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**DUTIES AND RESPONSIBILITIES OF MEMBERS OF MANAGEMENT
BODIES OF LEGAL ENTITIES IN THE LAW OF RUSSIA, GERMANY,
THE UK, AND THE STATE OF DELAWARE (THE UNITED STATES)**

Specialty 5.1.3 – Private (Civil) Law Sciences

Annotation of the Thesis
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Relevance of the research topic. The issue of duties and responsibilities of members of management bodies of a legal entity (hereinafter also, the “**corporate directors**”)¹ is inextricably linked with the very institution of a legal entity and began to be developed soon after the appearance of legal entities as subjects of law and economy.

A legal entity, as a purely legal structure, is unable to independently express its will and protect its interests without the assistance of individuals acting as its management bodies. At the same time, such individuals may have their own interests, which they, using the authority granted to them, may pursue to the detriment of the legal entity’s interests. Therefore, there is a need in mechanisms restricting any potential for abuse on the part of corporate directors – establishment of appropriate duties for corporate directors (including restrictions on performance of certain actions by them) and liability for their breach.

Concepts of duties of members of management bodies in legal entities and liability for their breach have developed in different jurisdictions in the 18th – 19th centuries. These concepts were based on various theoretical and doctrinal positions and were also strongly influenced by the historical development of a particular state. This led to differences between them, primarily with respect to the scope of duties assigned to corporate directors and criteria for their proper performance. Nevertheless, the duties in question are built on the same principles. These principles are associated primarily with the need for a member of a management body to organize affairs of a legal entity in the best possible way, without reducing its property mass, and, in parallel, to maximