under § 93(2) of AktG, and thus to compliance with other duties owed to the company, as well as to the validity of the shareholders' resolutions. Pursuant to § 93(2) of AktG, the director of a companies must compensate the company for damage resulting from a breach of any other duties. The authorised action therefore must be limited to a breach of duty of care and cannot include authorisation of breach of other duties. Although it may appear that there are no specific requirements to evaluate whether a certain breach of duty can be authorised, the answer of authorisation boundaries lays in the lawfulness of shareholders resolutions. This is where concept of the legality of shareholders' decisions becomes relevant. In Germany, unlike in the UK, shareholders have a fiduciary duty to the company and therefore cannot exercise their voting rights at the shareholders' meeting as they wish. According to Cahn (2016), by owing a fiduciary duty shareholders must exercise their voting rights not being guided by interests unrelated or even contrary to the interest of preserving and enhancing the value of the company. Therefore, when talking about the resolution authorizing a certain action of a company director, which includes breach of duty of care, shareholders must still assess whether the exemption from liability would not violate the interest of the company. One may say that the exemption automatically entails a violation of the company's interests, since it will not be compensated for the damage caused. In such a case, the business judgment rule should be remembered, as the shareholders may make a decision based on an assessment of the future liability of the director if the *ex ante* authorization did not happen. If a director could potentially avoid liability under the business judgment rule, it is likely that a decision to authorise his actions and therefore exempt him from liability would not cause more damage to the company. However, if the director would not escape the liability under the business judgment rule, the shareholders should think about not authorizing the decision as this would clearly be in the best interests of the company, as the director would not escape the liability that would ultimately arise.

Concluding with the *ex ante* authorization in Germany, it should be noted that shareholders’ resolution exempting company director from liability could also be held null and void pursuant to § 241 of AktG. For the purposes of this thesis, it should be noted that the resolution would be void if it is inconsistent with the nature of the company or if, by its content, it infringes provisions which were established exclusively or primarily for the protection of the company's creditors or which otherwise serve the public interest. It can therefore be concluded that, in Germany, the *ex ante* authorisation, and thus the exemption of company director from civil liability, although permissible, is very narrow and can only be granted in cases where there is a breach of the duty of care, provided that all the other duties are complied with and that there are no grounds for invalidity of the decision of shareholders.

Conclusion

While all three jurisdictions take the same approach that shareholders can authorise directors' actions, the results and scope of authorisation vary. In Lithuania, *ex ante* authorisation granted by the general meeting of shareholders does not exempt a director from liability on the grounds of separation of powers, whereas in the UK and Germany directors are exempted from liability if their actions have been authorised by a shareholder resolution. The difference between the UK and Germany is that in the UK, shareholders can authorise any act or omission of a director provided that the director acted *bona fide* and for proper purposes, whereas in Germany, authorisation is only granted for a breach of the duty of care provided that it does not harm the interests of the company more than would have been the case under the rule of exemption for business decision-making.

2.2.2. *Ex post* ratification

Ratification is an issue whose "tentacles creep into every part of company law" (Wedderburn, 1981 quoted Payne, 1999, p. 604). The exemption from civil liability is no exception. Whilst *ex ante* authorisation can be seen as giving "green light" for director to act in a certain way, due to which company director may in Germany and the UK avoid liability in the future, *ex post* ratification is a procedure that is used to ratify the act done by the director in breach of his duties or waive the existing damages claims of the company under certain conditions (Gerner-Beuerle *et al*., 2013). Since the breach has already occurred, ratification is the mechanism which determines whether the breach can be put right, and if it can be, whether it will be, as well as whether the company director who committed a breach ought to be released from his liability, and, ultimately, whether litigation can and will be commenced (Payne, 1999, p. 604). The concept is indeed complex and can have significant impact on the company and shareholders – exemption of company director from civil liability, therefore needs to be analysed on a jurisdiction-by-jurisdiction basis.

Lithuania

Just like *ex ante* authorisation, *ex post* ratification of company director's actions is not clearly regulated by Lithuanian law. Since the legislation does not provide for either the direct possibility of ratification of a director's action or any restrictions on it, it may be assumed that the general meeting of the shareholders is not restricted to ratify a certain decision of a director in the same way as it would authorise it *ex ante*. By analogy with the *ex ante* authorisation, it can be argued that, as a result of the division of powers, whether or not the shareholders approve and/or ratify the decision, the general meeting does not have the power of decision and does not exempt the director of his/her liability. However, is the outcome of *ex post* ratification exactly the same as *ex ante* authorisation and there is no way for a director to avoid liability for breach committed?

On the one hand, since the shareholders do not have fiduciary duties towards the company and do not perform the management function, which is left to the director (LAT judgment of 12 September 2014 in a civil case No 3K-3-389/2014), the ratification would not have any effect, and the director would have to account for his actions that include breach of duties and compensate the company for the damage caused (Article 6.251(1) of the CC).

On the other hand, however, it can be argued that the *ex post* ratification by the shareholders, although legally not entailing consequences of exemption, may have an indirect effect when the case is brought before the court and the court assesses the application of the business judgment rule. As it was already concluded, according to Lithuanian business judgment rule, director's civil liability does not arise for business failure, but for making a business decision in breach of fiduciary duties and/or in excess of authority (LAT judgment of 9 January 2014 in a civil case No 3K-7-124/2014). Considering that there is no specific regulation on the ratification of director's actions, ratification may include not only actions relating to breach of duty, acting *ultra vires* etc., but also actions relating solely to business failure. It can therefore be argued that, although the ratification of actions which may involve a failure of business does not in itself exempt the company director from liability, it may nevertheless assist the court in assessing the conduct of the company director when the case for damages for breach of duty reaches the court.

According to the long-established LAT case law, although shareholders do not have the same duties as the director, they are still subject to general duty of care and good faith (LAT judgment of 5 May 2011 in a civil case No 3K-3-228/2011). Also, when taking decisions, they must act in the best interest of the company and ensure that the decisions taken are reasonable, which corresponds to general duty of persons to observe the rules of conduct in such a way as not to cause damage to another person by their actions (acts, omissions), as set out in Article 6.263(1) of the CC (LAT judgment of 7 February 2011 in a civil case No 3K-3-29/2011). These duties indicate that shareholders, when approving any decision of a director, should ascertain whether the decision involves *ultra vires* conduct, breach of fiduciary duties or other actions that fall outside the scope of the Lithuanian business judgment rule. As a result, ratification may be used as a defence by a director in a liability case, arguing that the shareholders' ratification shows that the director acted *bona fide*, and therefore should not be subject to liability. The ratification of the director's actions to the detriment of the company would be legally void due to the shareholders' duties referred to above, and therefore could not be used as a defence in a case in which the business judgment rule might apply.

Considering the above-mentioned, the ratification by the shareholders meeting does not exclude or limit the director's liability in Lithuania *per se*. Nevertheless, considering the duty of shareholders not to cause damage to legal entity by their acts or omissions, the ratification can arguably be seen as possible evidence to support the exemption of company director from civil liability under the Lithuanian business judgment rule.

Germany

Continuing the analysis of exemption by *ex post* ratification in civil law jurisdictions, it should firstly be noted that unlike in Lithuania, in Germany the competence of shareholders to ratify actions the actions of a director is directly enshrined in § 119(1)(3) of AktG. Since the right of ratification is enshrined in the legal regulation and there are no restrictions related to directors' acts involving breach of duties owed, the questions arise: (1) whether ratification exempts company's director from civil liability, and (2) whether all actions, including breach of statutory duties, can be ratified with the aim to exempt director from civil liability.

To begin with, German law lays down clear requirements for waiving director's liability. Pursuant to § 93(4) of AktG, the director of a company may be exempted from liability once the general meeting of shareholders ratifies this being done. Apart from the grounds of nullity contained in § 241of AktG discussed in the previous subchapter, a resolution ratifying the act, including a breach of duty to act in the best interest of the company, will only be valid if none of the minority shareholders holding at least 10% of the share capital objects to it. The rationale for this requirement is very simple. As a general rule, a simple majority is required to pass a shareholders' resolution (§47 of GmbHG). However, if there is a controlling shareholder in the company, a majority vote may mean that the voices of minority shareholders, who may object to ratification and the exemption, are not heard. It can be argued that by ratifying the decision, the shareholders accept that they do not need protection and allow the directors to escape liability. As a result, if § 93(4) of AktG would not contain requirement related to the absence of objection of minority shareholders, such shareholders could potentially lose their right to bring derivative action, or as it is called special action under under § 148 AktG and protect their rights.

It is not enough that the resolution ratifying the act of director is passed without the objection of minority shareholders. According to § 93(4) of AktG, the resolution of the general meeting must be passed no later than three years after the claim against the director came into existence. The limitation period does not differ from the general limitation period under German civil law (§ 195 of BGB). Therefore, any settlement or waiver affecting claims that arose less than three years prior to the agreement is invalid. The ratification is also not effective for future claims because that would compromise the mandatory nature of § 93 AktG (Wagner, Klein, 2018, p. 185) and the claims vis-à-vis the third parties. Since the basis of German corporate law is concentration of liability (BGHZ 194, 26, no 23) and third parties are outside the scope of potential claimants under § 93 AktG (Wagner, Klein, 2018, p. 186), the exemption from liability that cannot in fact even arise is not possible. A further analysis of the relation between the exemption of company director from civil liability and the insolvency proceedings, i.e. claims that arise from third parties, will be done further in this thesis.

United Kingdom

Similarly to Germany, the possibility to ratify director's actions and therefore exempt him from liability is codified in Section 239 of the CA, according to which shareholders, acting either unanimously (if the conflicted director and members connected to him do not participate in the voting) or by a resolution in which the votes of the director and persons connected with him are not counted, can decide whether a certain act of a director, involving negligence, default, breach of duty or breach of trust in relation to the company, should be ratified and therefore exempt the director from liability in respect of his misconduct.

Prior to the entry into force of Section 239 of the CA, ratification mainly depended on the nature of the director's conduct, whether it was capable of being ratified by the shareholders (Leahy, Feld, 2017, p. 515). However, the enaction of Section 239 of the CA changed the regulation, making it more stringent and at the same time reducing the requirements, lowering the threshold for ratification. The current regulation provides that shareholders are content to ratify director's conduct, provided that the conflicted conduct of director is within the powers of the company, the creditors' interest are not affected and the conflicted director and persons related to him (her) are not voting (Leahy, Feld, 2017, p. 515). As a result, we can distinguish three main requirements for ratification under s. 239 of the CA:

1. The transaction must be within the powers of the company;
2. The creditor's interests must not be affected;
3. Conflicted director and persons related to him are not voting.

Analysing the requirements, it should firstly be noted that Section 239(7) of the CA preserves the existing law as to acts that are incapable of being ratified by the company (*Franbar Holdings Ltd v Patel*). As a result, it can be argued that the transactions that are not within the powers of the company and transactions which affect the rights of the creditors fall within the non-ratifiable transactions and therefore these two requirements should be analysed in the context of other non-ratifiable actions.

According to Section 31(1) of the CA, if the company's articles of association do not specifically limit the purpose of the company, its purpose is unlimited. This makes it difficult to distinguish which actions could not be ratified because they are outside the corporate capacity of the company. If the articles of association do not contain any limitation as to the purpose of the company, it may appear that all transactions can be ratified. For this reason, we move on to the more complex cases where transactions would not fall within the company's corporate sphere and would therefore be non-ratifiable because of their illegality.

It should first be noted that, as in Germany, in the UK shareholders cannot approve a director's breach of duty if it relates to the company's insolvency, as this would adversely affect the interests of creditors (Leahy, Feld, 2017, p. 520). Arguably such conduct would be treated as being of a fraudulent character or beyond the powers of the company (*Burland v Earle*) and is therefore clearly outside the scope of ratifiable conduct. A more detailed analysis of why the acts cannot be ratifiable when the company is in a difficult financial situation will be done further in this thesis.

Secondly, the attention should be drawn to a transaction that is in fact disguised distribution to or at the discretion of the shareholders if not made out of distributable profits. According to the Supreme Court in *Progress Property Co Ltd v Moorgarth Group Ltd.*, such a transaction is unlawful, however technical the error and however well-meaning are the directors who paid it. If a director engages in such an activity, it is irrelevant whether he was deliberately in breach of duty or merely deliberately ignorant of his duties. The illegal nature of the transaction means that the transaction is outside the company's competence and therefore the transaction cannot be ratified.

Finally, the shareholders meeting cannot ratify fraudulent transactions. According to HL Lord Radcliffe in *Welham v Director of Public Prosecutions*, a fraudulent transaction always involves a victim. For the purposes of this thesis, the victims may be the company, the shareholders or, more commonly, the creditors. Leahy and Feld (2017) argue that, for instance, the director can be a victim of a theft committed by all its shareholders, director may defraud shareholders by misapplying property available for distribution and creditors can be director or indirect victims of director’s fraud. In all these cases, the shareholders cannot ratify directors’ acts because such conduct falls outside the powers of the company and violates interests of the victim, either it is creditor, company or shareholders. If fraudulent transaction could be ratifiable, the shareholders would be acting dishonestly and using the company as a vehicle for fraud or wrongdoing (*Madoff Securities International Ltd v Raven*), which is indeed unlawful.

Moving on to the requirement for conflicted director and persons related to him not to vote, it should be remembered that in the UK, shareholders are not subject to fiduciary obligations and therefore can vote in their own interests, unless they would be exercising their voting rights for a purpose contrary to the authority conferred on them to vote at a general meeting (Leahy, Feld, 2017, p. 515). As mentioned previously, the right to vote however they please is not absolute, but the court would interfere only if satisfied that no reasonable person could have considered the resolution being beneficial to the company. If the court does not intervene, in theory the illegal ratification would not be invalidated, and the directors would escape liability where perhaps they should not have. To avoid such situations, the legislator excluded the vote of conflicted director and those persons who are most likely to be biased in favour of director or under his influence (Attorney General Lord Goldsmith, 2006). This new strict regulation of voting can arguably cause problems for directors wanting to escape liability for damage caused. In cases where there the director is a single shareholder or, for instance, besides the director there is another shareholder who falls within the definition of member of the director’s family under Section 253 of the CA, the ratification will not even be legally possible because none of the shareholders will have a right to vote. As a result, it will simply be impossible to exempt director’s actions, whilst the protection of the company’s interest will be protected.

Once the transaction meets the above-mentioned requirements, it can be ratified and the director is safe from proceedings by the company or a derivative action (Part 11 of the CA). However, it is questionable whether ratification safeguards director at all times, for instance, in the case of insolvency, where the company may change its mind and sue the director (Leahy, Feld, 2017, p. 516). This will therefore be analysed in more details further in this thesis.

Conclusion

Ex ante ratification is allowed in all three jurisdictions. The possibility of ratification is specifically provided for in Germany and UK, while Lithuanian law neither allows nor prohibits it. The analysis has shown that the difference between jurisdictions can be seen in the effect that the ratification has. In general, ratification in Germany and the UK exempts the company's director from liability, whereas in Lithuania it has no such effect. Ratification in Lithuania may only have the indirect effect of exempting from liability, as it may be used as a defence by the director in the event that the director's actions would be scrutinised by a court to determine whether they fall within the scope of the Lithuanian business judgment rule.

2.3. Exemption on behalf of the company

As mentioned at the beginning of this thesis, the specificity of a legal entity as a subject of legal relations is that it acquires civil rights, assumes civil obligations, and exercises them through management bodies of a legal person. Exemption from liability is no exception. The analysis has already shown that the shareholders can grant an exemption from liability, but can a separate exemption from liability be granted in the name of the company? If so, which company body has the competence to do that? In order to answer these questions, we will analyse the general rules in each jurisdiction. To assess whether the regulation in Lithuania is sufficient, the paper will also provide an analysis of the provisions in SPAs that exempt directors from liability.

Lithuania

According to Article 101(1) of the Labour Code of the Republic of Lithuania and Article 37(4) of ABI, an employment contract must be concluded with the company's manager. Therefore, director and company have a contractual relationship (LAT judgment of 20 November 2009 in a civil case No 3K-7-444/2009). Consequently, the principles of freedom of contract and the dispositive nature of contractual civil legal relations apply, allowing the company and the director to determine their mutual rights and obligations at their discretion, provided that this does not infringe the requirements of mandatory legal provisions (Articles 6.156 and 6.157 of the CC). Since civil liability cannot be limited to damage sustained by the reason of the debtor’s intentional fault or gross negligence, director and company can enter into an agreement, not limited to the employment contract, which would limit director’s liability, provided that the agreement does not limit or eliminate the liability for damage caused by the director intentionally or acting with gross negligence. Otherwise, the interests of company, its shareholders and its creditors would not be ensured, as well as mandatory legal norms, namely the duties imposed by the CC and ABI, would be infringed.

Since, in theory, an agreement between the director and the company can be concluded, the question arises as to who concludes such an agreement and therefore exempts the director from liability. In the case of an employment contract, according to Article 37(4) of ABI, the employment contract with the director is signed on behalf of the company by the chairman of the management board or another member authorised by the management board (or, in the absence of a management board, by the chairman of the supervisory board or another member authorised by the supervisory board, or, in the absence of a supervisory board, by a person authorised by the general meeting of shareholders). Therefore, it can be argued that the exemption on behalf of the company, stipulated in the employment agreement, is exercised by shareholders, management or supervisory boards. A problem may arise in cases where the sole shareholder of the company becomes a director and the company does not have a management board or supervisory board. This situation, where the employment contract is signed by the same person on both sides, is not regulated by law. Therefore, although may seem like a bizarre situation, it is legally allowed. The most important aspect is that on one side (acting on behalf of the company) the director will act as a shareholder and on the other side as a natural person elected as a director. It can therefore be concluded that the director's exemption on behalf of the company is carried out by the shareholder in the employment contract, even in companies where there is only one person exercising both the powers of director and the powers of the shareholders' meeting.

A more problematic aspect of the contractual exemption of a company's director from civil liability relates to SPAs, where a change of ownership can ultimately result in a change of the target company's directors, and the buyer can exempt the former (or sometimes present) director from liability. Although in such a case the agreement is signed between the buyer and the seller, theoretically company director can be contractually exempted from civil liability because buyer becomes a new owner or one of the owners of the target company and therefore can make decisions. However, it is difficult to assess to what extent such an exemption from liability is effective, as there is no case law on the matter.

Since the cases of exemption in SPAs have not reached Lithuanian courts yet, to illustrate how the theoretical possibility to exempt company director in the agreement works in practice, the analysis of 17 SPAs has been done (*Annex 1*). The analysis focused on the type of transaction, the provision exempting the company's director from liability and the director's relationship with the buyer. All the transactions analysed involved the sale of a controlling interest or the sale of all shares, thereby indicating that there was a change of ownership. The results of the analysis showed that 13 out of 17 SPAs contained provisions exempting company director, other management members from the liability, some of the SPAs even had an obligation on the buyer's side to provide a release letter. Without going into the details of release letters because the provisions of them (*Annex 2*) are almost identical to those included in the SPAs, the main focus of the analysis was on the provisions themselves and the reasons why they were or were not included in the SPAs.

Analysing the provisions that were included in SPAs, it can be seen that although formulated differently, all provisions, with the exception of one, which talk about exemption from liability instead of only about an obligation to provide release letter, state that the exemption is valid to the extent that director's actions do not constitute wilful misconduct or gross negligence. This is in line with Article 6.252(1) of the CC because these provisions indirectly stipulate that the exemption is only valid for claims resulting from simple negligence. Less stringent regulation regarding exemption was provided only in one SPA, where it was stated that a waiver is not valid only in the cases of wilful misconduct. Arguably, the rationale behind this may be the discussed fine line between simple and gross negligence, and potential fear that nearly everything can be regarded as gross negligence in different situations. If the seller wants to protect director, who has some sort of connection to the company, the fine line between types of negligence and therefore the types of claims become particularly important. Nevertheless, here it should be noted that, although gross negligence was not included as an exception to the exclusion of liability in this provision, the mandatory nature of Article 6.252(1) of the CC means that the exemption could still not work for grossly negligent behaviour.

The analysis has showed that only 2 SPAs contain positive obligation of the buyer to waive and release any and all claims that the buyer may have against director, whereas 7 of 17 SPAs expressly contain negative obligation of the buyer not to initiate any claims against director. Although there are no specific problems with the waiver of all rights, claims, demands or causes of action that the buyer, as the new owner of the company, already has, the enforcement of the negative obligation not to bring claims against the director may be an issue for the future. It is well recognised that parties, relying on the principles of freedom of contract and dispositive nature of the rules of civil law, may agree on the limitation of liability (Lazauskaitė, 2010, p. 171). However, this can be done to the extent that this is not contrary to mandatory rules of law. The purpose of civil procedure *inter alia* is to defend the interests of those persons, whose material subject rights or interests protected by laws are violated or contestable (Article 2 of CCP). The right of a person to apply to a court of law is *expressis verbis* enshrined in Article 30(1) of the Constitution of the Republic of Lithuania, and according to Article 4(3) of the Law on Courts is also granted to companies, institutions, organisations, and other bodies. This is mandatory legal rule. In interpreting the right of access to justice, the Constitutional Court of Lithuania has stated, that the rights of a person violated, *inter alia,* acquired rights and legitimate interests, must be protected irrespective of whether they are directly enshrined in the Constitution (Judgment of Constitutional Court of 6 June 2006 No 65-2400). Consequently, even if certain rights and legitimate interests of a company may not be included in Constitution, it has the constitutional right to apply for court to defend them.

As a result, waiver of unknown future claims would be a waiver of this constitutional right and failure to implement purpose of civil procedure. The legality and effective implementation of the provisions covering the waiver of future claims, i.e. the right to defend legitimate rights and interests which have been infringed, is therefore questionable. The argument that provisions containing negative obligation not to initiate claims in the future will likely be not enforceable in the event of a dispute is strengthened by Article 5(2) of CCP, which stipulates that a waiver of the right of access to justice is invalid. If an action has already been brought, there is nothing wrong for the seller and the buyer to agree to waive the action, as Article 42(1) of the CCP provides for this possibility.[11] However, in the light of the above, agreements, as well as release letters, containing waivers of future claims, are very unlikely to be enforceable.

Although it is unlikely that all of the provisions of analysed SPAs would be enforceable in the case of a dispute, it is still necessary to analyse why the provisions were or were not included. In 6 out of 12 SPAs that included exemption clauses director was somehow connected to the seller. In some cases, the director remained a minority shareholder of a target, in other cases he was even one of the sellers. As a result, the seller had a clear intention to protect the director, let him "start a fresh page" with the change of ownership. Arguably, there is no deeper rationale behind the protection, just the relationship between the seller and the director. However, this argument can be called into question by analysing the cases where the director was related to the seller and did not receive protection. The analysis has shown that this was the case in 4 SPAs. It may be difficult to understand why the director was not given protection even if he remained a minority shareholder or was even the seller and/or one of the sellers. One reason could be the advice of the seller's legal advisors, the negotiations between the parties. However, as this is done behind closed doors, we will never know if this is actually the reason. A more rational explanation for cases where a director was not given protection despite his or her ties to the seller may be the "reward" that the former director may have received after leaving the position. According to Article 38(1) of the Labour Code, the target company and the director may agree that the director will not carry out certain employment activities under an employment contract with another employer if those activities would be in direct competition with the employer's activities. According to Article 38(3) of the Labour Code, during the period of non-competition with the employer, the employee must be paid

[11] Article 42(1) of the CCP stipulates that the claimant shall have the right to *inter alia* increase or reduce the amount of the claim in accordance with the procedure laid down in CCP, or to waive the claim. Since by gaining the control of the target company buyer takes over the seller‘s rights and obligations, which *inter alia* include claims brought against the director, buyer can waive them.

compensation of at least forty per cent of the employee's average wage. It can therefore be argued that the former director is not protected by the exception clause since he has already been compensated under the non-competition agreement. However, this may only be one reason, albeit the most rational one, and the real reasons why a particular director is not exempted from liability will only be known to the parties to the SPA.

Also, the analysis has shown that in one SPA there was no exemption clause, even though the transaction involved all of shares. Although it may seem that a company would like to start from a "fresh start" as its ownership changes, the reason for the absence of an exemption clause in the SPA is that there is no link between the director and the company. The director in such a case may not have any link to the seller and be only formally elected to be a director. In such an event, the seller clearly does not have an intention to protect the director. Even if the director would remain with the company, an exemption clause would probably not be included in the SPA. The reason is simple - if the director is performing well, the company would not want to harm itself by suing the director and ultimately losing him.

Considering what has been said, it can be concluded that although Lithuanian legal system allows for contractual exemption of the company director from civil liability, provided that director’s conduct does not constitute gross negligence of wilful misconduct, exemption is only valid for claims that already exist. Since the cases involving exemption of company director from civil liability in SPAs have not reached the Lithuanians courts yet, the theoretical legal framework is arguably not properly applied. The provisions are too broad to cover not only existing but also future claims and would therefore be difficult to enforce as they are contrary to mandatory rules of law.

Germany

German regulation on the exemption on behalf of the company differs from Lithuanian regulation. As already discussed, in Germany, a director must act with care and in good faith when managing a company. This standard of care is a mandatory law and cannot be derogated from by contract (Hölters, W (ed.), 2014). As a result, director’s liability for damage to a corporation under § 93(2) of AktG is also seen as mandatory law and can be limited only in cases provided for by the legislator.[12] Considering that the standard of care applicable to the director cannot be modified by the contract as the director has an

[12] As previously discussed, the exemption from civil liability is only possible with the application of business judgment rule (§ 93(1) Aktg) and based on a lawful resolution of the shareholders meeting (§ 93(4) of AktG).

obligation to compensate the company for damage caused, it is questionable whether the exemption on behalf of the company is possible at all.

Considering the contractual exemption, German regulation is pretty straightforward – employment contracts, SPAs or other general agreements, where director's liability would be limited based on the fault type, as it is possible in Lithuania, are not legally allowed under German law, as this would constitute modification of standard of care applicable to a director. Therefore, when analysing SPAs governed by German law, we will probably not see provisions in which the buyer, as the new owner of the company, exempts the former or current director from liability in the same way as in Lithuania. However, this does not mean that an exemption on behalf of the company is not possible.

Whilst the company is already precluded from claiming damages in relation to actions validly approved or ratified by the shareholders, the company itself may waive specific claims against a director, i.e. exempt him from liability, when the shareholders discharge of the director, i.e. pass a resolution on the formal approval of the actions of managing director (§ 46 of GmbHG). With the discharge, the shareholders approve director's actions for the past discharge period and at the same time express their confidence in the director regarding the further management of the company (BGH, judgment of June 24, 2002-II ZR 296/01; BGH, judgment of May 20, 1985-II ZR 165/84). According to authors of commentaries on AktG, it is correct to regard the discharge as *sui generis* under German company law and not, for example, as a contract of remission or a negative acknowledgment of the damage caused to the company (Schmidt, *et al.*, 2015; Hüffer, Koch, 2018 etc.). However, then the question of prerequisites for discharge arises. Although there had been different discussions on this question among authors of commentaries of AktG, according to long-established case law, in factual terms only those claims against the managing director are covered which are based on facts which were either positively known to the shareholders' meeting at the time of its decision or were at least recognizable to it on careful examination (BGH, judgment of April 21, 1986-II ZR 165/85). If it is not clear to shareholders from the documents available that, for example, director has accepted a bribe, discharge does not usually mean that the company cannot claim damages against the company because the director deliberately concealed or even suppressed the breach fact. Also, If the managing director is also a shareholder, he is not entitled to vote (§ 47 GmbHG). The waiver is therefore not possible for a one-man GmbH.

If the underlying facts of the discharge resolution were known at the time of the discharge resolution and the director, being the shareholder, did not vote, the legal consequence is simple - company waives claims for damages against the managing director.

As in Lithuania, the right is exercised through shareholders. However, the discharge is in no case to be equated with a waiver of possible claims for compensation (Schmidt, *et al.*, 2015, p. 1912). Consequently, the waiver is only effective for the claims that already arose and does not limit the right of a company to defend its legal rights and interests in the future. Considering the principle of concentration of liability, the waiver of claims can only have an effect in the relationship between the company and the managing director. As a result, it can even be argued that the limitation of liability related to discharge can even be included in the director's service contract. The most important thing is not to include limitation based on the fault type, as this would be contrary to German law, and formulate provision clearly, indicating that, for instance, "With the approval of the annual financial statements, the managing director is to be granted discharge". Having such provision could arguably even assist in the future when the shareholders would threaten director with a derivative action (§ 148 of AktG) because the director would have a proof that the claims cannot exist as they are waived by the company.

United Kingdom

Regulation regarding the exemption of company director from civil liability on behalf of the company, i.e. contractual exemption, is very straightforward in the UK. As already discussed, UK law contains general prohibition on the exemption of a director from liability that would otherwise attach to him in connection with any negligence, default, breach of trust, or breach of duty in relation to the company. Section 232(3) of the CA specifically indicates that mentioned prohibition applies to exemption not only in the company's articles but also in the contracts. It is therefore highly unlikely that we would see the provisions of Lithuanian SPAs in English SPAs, director's service contract or any other agreements. However, this does not mean that limitation of liability on behalf of the company is not possible at all.

Although the UK law is very strict that a term of any contract or company's articles of association excluding or modifying liability for a breach of duties contained in Sections 171-177 of the CA is void, the legislator still provides exceptions to the general rule. As already mentioned, company is not prevented *from making such provision as has previously been lawful for dealing with conflicts* in articles of association (Section 232(4) of the CA). Mentioned provision specifically indicates articles of association, however, scholars argue that it does at the same time suggest that the company could include the same provision, carving or limiting the content of the statutory duty to avoid a conflict of interest and duty laid down in Section 175 of the CA 2006, in the contract between the company and a director (Cabrelli, McAlpine, 2018, p. 699), signed by an authorised person. Such a conclusion neither infringes the principle of freedom of contract nor mandatory legal norms, provided that the provision is precisely formulated and does not infringe general prohibition contained in Sections 232(1) of the CA. Therefore, is likely to be seen in the practice. Here it should be stressed that the exemption on behalf of the company based on that provision is subject to the compliance with general duties listen in Sections 171-174 and Sections 176-177 of the CA. If they are breached, exemption provision, as discussed previously in this thesis, is void.

Conclusion

The exemption from civil liability on behalf of the company differs in all three jurisdictions. In Lithuania, exemption is theoretically possible by contract, including but not limited to the employment contract and the SPA, provided that the exemption does not cover gross negligence and wilful misconduct. In Germany, a company may waive existing claims when shareholders pass formal resolution approving director’s actions, whereas UK law provides for a theoretical possibility to exempt a director from liability arising out of breaches of the statutory duty to avoid conflicts of interest by contract. In Lithuanian and German cases, the exemption would essentially be done by shareholders and in the case of the UK by authorized person signing the agreement.

As regards Lithuanian regulation, the analysis of Lithuanian SPAs has shown that the absence of case law on the matter results in theoretical legal framework being applied too broadly. Under the mandatory legal rules, a company can only waive existing claims, and waiver of future claims violates the company's constitutional right to protect its legal rights and interests, as well as mandatory rules set in CCP. Therefore, provisions which provide that the company will not initiate future claims would be difficult to enforce in the event of a dispute. The same applies to release letter – if they provide that the director is exempted from future claims, the validity of the release letter or its certain provision is questionable in the same way as provisions in the SPAs providing an obligation for a company not to initiate future claims.

2.4. Boundaries of exemption from civil liability in the case of insolvency

According to company law theorists Easterbrook and Fischel (1985), the protection of company’s creditors is adequately ensured *inter alia* by the liability of the management bodies for shareholders. Nevertheless, when we talk about liability of management bodies, i.e. director for the purposes of this thesis, we mainly refer to the protection of company and in some cases shareholders, not even mentioning creditors. The rationale behind this rests in the solvent state of the company – if the company is solvent, the main aim of the director, as a management body of the company, is to manage, protect and enhance shareholders' investment. In such a case, the creditors are only owed a duty of adherence to the contractual terms (Hayes, 2015, p. 2). The situation however changes when the company becomes insolvent.

The scholars have noted that when a company faces financial difficulties, directors often take extremely risky decisions, with the full risk of those decisions being borne by creditors (Armour, 2005, p. 1; Tikniūtė, 2008, p. 62). The reason behind this is simple – if the company is insolvent or in the vicinity of insolvency, the interests of the company are in reality the interests of existing creditors alone (Triantis, Daniels, 1995, p. 1100). In such a situation, the shareholders are no longer the owners of the residual value of the firm, and creditors, who's money the company is effectively trading with, are arguably seen as the major stakeholders in the company (Keay, 2003, p. 668). As a result, the protection to creditors must increase and the exemption of company director from civil liability becomes questionable. Many questions, including, but not limited to, the validity of the exemption of director from civil liability done in the insolvent state of the company, the possibility to exempt director from liability related to insolvency etc. arise, which must be answered on a jurisdiction-by-jurisdiction basis.

Lithuania

LAT has held that insolvency proceedings in Lithuania pursue two conflicting objectives: not only to protect the rights of creditors by satisfying their legitimate claims in the insolvency proceedings as quickly as possible (the liquidation of the insolvent debtor), but also to restore the solvency of the insolvent company, to relieve it of its debts and to enable it to continue or restart its business activities (the rehabilitation or reconstitution objective) (Judgment of the Court of Appeal of Lithuania of 31 March 2014 in a civil case No 2-611/2014). Although the Lithuanian legal doctrine recognises that timely initiation of bankruptcy proceedings is an important prerequisite for an efficient bankruptcy process, and a breach of this obligation may lead to a decrease in the company's assets and a reduction in the creditors' ability to satisfy their claims (Tamošiūnienė *et al*., 2020, p. 47-63), the liability of the company's director for the failure to initiate timely bankruptcy proceedings, and thus the exemption from such liability, has not been given any attention.

As a result, the situation in Lithuania should be analysed by assessing existing regulation and case-law.[13]

Back in 2012 LAT has clarified that simple negligence related to business risk should not give rise to civil liability under Article 6.263 of the CC (LAT judgment of 1 February 2012 in a civil case No 3K-3-19/2012). As already discussed, directors of solvent companies are allowed to take business risks and are not required to compensate damage that arises from business failures. The situation with insolvent companies is completely different. Article 2(7) of JANI defines insolvency of the legal entity as the state when the legal person is unable to meet its financial obligations when due or when the legal person's liabilities exceed the value of its assets. Although scholars argue that the definition itself is wide as it provides the basis for the development of completely uncertain interpretations as to when a company is considered insolvent and when the obligation to open insolvency proceedings arises (Jokubauskas, Kirkutis, 2021, p. 448), LAT has clarified that when a company fails to operate or, although it does, suffers increasing losses due to non-payment to creditors, such actions are not consistent with reasonable business risk and are contrary to good business standards (LAT judgment of 21 October 2016 in a civil case No 3K-3-327). Therefore, irrespective of the precise moment when the obligation to open insolvency proceedings arises, the director's actions in connection with the insolvency proceedings cannot be regarded as falling within the normal business risks afforded to solvent companies and are questionably linked to the exemption from liability. A contrary interpretation would not ensure the effective protection of creditors' interests, which is the main objective of insolvency proceedings (Jokubauskas, 2021).[14]

Question related to exemption from liability in the case of insolvency can arguably be dispelled by notion that *lex specialis* regulating insolvency relations is JANI (Judgment of Court of Appeal of Lithuania of 27 January 2022 in a civil case No e2-186-407/2022). Considering the supremacy of *lex specialis,* having JANI as special legal acts means that liability for company director arises not under Article 2.87(7) of the CC but under Article 13(1) of JANI (Jankauskas, 2005, p. 21). Since Article 13(1) of JANI can be interpreted by a way of analogy to Article 8(4) of Enterprise Bankruptcy Law of the Republic of

[13] On 1 January 2020 JANI has replaced the previously existing legal framework for corporate insolvency and restructuring proceedings. Some of the provisions of JANI are taken from previously regulation, therefore, the already existing case-law should be evaluated and applied analogically when the provision is analogic to provision of Enterprise Bankruptcy Law of the Republic of Lithuania (*lLietuvos Respublikos įmonių bankroto įstatymas*).

[14] Although Article 13(1) of JANI does not specifically define persons who may be deemed to have suffered damage, i.e. the company, its creditor or creditors, a systematic analysis of JANI, taking into account that competence to bring a claim for damages caused belongs to meeting of creditors (Article 44(10) of JANI), leads to the conclusion that creditors are indeed the main object of insolvency proceedings.

Lithuania,[15] case law related to interpretation of Article 8(4) of Enterprise Bankruptcy Law of the Republic of Lithuania also applies. Therefore, it may be concluded that, unlike in the case of a detrimental business decision or a breach of fiduciary duties, a breach of the statutory duty to initiate insolvency proceedings in a timely manner gives rise to civil liability in the case of a manager's simple negligence (LAT judgment of 27 October 2014 in a civil case No 3K-3-453/2014).

While it may be argued that the exemption from liability is allowed because JANI does not contain any provisions restricting or prohibiting the exemption, it must be remembered that those areas which are not regulated by *lex specialis,* in this case by JANI, the regulation set in other acts of the same legal force, in this case CC, applies. Consequently, since exemption from civil liability is impossible in the case of gross negligence and wilful misconduct (Article 6.252(1) of the CC), the restriction applies in the case of insolvency as well. Since there are three fault types: gross negligence, wilful misconduct and simple negligence, the latter being the decisive factor for liability for breach of the obligation to initiate insolvency proceedings in time, it can be concluded that the exemption from civil liability in the event of insolvency is not available. A contrary conclusion would mean violation of Article 13(1) of JANI, which is mandatory legal rule, and failure to guarantee the right for creditors to satisfy their claims.

Germany

As already discussed, a director of a company in Germany can only be exempted from liability if his acts involving breach of duty of care are authorised or ratified by the shareholders meeting. It is impossible to modify standard of care and exempt director based on the fault type or conclude an agreement between company and director, exempting him from liability in respect of third parties, as this would constitute a contract at the expense of third parties, which is legally not allowed under German law (Wagner, Klein, 2018, pp. 194). Therefore, unlike in Lithuania, the focus will be on the validity of shareholders' decisions when the company is at risk of insolvency, rather than on the type of fault giving rise to civil liability.

In Germany it is well established that once the company becomes insolvent, the interests regarding company's assets shift from the shareholders to company's creditors (Wagner, Klein, 2018, pp. 172). Since the director is generally protected from damage

[15] According to both Article 8(4) of Enterprise Bankruptcy Law of the Republic of Lithuania and Article 13(1) of JANI, company director is liable to compensate damage caused by breach of *inter alia* duty to initiate insolvency proceedings in a timely manner.

claims in insolvency proceedings as his liability is separate from the liability of a company, creditors can seek personal recovery for damages from directors only when they violate statutory duties. One of the duties is to file a request for the opening of insolvency proceedings if company is illiquid (*zahlungsunfähig*), or over-indebted (*überschuldet*) at the latest three weeks after the commencement of insolvency and six weeks after the commencement of overindebtedness (§ 15(a)(1) of InsO). This duty protects creditors in several ways – prevents directors from gambling with company's assets, provides notice to existing and potential creditors of the company's financial distress, prevents payments to preferred creditors (Wood, 2007, p. 156). As a result, creditors may bring a claim against the director under § 823(2) of BGB for breach of duty enshrined in § 15(a)(1) of InsO.

Unlike Lithuania, Germany has adopted the creditor-friendly "strict" approach (Franken, 2004, p. 80). The aim of this model is to protect the rights of creditors as far as possible, and the priority is not to prolong the company's viability and restore its solvency, but to liquidate it (§ 1 of IsO). This aim is arguably the reason why the exemption from civil liability by authorisation or ratification by the shareholders meeting is not effective if the company is, among other things, unable to pay their debts as they become due (§ 93(4) of AktG). Since the prohibition of exemption is directly enshrined in AktG, the regulation is very straightforward, and the detailed analysis of norm itself should be left to separate scholar works. Therefore, for the purposes of this thesis we may conclude that the authorisation or ratification of director's actions by the shareholders meeting is not effective if the actions relate to breach of duties that the director has when the company faces insolvency. A contrary conclusion would probably mean that the director could seek protection from creditors' claims, defend against attempts to rehabilitate the company and thereby weaken the position of creditors. Consequently, the mandatory nature of compensation under § 823(2) of BGB would be threatened.

United Kingdom

As already discussed, in common law, director has a duty to act *bona fide* in the interests of the company as a whole (*Towers v Premier Waste Management Ltd; Howard Smith Ltd v Ampol Petroleum Ltd).* Scholars argue that codification of this duty in Section 172 of the CA may imply that "to promote the success of the company" means to act for the benefit of all its members (Cabrelli, McAlpine, 2018, p. 680). In such a case, creditors' interests would have to be always considered and the issue of exemption questioned not only in the cases of insolvency. However, a broad interpretation of this duty is arguably inconsistent with the case law of the Court of Appeal of England and Wales. Back in 2011 the Court of

Appeal has held that the duty to promote the success of the company flows from the director's fiduciary relationship with the company (*Towers v Premier Waste Management Ltd* per Mummery LJ). The duty is therefore owed to the company, not directly to creditors (*Re Horsley & Weight Ltd*). Consequently, it cannot be concluded that the director must subordinate his interests to the interests not only of the company but also to creditors in order to discharge his duty to act in the best interests of the company when the company is solvent. The situation however changes when the company faces insolvency.

It is well established in English law that, in the event of insolvency, a director's duties are altered so that he is required to have at least "due regard" for the interests of creditors (*West Mercia Safetywear v Dodd*). This duty can be said to be codified in Section 214 of the Insolvency Act 1986, according to which directors are required to take every step with a view to minimizing the potential loss to the company's creditors. The rule of law has been recognized in many cases,[16] however, in none of them the duty owed to the company has been modified as to be completely replaced. As a result, we may conclude that in UK that the director's duty to act in the best interest of the company expands to interests of the creditors when the company is insolvent or on the verge of insolvency, but the duties to the company remain. Although UK law takes the same approach as German law - strictly prioritising the interests of creditors when the company is facing insolvency - the potential breach of duty goes much further than simply not initiating insolvency proceedings, as is the case in Lithuania and Germany. Therefore, the analysis of the validity of exemption by the shareholders' authorisation and ratification in the case of insolvency will be analysed more broadly.

Although the requirements for ratification under the U law are quite broad, one thing is clear – the members of an insolvent company cannot ratify conduct of its directors which amounts to serious[17] and fraudulent[18] misconduct as to provide directors with a defence to a breach of duty claim. The rationale for this restriction can arguably be found in relation between Section 172 of the CA (duty to promote the success of the company) and Section 214 of the Insolvency Act 1986. According to Arnold QC (2017) and Haywood (2017), once the company has no reasonable prospect of avoiding insolvent liquidation, the mere fact that the director can show that he acted in a way which would be most likely to promote the success of the company for the benefit of its members as a whole, having regard to the matters referred to in Section 172(1), will not enable him to avoid liability for wrongful

---

[16] See, for instance, *Facia Foorwear Ltd v Hinchcliffe, GHLM Trading Ltd v Maroo, Vivendi SA v Richards, Bilta (UK) Ltd v Nazir, BTI 2014 LLC v Sequana SA*.
[17] *obiter* of Cumming-Bruce and Templemann LLJ in *Re Horsley & Weight Ltd*
[18] Slade LLJ in *Rolled Steel Ltd v British Steel Corp*

trading if he failed to take every step that he ought to have taken to minimize the potential loss to the company’s creditors. Serious and dishonest misconduct would indeed constitute a failure to take such action. Therefore, the shareholders do not have the power or the right to exempt the director from liability arising from such failure.

This restriction applies to both authorisation and ratification. The main considerations to be considered when deciding whether the shareholders can relieve the company's directors of their liability are (1) whether the company is experiencing financial difficulties which may jeopardise the interests of creditors; (2) whether the breach of duty adversely affects the interests of the company. As regards the first point, it should be noted that it is irrelevant whether the director reasonably and in good faith believed that the company was solvent. What matters is the objective solvency at the relevant time (*Madoff Securities International Ltd v Raven*). If, at the time of the transaction, the company is or was unable to pay its debts or had the intention to defraud its creditors, the shareholders should consider that the company is objectively insolvent or on the verge of insolvency and should not pass a resolution authorising or approving the director's actions to exempt him of liability. It should be noted here that shareholders may find it extremely difficult to assess the solvency of the company and therefore authorisation or ratification is ongoing. In such a case, the invalidity of the exemption would still apply as the court could invalidate the transaction and deny the director an authorisation or ratification defence (Leahy, Feld, 2017, p. 527).

Conclusion

The exemption of company director from civil liability in the case of insolvency is impossible in all three jurisdictions. The main reason behind this uniform approach is the protection of creditors’ interests. It is common approach in all three jurisdictions that when the company is solvent, the duties are owed to company and shareholders, however, the focus of duties changes when the company faces financial difficulties. The approach towards the limitation of exemption differs in each jurisdiction.

In Germany and Lithuania, company's director cannot be exempted from liability for failing to initiate insolvency proceedings when the company is facing insolvency. In Germany, this means that an exemption from civil liability by authorisation or approval of the shareholders' meeting is not valid if the company is, among other things, unable to pay its debts as they fall due. In contrast, Lithuanian law provides that liability for failure to initiate insolvency proceedings is based on simple negligence. Since exemption from liability is not possible for gross negligence or wilful misconduct, simple negligence becomes the last type of fault that cannot be avoided.

Compared to Lithuania and Germany, UK has a slightly different approach towards the prohibition of exemption when the company faces financial difficulties. Under UK law, when the company faces insolvency, director has a specific duty to take every step with a view to minimizing the potential loss to the company's creditors. However, the duties owed to the company are not eliminated. By ratifying or authorizing actions of director shareholders must consider not only whether the company is in financial difficulties which may jeopardise the interests of the creditors, but also whether the breach of a certain duty adversely affects the interests of the company. It may therefore be concluded that civil liability of a company's director in the UK, unlike in Lithuania and Germany, is not focused on the duty to initiate insolvency proceedings in a timely manner, but on the assessment of the company's solvency and the impact of a particular act on the interests of creditors and the company.

3. ALTERNATIVES TO EXEMPTION FROM CIVIL LIABILITY

The analysis of directors' liability has shown that company directors are held to a higher standard of conduct and are therefore subject to high civil liability. The strict civil liability leads to a presumption of fault and narrow possibilities to exempt directors from civil liability. While there is no doubt that the exemption from civil liability is limited to protect the interests of the company, its shareholders and, in the event of insolvency, its creditors, the interests of the director himself and the protection of his assets remain precarious. Given that a company acquires its rights, assumes its civil obligations and exercises them through the director, who, in the course of his management of the company, is exposed to a wide range of potential liabilities arising from his actions (or inactions), the director should presumably be afforded some protection against the risks and liabilities associated with the activities of the management body, even if an exemption from civil liability is not possible. To clarify whether a director can be protected from civil liability in the absence of an exemption, the following analysis will focus on D&O insurance and indemnification by the buyer and seller in the event of M&A transaction.

3.1. D&O insurance

D&O insurance is now widely recognised in North America and Europe as a corporate risk management tool, aimed at protecting company directors from claims that may arise from the decision and actions they take as the managing body of the company (Jia, Tang, 2018, p. 1013). As discussed in the first part of this thesis, civil liability has several functions, two of which are compensatory and preventive. Whilst the compensatory function is exercised through proper imposition of civil liability and limitations to exemption, D&O insurance assists in serving preventative function. If director is or can be held liable more often in the cases where civil liability law gives grounds thereto, the incentives to exercise due care and prevent unacceptable risks is stronger (Weterings, 2015, p. 311). Nevertheless, the impact of D&O insurance on corporate governance is constantly debated. Some scholars argue that D&O insurance is not only beneficial for the director, as it protects him/her from litigation risk and personal financial liability, but also for the company, as the director can serve the company professionally without fear of personal financial loss (Core, 1997). However, others argue that because directors are shielded from litigation risk and personal financial liability, they may reduce monitoring efforts and pursue personal interests at the expense of shareholders (Chung and Wynn, 2008). Separate studies are needed to conclude on the impact of D&O insurance on corporate governance. Therefore, for the purposes of this thesis, the most important thing about D&O insurance is that it may operate as an alternative to the exemption. Having it as an alternative requires an analysis of whether D&O insurance applies in the relevant jurisdictions, how it applies and what its limits are.

Lithuania

Legal doctrine recognises that D&O insurance is a professional liability policy that pays claims on behalf of the executives for claims arising out of wrongful acts such as error, neglect, breach of duty, or misleading statements (Knepper, 1978; Bickelhaupt, 1983, p.532). It is one of the general liability insurance contracts (Bickelhaupt, 1983, p. 518). Therefore, in accordance with Article 7(3)(13) of the Law on Insurance of Lithuania, the risk of aforementioned claims may be the subject of insurance and a director of the company may insure his/her civil liability. Lithuanian laws nevertheless do not provide for compulsory D&O insurance, so it is available only on a voluntary basis.

Since D&O insurance is voluntary and there is no clear legal regulation on this matter, it is not widely used. The director's liability is not exempted or otherwise limited by D&O insurance – it is simply protected by a certain amount against claims by the company and by third parties (shareholders, creditors). Therefore, given that the losses in the event of a breach of fiduciary duty are significant and insurance is very expensive, a director may refrain from insuring his or her own civil liability, as it is unrealistic to expect that the losses will be fully compensated (Greičius, 2007, p. 224). Although a director may refrain from insuring his civil liability himself, director may be insured by the legal entity. In such a case, not only does the company ensure that the damage caused to the company by the director's unlawful actions will be compensated, it also increases the chances of attracting new talent. Research conducted by R. Šapokė even showed that D&O insurance has become a condition of the director’s employment with the company (Šapokė, 2019, p. 44). It can therefore be argued that, although directors in Lithuania may refrain from taking out their own D&O insurance because it requires significant financial resources, they still want an alternative protection against liability arising from activities carried out in the course of running a business, from which they cannot be exempted, and that companies are willing to provide this protection in order to add value to the business by hiring highly qualified individuals.

Although D&O insurance can be used as an alternative to exemption from civil liability because it helps to reduce consequence of director’s liabilities for both company and director, coverage of D&O insurance is not without limits. D&O insurance provides company director with reimbursement of legal defence costs and/or compensation for damages for which he is held liable under the law. The main requirement for director or the company wanting to insure company director is to disclose to the insurer, prior to the conclusion of the insurance contract, all information about prior claims (whether there are any already existing claims) and any other circumstances which may result in claims (Article 6.993(1) of the CC). Failure to disclose required information or misrepresentation may result in D&O insurance being void. Other limits refer to the amount of coverage, fines or penalties imposed by law, and, most importantly, matters which may be deemed legally uninsurable (Hinsey *et al.*, 1972, p. 147). For the purposes of this thesis "legally uninsurable" matters shall be understandable as wilful misconduct as such conduct implies that the director clearly intended to cause damage to the company or to other persons and is therefore not eligible for relief. This leaves us with the conclusion that essentially, D&O insurance covers out-of-court claims by the company against a director for such matters as failure on business expansion, using company funds for personal benefit, everyday business decisions, selling or buying goods, services for an inadequate price. In addition, since D&O insurance may apply to claims brought by third parties, it may also apply in the case of derivative action brought for matters indicated above. The liability for mentioned matters must arise from negligence, not differentiating whether it is gross or simple. It may also be argued that since liability for failure to initiate insolvency arises from simple negligence, D&O insurance would also cover failure to initiate and/or mismanagement of insolvency which leads to insolvency, provided that the liability does not arise from an intentional act. Given that the director of a company cannot be exempted from liability for breach of the duty to initiate insolvency proceedings, D&O insurance can indeed be seen as an alternative way for a director to protect his personal assets.

D&O insurance is usually offered on a "claims-made" basis, which means that D&O coverage includes only the claims that arise after the D&O policy was concluded. It therefore may be concluded that D&O insurance in Lithuania, as an alternative to exemption from civil liability, has a similar scope – works on contractual basis only in respect of claims that already arose, does not extend to some unknown claims, but does not exclude the liability of the company's director.

Germany

§ 93(2) of AktG provides that under German law a director may be covered by D&O insurance against risks arising from his or her procedural activities in the company. The purpose and application of D&O insurance are not substantially different from those discussed in Lithuania. It is a voluntary insurance policy, taken out by the director himself or the company he is managing, aimed at covering the judicial and extrajudicial defence against unfounded claims for damages and the satisfaction of justified claims for damages, as well as the costs of litigation (Graf von Westphalen *et al.* (ed.), 2022, p. 89). Similarly to Lithuania, director or the company (depending on who is the policyholder) must disclose to the insurer the risk factors which are relevant to the insurer's decision to conclude the contract with the agreed content and which the insurer has requested in writing (§ 19(1) of VVG). Disclosure of information assists to monitor the policyholder and the insured party/parties and adjust he premium and the insurance conditions to their behaviour and the actual risk (Cane, 1997, p. 220). The risks identified help to determine the scope of cover, which, as in Lithuania, is usually general, but includes certain exceptions.

While in Germany D&O insurance, just like in Lithuania, is based on claims-made principle (Thümmel, 2008 quoted Graf von Westphalen *et al.* (ed.), 2022, p. 92), this does not mean that breach of duties, which occurred before the conclusion of the insurance contract, cannot be asserted during the contract period. Under German law, the general D&O insurance provisions may contain a reverse cover allowing insurance against a breach of duty occurring prior to the conclusion of the D&O policy, provided that the breach of duty was not known to the policyholder or the insured at the time of the conclusion of the insurance contract (Graf von Westphalen *et al.* (ed.), 2022, p. 92). It may nevertheless be hard to benefit from reverse insurance because the exclusion related to information known to the policyholder is partly extended to the negligent ignorance of the breach of duty (Clause 3.2. of AVB-AVG). Given the higher standard of care to which a director is held, any negligence or omission on the part of a director may be considered negligent ignorance. The burden of proof for the facts of exclusion, including but not limited to the reverse insurance, is on the insurance company, making it more difficult for the director to use D&O insurance as an alternative to exemption from liability. Therefore, it may be argued that, although a possibility of reverse insurance exists, in Germany, as in Lithuania, D&O insurance could generally be used as an alternative to exemption only for claims arising from breaches of duty that occurred after the conclusion of the D&O insurance contract.

Analysing other exclusions, D&O insurance policies in Germany contain nearly the same general exclusions as D&O policies in Lithuania. Conditions of D&O insurances usually tend to exclude any damages claims based on intentional causation of harm or wilful breach of duty, fines imposed by the law, breaches of duty that occurred after the conditions for the opening of insolvency proceedings were satisfied, claims brought under foreign law etc. While Germany maintains the same approach as Lithuania – a director cannot enjoy the reduced consequences arising from breach of a certain duty if he deliberately intended to cause harm for the company, Germany further extends the scope of exclusions in the D&O insurance cover – the insurer has the right to reduce the amount of the claim compensation in the case of a breach of duty caused by gross negligence (Wagner, Klein, 2018, p. 204). Therefore, it can be argued that the right of German directors to use D&O insurance as an alternative to exemption from civil liability is narrower than the right granted to Lithuanian directors, although arguably would also work as an alternative to exemption from civil liability in the cases where director breaches duty to initiate insolvency. Full compensation can only be received for mistakes and/or in daily business management, breaches of duties that arise from simple negligence.

Considering the above-mentioned it may be concluded that D&O insurance in Germany, as an alternative to exemption from civil liability, can work in the cases when shareholders meeting has not ratified or authorized director's breach of duty. With D&O insurance, a director can have a direct claim against the insurer for judicial and extrajudicial protection against unjustified claims for damages, for the settlement of justified claims for damages and for the costs of litigation, provided that the damage caused to the company or to third parties has not been caused intentionally or by gross negligence.

United Kingdom

As in Germany and Lithuania, UK law allows a company to limit the liability of its directors, although not exempt them from liability completely, by permitting companies and directors themselves to purchase D&O insurance (Section 233 of the CA; provision 53 of Model Articles for private companies limited by shares). It has no specific legal regulation. According to UK law, it is a voluntary insurance, and the company even has the discretion in its articles of association to determine the circumstances in which directors are permitted to be insured under D&O insurance (Hill, 2017, p. 530).

Just like in Germany and in Lithuania, D&O insurance will cover not only the amount of judgment but also the legal costs incurred in defending claims and seeking to avoid liability (Hill, 2017, p. 531-532). However, since the rationale for allowing to use D&O insurance as an alternative to exemption from liability is the need of a balance between the fair judgment of cases where something has gone wrong as a result of either negligence or dishonesty and the willingness of highly-qualified directors to take informed and rational risks (White Paper on Company Law Reform, 2005, p. 23), the coverage of D&O insurance is not without boundaries.

According to Article 233 of the CA, D&O insurance may protect director from claims of negligence, default, breach of duty or breach of trust in relation to the company, which essentially covers all types of conduct that are prohibited to be included in exemption clauses. However, it should be noted here that D&O insurance cover will only apply in such cases if, firstly, the policyholder has complied with the duty to disclose material circumstances under Article 3(4) of the Insurance Act 2015. Secondly, the claim does not fall within the following: fines and criminal convictions, financial consequences of problems of which the insured was aware prior to the commencement of the policy cover, claims arising out of incidents involving pollution of the environment, liabilities arising out of wilful misconduct, losses arising out of breaches of duty, resulting in director making a personal profit (Hill, 2017, p. 531-532). Although the exclusions do not differ from the ones discussed previously, it is important to highlight that in the UK, just like in Germany and Lithuania, director cannot enjoy the limitation of his civil liability if he deliberately intended to cause damage to the company, third persons. It may therefore be argued that such an exclusion can be held to be a general one because deliberate or conscious acts, omissions, illegality, fraud or dishonesty are deemed to be contrary to public policy (Cabrelli, McAlpine, 2018, p. 722).

Considering that D&O insurance in UK can be used as an alternative to exemption from civil liability, directors can enjoy reimbursement of legal defence costs and (or) compensation for damages from which he cannot be exempted from by articles of association or contract under Section 232(1) of the CA and when the meeting of shareholders has not ratified or authorised certain breach. The unratified or unauthorised breach must not constitute wilful misconduct, illegality or other acts that are exempted from the coverage of D&O insurance.

Conclusion

In all three jurisdictions, D&O insurance can be used as an alternative to exemption from civil liability if the insurer has been disclosed the relevant risk factors, previous claims, circumstances that may give rise to future claims. Due to the principle of freedom of contract, the coverage of D&O insurance policies may vary. However, the standard exclusions in all three jurisdictions relate to wilful misconduct, fines and criminal penalties, as it would be contrary to law and public policy to reduce the director's financial liability in such cases. The wilful misconduct exclusion is further extended in Germany, allowing the insurer to reduce the compensation for gross negligence. Although in all three jurisdictions D&O insurance is not mandatory, its existence is a clear benefit to the director as he can obtain reimbursement of the costs of legal defence and/or damages for which he is held liable under the law when the exemption from civil liability does not work.

3.2. Indemnification

As already discussed in the practical study of the Lithuanian SPAs, the liability of a company's director is a particularly important but complex aspect of M&A transactions. Although the exemption of company director from civil liability either by clause in SPA or release letter if agreed by the parties is an important procedural step, the major concerns for the parties involved in M&A transaction (buyer and seller) are reflected in the conditions section and indemnity section. Whilst conditions section is relevant because it lists the conditions necessary to close the transaction, the indemnity section establishes the liability, if any, of each party to the other for problems relating to the target company that are discovered after the closing (Foster Reed *et al.*, 2007, pp. 468-469). Being able to establish the liability, the indemnity section is therefore able to limit the liability. However, given that indemnification clauses are essentially contractual arrangements between the parties to the transaction, i.e. seller and the buyer, the question arises whether indemnification can be extended to director of a target company.

As mentioned in the introduction to this thesis, inconsistent regulation makes it impossible to carry out a comparative analysis of the regulation in the jurisdictions concerned. The following analysis will therefore focus on the general possibility of indemnification of the director of the target company in M&A transactions and whether this would be a theoretical alternative to exemption from civil liability in the relevant jurisdictions.

In legal doctrine indemnification is recognised as the reimbursement of the other party for loss incurred following closing for which they were not responsible (DePamphilis, 2018, p. 190). Usually the seller agrees to indemnify the buyer of liability in the event of misrepresentations or breaches of warranties or covenants contained in the SPA or Business Transfer Agreement (BTA) and *vice versa* (Miller, Jr. and Segall, 2017, p. 185). As for the indemnification clause in the SPA or BTA itself, it is unlikely that they would apply to the director of the target company, as the indemnification clauses only apply to the parties to the contract, the seller and the buyer, and could therefore potentially only apply to indemnification of the directors of the seller or the buyer, which is a topic for further research. However, the alternative to exemption of target’s director from civil liability in both BTAs and SPAs after closing may be indemnification agreement.

Due to principle of freedom of contract seller and the buyer could agree to indemnify target's director, who stays in the office after the transaction is closed, from liability that would otherwise arise in managing business after the transaction is closed. In such a case, it may be argued that indemnification agreement in Lithuania would be governed by Article 6.252(1) of the CC, meaning that the target's director would be indemnified against any liabilities that arise from simple negligence and does not violate values mentioned in Article 1.114(1) of the CC. Indemnification would arguably not extend to third parties and would be limited to relationship between the company (target) and its director. Consequently, indemnification agreement would work identically as provisions exempting company director from liability. The main difference is that provisions exempting target director from civil liability are focused on exemption from liability for the claims that arose prior to closing and indemnification is focused on the reimbursement by the buyer for the claims that arose after the closing.

Indemnification agreement would have a slightly different impact in Germany and UK. Although the regulation in both jurisdictions is not very extensive, one thing is arguably clear – indemnification is possible in respect of claims from third parties. Starting with Germany, it should first be remembered that the standard to act with the care of a prudent businessman is mandatory and cannot be derogated from by the articles of association of the company or by any other agreement, including but not limited to an indemnity agreement (BGB § 276). As a result, contractual limitation of internal liability is not possible. This is not the case with external liability. Although it cannot be limited or avoided by a shareholders' resolution, indemnification for third-party claims is possible and may even be compulsory if the director has not breached the director's duty of care towards the company (Madisson, 2012, p. 64). It can therefore be argued that in Germany, an indemnity agreement would act as an alternative to an exemption from liability for third-party claims that arise after the closing of the M&A transaction, provided that there has been no breach of the duties owed to the company.

Indemnification agreement in the UK would have the same effect as in Germany because the third party indemnities are specifically allowed in the CA. Section 232(2)(b) of the CA provides an exemption to the general prohibition of provisions indemnifying director against any liability attaching to him in connection with any negligence, default, breach of duty, or breach of trust in relation to the company of which he is a director, contained in Section 232(2). Qualifying third party indemnity would be such which does not extend to indemnification against liability incurred to the company or an associate company.[19] Important thing to note here is that the indemnification regarding third parties would work in connection with any negligence, default, breach of duty, or breach of trust in relation to the company. The restriction that applies to exemption would not apply. It may therefore be argued that indemnification agreement would work as an alternative to the exemption from third-party claims but nonetheless be prohibited in director-company relationship.

Considering the above-mentioned, indemnification section within the SPA or BTA could not extend to director of a target company. However, an indemnity could be an alternative to an exemption from civil liability, if agreed by the seller and the buyer in a separate agreement. Such an indemnity agreement in Lithuania would probably only apply to the relationship between the director and the company, whereas in Germany and the UK it would only apply to third party claims.

[19] Associate company' is defined by Section 256 of the CA.

CONCLUSIONS

1. In all three jurisdictions directors owe a duty not only to the company but also to the shareholders. The difference is that in Lithuania the duties are owed to both company and shareholders and are not limited to certain circumstances, whilst in Germany and the UK the company director owes duties directly to the company and duties to the shareholders only arise in certain circumstances.
2. In all three jurisdictions civil liability of a director arises once the breach of duties imposed by the law occurs and certain conditions, in civil law countries named as conditions of civil liability and in common law countries named as cause of action, are met. Civil law countries Lithuania and Germany focus on civil liability and enforce remedies provided for by the law (compensation for damage), whereas in the common law country the remedies extend to the common law tradition when the breach of fiduciary duty occurs.
3. While German and UK law take a very strict approach to limitation of liability based on the type of fault and do not allow for liability limitations based on the type of fault, Lithuanian law distinguishes between the types of fault and leaves open the possibility of exempting a director from civil liability for simple negligence.
4. All three jurisdictions recognise business judgment rule as a way to limit director's civil liability. In all three jurisdictions directors are protected in making entrepreneurial decisions, provided they act *bona fide* in making those decisions. However, the difference between jurisdiction is that in Lithuania and the UK the good faith of director is presumed whilst in Germany the burden of proving that the director exercised care of a diligent and conscientious manager is on the director.
5. The jurisdictions analysed do not have a uniform approach towards the exemption in the articles of association. As far as civil law countries are concerned, Lithuania generally allows for the exemption of a company's director from civil liability in the company's articles of association, except in cases where the director is acting through gross fault or has caused non-pecuniary damage, whereas in Germany such an exemption is not possible at all. The most developed regulation is in the UK, where the legislator provides for a general prohibition on the exemption of directors from liability in the articles of association but leaves open the possibility of providing in the articles of association for an exemption from civil liability for a breach of the duty to avoid conflicts of interest. However, this possibility is not absolute - director of the company must comply with the other general duties set out in the CA.

6. The results and scope of authorisation of director's actions vary across jurisdictions. In Lithuania, *ex ante* authorisation granted by the general meeting of shareholders does not exempt a director from liability on the grounds of separation of powers, whereas in the UK and Germany authorisation by a shareholders' resolutions works as an exemption from civil liability. The difference between the UK and Germany is that in the UK, shareholders can authorise any act or omission of a director provided that the director acted *bona fide* and for proper purposes, whereas in Germany, authorisation is only granted for a breach of the duty of care if it does not harm the interests of the company more than would have been the case under the rule of exemption for business decision-making.
7. Although *ex ante* ratification of director's actions is allowed in all three jurisdictions, jurisdictions differ in the effect that the ratification has. In general, ratification in Germany and the UK exempts the company's director from liability, whereas in Lithuania it has no such effect. Ratification in Lithuania may only have the indirect effect of exempting from liability, as it may be used as a defence by the director in the event that the director's actions would be scrutinised by a court to determine whether they fall within the scope of the Lithuanian business judgment rule.
8. The exemption from civil liability on behalf of the company differs in all three jurisdictions. In Lithuania, exemption is theoretically possible by contract, provided that the exemption does not cover gross negligence and/or wilful misconduct. In Germany, a company may waive existing claims when shareholders pass a formal resolution approving director's action, whereas UK law provides for a theoretical possibility to exempt a director from liability arising out of breaches of the statutory duty to avoid conflicts of interest by contract. In Lithuanian and German cases, the exemption would essentially be done by shareholders and in the case of the UK by authorized person signing the agreement.
9. Absence of case law on the contractual exemption in Lithuania results in theoretical legal framework being applied too broadly. Practical analysis of SPAs has shown that provisions which provide that the company will not initiate future claims would be difficult to enforce in the event of a dispute because under the mandatory legal rules, a company cannot waive future claims as this would violate the company's constitutional right to protect its legal rights and interests. The same applies to release letters – if they provide that the director is also exempted from future claims, the validity of the release letter or its certain provision is questionable in the same way as provisions in the SPA providing an obligation for a company not to initiate future

claims. Therefore, waivers can only be granted in respect of claims that have already arisen.

10. The exemption of company director from civil liability in the case of insolvency is impossible in all three jurisdictions, however the approach towards the limitation of exemption. In Germany and Lithuania, a company's director cannot be exempted from liability for failing to initiate insolvency proceedings when the company is facing insolvency. In Germany, this means that an exemption from civil liability by authorisation or approval of the shareholders' meeting is not valid if the company is, among other things, unable to pay its debts as they fall due. In contrast, Lithuanian law provides that liability for failure to initiate insolvency proceedings is based on simple negligence. Since exemption from liability is not possible for gross negligence or wilful misconduct, simple negligence becomes the last type of fault that cannot be avoided. Under UK law, civil liability is not focused on the duty to initiate insolvency proceedings in a timely manner, but on the assessment of the company's solvency and the impact of a particular act on the interests of creditors and the company. If financial difficulties jeopardise the interests of the creditors and the breach of a certain duty adversely affects the interests of the company, the exemption by the shareholders meeting is not valid.

11. In all three jurisdictions, voluntary D&O insurance can be used as an alternative to the exemption from civil liability, provided that the insurer has been disclosed the relevant risk factors, past claims, circumstances that may give rise to future claims, and that the director's actions do not constitute wilful misconduct, fines and criminal sanctions, i.e. actions that are not normally not covered by D&O insurance. If a director is covered by D&O insurance, he/she may be reimbursed for legal defence costs and/or damages for which he/she is legally liable when the exemption from liability does not work.

12. Indemnification of company director in M&A transactions can be used as alternative to the exemption of target company’s director from civil liability if agreed by the seller and the buyer in a separate agreement. Such an indemnity agreement in Lithuania would probably only apply to the relationship between the director and the company, whereas in Germany and the UK it would only apply to third party claims.

LIST OF REFERENCES

Legal acts

European Union legal acts

1. Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law (codification).

Lithuanian legal acts

2. Lietuvos Respublikos Konstitucija (1992). *Valstybės žinios,* 1992, 33-1014.
3. Lietuvos Respublikos akcinių bendrovių įstatymas (1990). *Lietuvos aidas*, 1990, 57-0.
4. Lietuvos Respublikos teismų įstatymas (1994). *Valstybės žinios*, 1994, 46-851.
5. Lietuvos Respublikos civilinis kodeksas (2000). *Valstybės žinios*, 2000, 74-2262.
6. Lietuvos Respublikos akcinių bendrovių įstatymas (2000). *Valstybės žinios*, 2000, 64-1914.
7. Lietuvos Respublikos įmonių bankroto įstatymas (2001). *Valstybės žinios,* 2001, 31-1010.
8. Lietuvos Respublikos civilinio proceso kodeksas (2002). *Valstybės žinios*, 2002 36-1340.
9. Lietuvos Respublikos draudimo įstatymas (2003). *Valstybės žinios*, 2003, 94-4246.
10. Lietuvos Respublikos darbo kodeksas (2016). *TAR*, 2016, 23709.
11. Lietuvos Respublikos juridinių asmenų nemokumo įstatymas (2019). *TAR*, 2019, 10324.

German legal acts

12. Gesetz betreffend die Gesellschaften mit beschränkter Haftung (GmbHG) in der im Bundesgesetzblatt Teil III, Gliederungsnummer 4123-1, veröffentlichten bereinigten Fassung, das zuletzt durch Artikel 6 des Gesetzes vom 15. Juli 2022 (BGBl. I S. 1146) geändert worden ist.
13. Aktiengesetz (AktG) vom 6. September 1965 (BGBl. I S. 1089), das zuletzt durch Artikel 2 des Gesetzes vom 20. Juli 2022 (BGBl. I S. 1166) geändert worden ist.
14. Insolvenzordnung (IsO) vom 5. Oktober 1994 (BGBl. I S. 2866), die zuletzt durch Artikel 11 des Gesetzes vom 20. Juli 2022 (BGBl. I S. 1166) geändert worden ist.

15. Bürgerliches Gesetzbuch in der Fassung der Bekanntmachung (BGB) vom 2. Januar 2002 (BGBl. I S. 42, 2909; 2003 I S. 738), das zuletzt durch Artikel 6 des Gesetzes vom 7. November 2022 (BGBl. I S. 1982) geändert worden ist.

UK legal acts

16. Companies Act 2006
17. Insurance Act 2015

Special literature

18. Abramavičius, A. and Mikelėnas, V. (1999). *Įmonių vadovų atsakomybė*. Vilnius: VĮ Teisinės informacijos centras.
19. Ambrasienė, D. *et al*. (2004). *Civilinė teisė. Prievolių teisė*. Vilnius: Lietuvos teisės universiteto Leidybos centras.
20. Arnold QC, M. (2017). GENERAL DUTIES OF DIRECTORS. In: Mortimore, S. (ed.). (2017). *Company Directors: Duties, Liabilities, and Remedies.* 3rd edition. New York: Oxford University Press, 237-258.
21. Baublys, L. *et al.* (2012). Teisės teorijos įvadas. Vilnius: Leidykla MES.
22. Baums, T. (1996). Personal Liabilities of Company Directors in German Law [interactive]. Available at: https://core.ac.uk/download/pdf/14504645.pdf [accessed on 13 December 2022].
23. Bickelhaupt, D. L. (1983). *General Insurance.* 11th edition. Homewood: Richard D. Irvin, Inc.
24. Branson M., D. (2002). The Rule That Isn't a Rule - The Business Judgment Rule. *Valparaiso University Law Review,* 36(3), pp. 631-654 [interactive]. Available at: https://scholar.valpo.edu/cgi/viewcontent.cgi?referer=&httpsredir=1&article=1312&context=vulr [accessed on 25 October 2022].
25. Bruce, FCIS, M. (2011). *Rights and Duties of Directors*. 11th edition. Croydon: Bloomsbury Professional.
26. Cabrelli, D. and McAlpine, A. (2018). Directors‘ and Officers‘ Liability in the United Kingdom. In: Deakin, S., Koziol, H. and Riss, O. (2018). *Directors and Officers (d and o) Liability*. Berlin, Boston: De Gruyter, 669-722.
27. Cahn, A. (2016). The Shareholders' Fiduciary Duty in German Company Law. From: Birkmose, H. S. (ed)(2017). *Shareholders' Duties.* Nordic & European Company Law Working Paper No. 18-13. Kluwer Law International, 347-361.

28. Cahn, A. and Donald, C. D. (2018). *Comparative Company Law Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA.* 2nd edition. Cambridge University Press.
29. Cane, P. (1997). The anatomy of tort law. 1st edition. Oxford: Hart Publishing.
30. Chung, H. H. and Wynn, J. P. (2008). Managerial Legal Liability Coverage and Earnings Conservatism. *Journal of Accounting and Economics*, 46, 135-153, https://doi.org/10.1016/j.jacceco.2008.03.002.
31. Core, J. E. (1997). On the Corporate Demand for Directors' and Officers' Insurance. *Journal of Risk and Insurance*, 64(1), 63-87 [interactive]. Available at: https://www.jstor.org/stable/253912#metadata_info_tab_contents [accessed on 13 December 2022].
32. Deipendbrock, G. (2016). The 'Business Judgment Rule' and the Problem of Hindsight Bias – Observations from a German Company Law Perspective. *European Business Law Review*, 27(2), 197-221.
33. DePamphilis, D. M. (2018). Chapter 5 - Implementation: Search Through Closing: Phases 3–10 of the Acquisition Process. In: DePamphilis, D. M. (2018). *Mergers, Acquisitions, and Other Restructuring Activities*: *An Integrated Approach to Process, Tools, Cases, and Solutions.* 9th edition. Academic Press, 165-201, https://doi.org/10.1016/B978-0-12-801609-1.00005-1.
34. Dotevall, R. (2016). Is a Common Structure of Company Directors' Duties Evolving in EU? *European Business Law Review*, 27(2), 285-294.
35. Easterbrook, F. H. and Fischel, D. R. (1985). Limited Liability and the Corporation. *University of Chicago Law Review*, 52(1), 89-117.
36. Easterbrook, F. H. and Fischel, D. R. (1991). *The Economic Structure of Corporate Law*. Boston: Harvard University Press.
37. Finn, P. D. (1978). Fiduciary Obligations. *U.N.S.W. Law Journal*, 2(4), 408-412.
38. Foster Reed, S., Reed Lajoux, A. and Nesvold, H. P. (2007). *The Art of M&A: A Merger/Acquisition/Buyout Guide.* 4th edition. USA: McGraw-Hill.
39. Franken, S. (2004). Creditor- and debtor- oriented corporate bankruptcy regimes revisited. *European Business Organization Law Review*, 5(4), 645-676.
40. Gerner-Beuerle, C. and Schuster, E.-P. (2014). The Evolving Structure of Directors' Duties in Europe. *European Business Organization Law Review*, 15(2), 191-233.
41. Gerner-Beuerley, C. *et al.* (eds.). (2019). *The private international law of companies in Europe*. Munich/Baden-Baden/Oxford: C.H. Beck/Nomos/Hart Publishing.

42. Girasa, R. (2013). *Corporate Governance & Finance Law*. New York: Palgrave Macmillan.
43. Graf von Westphalen, F., Pamp, R. and Thüsing (G.) (ed.). (2022). *Vertragsrecht und AGB-Klauselwerke*. München: Verlag C. H. Beck.
44. Grantham, R. (2003). Company Director's Personal Liability in Tort, *The Cambridge Law Journal*, 62(1), 15-17.
45. Greičius, R. (2007). *Privataus juridinio asmens fiduciarinės pareigos*. Vilnius: VĮ Teisinės Informacijos Centras.
46. Hayes, M. D. (2015). When the Tides Turn: Fiduciary Duties of Directors and Officers of Distressed Companies, *Business Law Today*, 1-4.
47. Hayton, D. (1987). Company–Directors' "Duties" and Exempting Articles. *The Cambridge Law Journal*, 46(2), 217-219, https://doi.org/10.1017/S0008197300119841.
48. Haywood, M. (2017). DUTY TO ACT WITHIN POWERS. In: Mortimore, S. (ed.). (2017). *Company Directors: Duties, Liabilities, and Remedies.* 3rd edition. New York: Oxford University Press, 259-278.
49. Hill, S. (2017). DIRECTORS' LIABILITIES: PROVISION OF INSURANCE. In: Mortimore, S. (ed.). (2017). *Company Directors: Duties, Liabilities, and Remedies.* 3rd edition. New York: Oxford University Press, 529-550.
50. Hinsey, J. IV *et al.* (1972). What Existing D&O Policies Cover. *The Business Lawyer*, 27, 147-164 [interactive]. Available at: https://www.jstor.org/stable/40684856#metadata_info_tab_contents [accessed on 13 December 2022].
51. Hood, P. (2000). What is so special about being a fiduciary? *Edinburgh Law Review*, 4(3), 308-335.
52. Hüffer, U. and Koch, J. (2018). *Aktiengesetz. Beck'scher Kurz-Kommentare*. 13th edition. Munich: Verlag C. H. Beck.
53. Jankauskas, K. (2005). *Teisės principų samprata ir jos įtvirtinimas konstitucinėje jurispurdencijoje*. Daktaro disertacija, socialiniai mokslai, teisė (01S), Lietuvos teisės universitetas.
54. Jarusevičius, J. (2019). Verslo sprendimo taisyklės taikymo priežastys. *Teisė*, 110, 80–102, https://doi.org/10.15388/Teise.2019.110.5.
55. Jia, N. and Tang, X. (2018). Directors' and Officers' Liability Insurance, Independent Director Behavior, and Governance Effect. *The Journal of Risk and Insurance*, 85(4), 1013-1054, https://doi.org/10.1111/jori.12193.

56. Jokubauskas, R. (2021). Juridinių asmenų nemokumo procesas. Monografija. Krakow: KSIĘGARNIA AKADEMICKA.
57. Jokubauskas, R. and Kirkutis, M. (2021). Įmonės vadovo civilinė atsakomybė dėl laiku neinicijuoto nemokumo proceso. *Jurisprudencija*, 2021, 28(2), 430-451.
58. Keay, A. (2003). Directors' Duties to Creditors: Contractarian Concerns Relating to Efficiency and OverProtection of Creditors. *The Modern Law Review*, 66(5), 665-699, https://doi.org/10.1111/1468-2230.6605001.
59. Knepper, W. E. (1978). *Liability of Corporate Officers and Directors.* 3rd edition. Indianapolis: Allen Smith.
60. Hölters, W. (ed.). (2014). *Aktiengesetz AktG*. 2nd edition. Munich: Verlag C. H. Beck.
61. Kraakman, R. et al. (2009). *The Anatomy of Corporate Law: A Comparative and Functional Approach.* 2nd edition. Oxford: Oxford University Press.
62. Lazauskaitė, R. (2010). Susitarimų dėl sutartinės atsakomybės ribojimo teisinė prigimtis. *Socialinių mokslų studijos*, 1(5), 169-184.
63. Leahy, B. and Feld, A. (2017). DIRECTORS‘ LIABILITIES: EXEMPTION, INDEMNIFICATION, AND RATIFICATION. In: Mortimore, S. (ed.). (2017). *Company Directors: Duties, Liabilities, and Remedies.* 3rd edition. New York: Oxford University Press, 503-527.
64. Madisson, K. (2012). *Duties and liabilities of company directors under German and Estonian law: a comparative analysis*. RGSL Research papers No. 7 [interactive]. Available at: https://www.rgsl.edu.lv/uploads/research-papers-list/16/7-karin-madisson-final.pdf [accessed on 14 December 2022].
65. Mertens, H.-J. and Cahn, A. (2010). *Kölner Kommentar zum Aktiengesetz*. 3rd edition. Köln: Carl Heymanns.
66. Mikalonienė, M. (2011). Bendrovės įstatų teisinė prigimtis. *Current Issues of Business and Law*, 6(2), 265-285.
67. Mikelėnas, V. (1995). *Civilinės atsakomybės problemos: Lyginamieji aspektai*. Vilnius: Justitia.
68. Mikelėnas, V. (2003). *Lietuvos Respublikos civilinio kodekso komentaras. Šeštoji knyga. Prievolių teisė.* Vilnius: Justitia.
69. Mikelėnas, V. *et al.* (2002). *Lietuvos Respublikos civilinio kodekso komentaras. Antroji knyga*. Vilnius: Justitia.
70. Miller, Jr., E. L. and Segall, L. N. (2017). *Mergers and Acquisitions. A Step-by-Step Legal and Practical Guide*. 2nd edition. New Jersey: John Wiley & Sons, Inc.

71. Norkūnas, A. and Selelionytė-Drukteinienė, S. (2008). *Civilinės atsakomybės praktikumas.* Mokomasis leidinys. Vilnius: Mykolo Romerio universiteto Leidybos centras.
72. Payne, J. (1999). A Re-examination of ratification. *Cambridge Law Journal*, 58(3), 604–626.
73. Radin A., S. (2009). *The Business Judgment Rule: Fiduciary Duties of Corporate Directors*. 6th edition. Aspen Publishers.
74. Schmidt, K. and Lutter, M. (2015). *Aktiengesetz Kommentar*. 3rd edition. Otto Schmidt.
75. Sealy, L. (1987). Company–Directors' "Duties" and Exempting Articles. *The Cambridge Law Journal*, 46(2), 217-219, doi:10.1017/S0008197300119841.
76. Šapokė, R. (2019). Aukščiausio lygio vadovų atlygio dizainui įtaką darantys veiksniai. Baigiamasis magistro studijų projektas, žmonių išteklių vadyba (6211LX039), Kauno technologijos universitetas.
77. Tamošiūnienė, E. *et al.* 2020. Nemokumo proceso inicijavimo veiksmingumo problemos. *Teisė*, 1170, 47-63, https://doi.org/10.15388/Teise.2020.117.3.
78. Thümmel, R. C. (2008). *Persönliche Haftung von Managern und Aufsichtsräten.* 4th edition.
79. Tikniūtė, A. (2008). Juridinio asmens valdymo organų pareigos kreditoriams problema. *Jurisprudencija*, 110(8), 57-64.
80. Triantis, G. C. and Daniels, R. (1995). The Role of Interactive Corporate Governance. *California Law Review*, 83, 1073-1113.
81. Vaišvila A. (2004). Teisės teorija: vadovėlis. Vilnius: Justitia.
82. W. (1981). Derivative Actions and Foss v. Harbottle. *The Modern Law Review*, 44(2), 202-212.
83. Wagner, G. and Klein, F. (2018). Directors‘ and Officers‘ Liability in Germany. In: Deakin, S., Koziol, H. and Riss, O. (2018). *Directors and Officers (d and o) Liability*. Berlin, Boston: De Gruyter, 159-206.
84. Weterings, W. (2015). Directors' & Officers' Liability, D&O Insurance and Moral Hazard: More Control of Moral Hazard by D&O Insurers Needed to Increase the Incentives of Directors and Supervisory Board. *European Business Law Review*, 26(2), 305 – 320, https://doi.org/10.54648/eulr2015015.
85. Wood, J. (2007). Director Duties and Creditor Protections in the Zone of Insolvency: A Comparison of the United States, Germany, and Japan. *Penn State International Law Review*, 26(1), 139-168.

86. Wooldridge, F. (2010). Duty of care and responsibilities of the management board of a German public company. *Amicus Curiae*, 82, 28-32 [interactive]. Available at: https://sas-space.sas.ac.uk/2805/1/Amicus82_FrankWooldridge.pdf [accessed on 20 December 2022].

Case law

Lithuanian case law

87. Ruling of the Constitutional Court of 30 May 2003. *Valstybės žinios*, 53-2361.
88. Ruling of the Constitutional Court of the Republic of Lithuania of 6 June 2006. *Valstybės žinios*, 65-2400.
89. Ruling of the Constitutional Court of the Republic of Lithuania of 19 August 2006. *Valstybės žinios*, 90-3529.
90. Judgment of the Supreme Court of Lithuania of 1 February 2012 in a civil case No 3K-3-19/2012.
91. Judgment of the Supreme Court of Lithuania of 12 September 2014 in a civil case No 3K-3-389/2014.
92. Judgment of the Supreme Court of Lithuania of 2 December 2021 in a civil case No e3K-3-300-313/2021
93. Judgment of the Supreme Court of Lithuania of 2 May 2014 in a civil case No 3K-3-252/2014.
94. Judgment of the Supreme Court of Lithuania of 20 November 2009 in a civil case No 3K-7-444/2009.
95. Judgment of the Supreme Court of Lithuania of 20 November 2013 in a civil case No 3K-3-581/2013.
96. Judgment of the Supreme Court of Lithuania of 21 October 2016 in a civil case No 3K-3-327
97. Judgment of the Supreme Court of Lithuania of 22 September 2015 in a civil case No 3K-3-470-969/2015
98. Judgment of the Supreme Court of Lithuania of 25 March 2011 in a civil case No 3K-3-130/2011
99. Judgment of the Supreme Court of Lithuania of 25 November 2016 in a civil case No 3K-3-485-421/2016
100. Judgment of the Supreme Court of Lithuania of 27 October 2014 in a civil case No 3K-3-453/2014.

101. Judgment of the Supreme Court of Lithuania of 3 June 2016 in a civil case No 3K-3-298-701/2016
102. Judgment of the Supreme Court of Lithuania of 30 November 2009 in a civil case No 3K-3-528/2009
103. Judgment of the Supreme Court of Lithuania of 4 November 2019 in a civil case No e3K-3-320-916/2019.
104. Judgment of the Supreme Court of Lithuania of 5 May 2011 in a civil case No 3K-3-228/2011.
105. Judgment of the Supreme Court of Lithuania of 7 February 2011 in a civil case No 3K-3-29/2011.
106. Judgment of the Supreme Court of Lithuania of 9 January 2014 in a civil case No 3K-7-124/2014;
107. Judgment of the Supreme Court of Lithuania of 5 May 2014 in a civil case No 3K-3-244/2014;
108. Judgment of the Supreme Court of Lithuania of13 April 2017 in a civil case No e3K-3-180-378/2017
109. Judgment of the Court of Appeal of Lithuania of 27 January 2022 in a civil case No e2-186-407/2022
110. Judgment of the Court of Appeal of Lithuania of 31 March 2014 in a civil case No 2-611/2014

Germany case law

111. Federal Court of Justice judgment of 21 April 21 1997-II ZR 175/95..
112. Federal Court of Justice judgment of 28 October 1971-II ZR 49/70.
113. Federal Court of Justice judgment of 24 June 2002-II ZR 296/01.
114. Federal Court of Justice judgment of 20 May 1985-II ZR 165/84.
115. Federal Court of Justice judgment of June 24, 2002-II ZR 296/01.
116. Federal Court of Justice judgment of May 20, 1985-II ZR 165/84.
117. Federal Court of Justice judgment of April 21, 1986-II ZR 165/85.

UK case law

118. *Burland v Earle [1902] AC 83, 93, PC.*
119. *Dorchester Finance v Stebbing* [1989] BCLC 498.
120. *Franbar Holdings Ltd v Patel* [2009] Bus. L.R. D14
121. *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821
122. *Madoff Securities International Ltd v Raven* [2012] 2 All E.R. (Comm) 634

123. *Movitex Ltd. v Bulfield & Ors.* (1986) 2 B.C.C. 99403
124. *Neptune (Vehicle Washing Equipment) Ltd. v. Fitzgerald* [1996] Ch. 274
125. *Northern Counties Securities Ltd v Jackson & Steeple Ltd* [1974] 1 W.L.R. 1133
126. *Percival v Wright* [1902] 2 Ch 421.
127. *Peskin v Anderson* [2000] EWCA Civ 326.
128. *Peskin v Anderson* [2001] 1 BCLC 372.
129. *Peter's American Delicacy Co Ltd v Heath* (1939) 61 CLR 457, 482, 511.
130. *Progress Property Co Ltd v Moorgarth Group Ltd.* [2011] 1 W.L.R. 1
131. *Re Brazilian Rubber Plantations and Estates Ltd* [1991] 1 Ch 425
132. *Re Charterhouse Capital Ltd [2015] B.C.C. 574*
133. *Re Home and Colonial Insurance Co Ltd* [1930] 1 Ch 102
134. *Re Horsley & Weight Ltd* [1982] Ch. 442
135. *Re Lands Allotment Company* [1894] 1 Ch 616, 631.
136. *Regal (Hastings) Ltd v Gulliver* [1942] 1 All England Law Reports (All ER) 378.
137. *Rolled Steel Ltd v British Steel Corpn* [1986] Ch 246, 296, CA.
138. *Shuttleworth v Cox Bros & Co (Maidenhead) Ltd* [1927] 2 K.B. 9
139. *South Australia Asset Management Corporation v York Montague Ltd* [1997] AC 191.
140. *Towers v Premier Waste Management Ltd* [2011] EWCA Civ 923
141. *Welham v Director of Public Prosecutions* [1961] AC 103, 123
142. *West Mercia Safetywear v Dodd* (1988) 4 BCC 30

Other sources

143. Allgemeine Versicherungsbedingungen für die Vermögensschaden-Haftpflichtversicherung von Aufsichtsräten, Vorständen und Geschäftsführern (AVB-AVG).
144. Armour, J. (2001). The Law and Economics of Corporate Insolvency: A Review. ESRC Centre for Business Research, University of Cambridge, Working Paper, 2005, Nr. 197 [interactive]. Available at: https://core.ac.uk/download/pdf/7151494.pdf [accessed on 12 December 2022].
145. Companies House (2018). *Model articles for private companies limited by shares* [interactive]. Available at: https://www.gov.uk/government/publications/model-articles-for-private-companies-limited-by-shares/model-articles-for-private-companies-limited-by-shares- [accessed on 13 December 2022].

146. Engert, A. and Goldlucke, S. (2013). *Why agents need discretion: The business judgment rule as optimal standard of care* [interactive], University of Mannheim Working Paper Series. Available at: https://madoc.bib.uni-mannheim.de/32959/1/Engert_und_Goldluecke_13-04.pdf [accessed on 25 October 2022].
147. Gerner-Beuerle, C., Paech, P. and Schuster, E. P. (2013). *Study on Directors' Duties and Liability prepared for the European Commission* [interactive]. Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3886382 [accessed on 26 October 2022].
148. Longman. (2005). Dictionary of Contemporary English. 4th edition. Harlow: Pearson Education Limited.
149. Lord Goldsmith. (2006). Lords Hansard [interactive]. Available at: https://publications.parliament.uk/pa/ld200506/ldhansrd/vo060509/text/60509-31.htm#60509-31_spnew1 [accessed on 14 December 2022].
150. The Department of Trade and Industry (2005). White Paper on Company Law Reform [interactive]. Available at: https://webarchive.nationalarchives.gov.uk/ukgwa/20070603164510/http://www.dti.gov.uk/cld/WhitePaper.pdf [accessed on 14 December 2022].

SUMMARY

Exemption of Company Directors from Civil Liability with Respect to the Company and its shareholders: a Comparative Analysis

Master's thesis examines the regulation of the exemption of a company's director from civil liability with respect to the company and its shareholders in Lithuania, Germany and the United Kingdom. The first part of the thesis presents the concept of civil liability of the company's director, analyses the duties of the company's director towards the company and its shareholders, and the moment when civil liability arises in different jurisdictions. After analysing when and why civil liability arises, the analysis continues with the limitation of civil liability according to the type of fault and the protection of the director by the business judgment rule. The second part of the thesis examines the exemption from civil liability of the director of a company. The analysis starts with the exemption in the company's articles of association, examining whether the laws of the different jurisdictions allow for such type of exemption and, if not, the reasons for this. It then moves on to the exemption on behalf of shareholders. This part analyses whether the authorisation or ratification by the shareholders' meeting of a particular act by the director exempts him from civil liability, and discusses which acts cannot be authorised or ratified. The analysis of the exemption from civil liability then moves to the exemption on behalf of the company. This part analyses whether contractual exemption of the director is possible and who actually exempts the director - the company, authorised persons or the shareholders. In order to analyse whether the theoretical possibility of contractually exempting company's director from civil liability in Lithuania is correctly applied in practice, the results of research of 17 SPAs is presented. The second part of the thesis concludes with an analysis of the limits of the exemption from civil liability in the event of insolvency. The third part analyses the alternatives to the exemption from civil liability - D&O insurance and indemnification in the M&A transactions.

ANNEX 1

	Type of transaction	Provision exempting director	Is CEO connected to seller?
1.	Sale of controlling stake	None the present or previous managing director of the Company or its subsidiaries, current or former members of the management board of the Company or its subsidiaries, current or former members of the supervisory council of the Company, appointed after [___] shall be liable to the Purchaser and/or the Company or its subsidiaries for actions taken by them in their capacity as members of management bodies of the Company or its subsidiaries to the extent such actions do not constitute wilful misconduct or gross negligence. The Purchaser shall not itself initiate any claims against the above-mentioned persons.	N/A
2.	Sale of all shares	The Buyer shall not, and shall procure that the Company and any further acquirers of the Company's shares do not, file any claims against the individuals - members of the management bodies of the Company, also the chief financial officer that served in those positions prior to the Closing Date and any of the Resigning Persons for any and all damage, liability, responsibility or claims of any kind that may arise, be filed or otherwise applied in relation to their service as members of the	Yes, director stays in the company (related to seller through loyalty).

		management bodies of the Company prior to the Closing, except in cases of wilful misconduct or gross negligence of such members. This release of liability expressed herein shall survive the transfer of ownership of the Company's shares to the Buyer, as well as the change of the Company's manager (general director) and/or the formation of new bodies of the Company.	
3.	Sale of controlling stake	The Buyer shall present to the Seller a waiver to the CEO and the Managing Partner of the Company releasing CEO and the Managing Partner from all liabilities from their acts and omissions, except for the cases of a wilful misconduct (in Lithuanian – *tyčia*) of the CEO and the Managing Partner, until the Closing Date.	Yes, director remained a minority shareholder.
4.	Sale of controlling stake	None of the present or previous CEO and members of the management board of the Company shall be liable to the Buyer and/or the Company for actions taken by them in their capacity as, respectively, the CEO or the members of the management board of the Company before the Closing Date, to the extent such actions do not constitute wilful misconduct or gross negligence. The Buyer shall not and shall procure that the Company does not file Claims against them (for any damage, liability, responsibility) that may arise, be filed or otherwise applied in relation to their service as the CEO, the members of	Yes, director was one of the sellers and director remained a minority shareholder.

		management board of the Company prior to the Closing. <…> The Buyer, the Company and Group Companies shall provide release letter(s) in a form of [___] issued to the benefit of the CEO and all members of the management board of the Group Companies, particularly stating that the Buyer, the Group Company and Group Companies do not have any claims against them and should any claims occur the CEO and the members of the management board of the Group Company are released from any liability in their capacity as CEO and members of the board of the Group Company for the actions taken by them before the Closing. For the avoidance of any doubt, the Parties hereby also acknowledge and confirm that such release letters issued to the benefit of the Seller 1 and the Seller 2 are purely related to: i) obligations of the Seller 1 acting as the CEO and member of the management board of the Company before Closing Date; ii) obligations of the Seller 2 acting as the member of the management board of the Company before Closing Date, and under no circumstances can be invoked by the Seller 1 or the Seller 2 to limit or waive Seller's 1 or Seller's 2 own liability under this Agreement.	

5.	Sale of controlling stake	No	Yes, director was one of the sellers and remained a minority shareholder.
6.	Sale of all shares	The Buyer and the Company shall provide release letter issued to the benefit of the CEO of the Company covering the obligations of the Buyer established in clause [___], in particular stating that the Buyer and the Company does not have any claims against them and should any claims occur the CEO will be released from any liability, except for claims resulting from gross negligence or wilful default of the CEO.	No
7.	Sale of all shares	No	No
8.	Sale of controlling stake	No	Yes, director remained a minority shareholder.
9.	Sale of all shares	No	Yes, director was a seller.
10.	Sale of all shares	No	Yes, director was a seller.
11.	Sale of controlling stake	The relevant Group Company and the Purchaser will provide confirmations that the Group Companies and the Purchaser do not have, and will not have in the future, any claims against the current and former executives, financial managers and board members of the Group Companies in respect of their employment and/or positions with the relevant Group Companies up to the date of the Completion of the Transaction, except in the event that it is determined that any such persons are wilful or grossly negligent.	No

12.	Sale of all shares	None of the persons holding positions of CEOs of the Target Companies before the Closing shall be liable to the Buyer and/or the Target Companies for any actions taken by them in their capacity as CEOs of the Target Companies before the Closing, to the extent such actions do not constitute wilful actions or gross negligence on their part. The Buyer shall not, and shall procure that no Target Company files any claims against them (for any damage, liability, responsibility) that may arise, be filed or otherwise applied in relation to their service as CEOs of the Target Companies prior to the Closing.	No
13.	Sale of all shares	Without limiting the foregoing, the Buyer hereby waives and releases any and all rights, claims, demands, or causes of action that may otherwise be available at law or granted by statute, to impose any liability on the Protected Persons. The Buyer ensures that after the Closing the Group waives and releases any and all rights, claims, demands, or causes of action that may otherwise be available at law or granted by statute, to impose any liability on the Protected Persons. <…> No liability limitations provided in the Agreement shall apply in the event of fraud, wilful misconduct, gross negligence.	Yes, director remained a minority shareholder.

		Protected Persons means any of the persons that served as a Managing Director (CEO) or a Board member of the Company prior to the Closing.	
14.	Sale of all shares	The Buyer and the Company have provided release letter in a form of [___] issued to the benefit of the Director stating that the Buyer and the Company does not have any claims against the Director, and should any claims occur the Director is released from any liability in his capacity as Director of the Company.	Yes, director was indirectly related to one of the sellers.
15.	Sale of all shares	The Buyer waives any and all Claims (including for negligence) that it might otherwise have against any officer, employee, agent, Adviser or consultant of any Seller or any of its Affiliate in respect of any information that any such person has in any capacity supplied to the Buyer in connection with the Warranties and/or the information Disclosed.	No
16.	Sale of all shares	The present and previous members of management bodies of the Companies, , which took office in each of the Companies after each of the Companies became an Affiliate of the Sellers, shall not be liable to the Purchaser and/or any of the Companies for the actions taken by them in their capacity as members of management bodies of any of the Companies before the Closing to the extent such actions do	Yes, director was directly related to one of the sellers.

		not constitute wilful misconduct or gross negligence <…>.	
17.	Sale of all shares	The Buyer shall not initiate, support or make any claims to the present and previous members of management bodies of the Companies, which took office in each of the Companies after each of the Companies became an Affiliate of the Seller, for the actions taken by them in their capacity as members of management bodies of any of the Companies before the Closing to the extent such actions do not constitute wilful misconduct or gross negligence.	No

ANNEX 2

Examples of provisions in the release letters:

1. the CEO shall not be liable to the Buyer and / or the Company for actions taken prior to the Completion Date in the performance of his duties as CEO of the Company;

2. the Buyer and the Company does not have and shall not file any claims against the CEO of the Company and should any claims occur, be filed or otherwise applied in relation to his service as the CEO of the Company respectively prior to the Completion Date, the CEO of the Company is released from any liability in his capacity as CEO of the Company;

3. [___] shall not be liable to the Buyer for actions taken prior to the Closing Date in the performance of his duties as CEO of the Company;

4. [___] shall not be liable to the Buyer and/or the Company for actions taken by him in his capacity as the member of the Management Board [or the CEO] of the Group Company before the Closing Date, excluding in case of wilful misconduct, gross negligence or criminal conduct;

5. the Buyer and the Company does not have and shall not file any claims against [___] in relation to his service as the member of the Management Board [or the CEO] of the Group Company prior to the Closing Date, and should any such claims occur, be filed or otherwise applied [___] is released from any liability in his capacity as member of the Management Board [and/or CEO] of the Group Company, respectively, excluding in case of wilfull misconduct, gross negligence or criminal conduct.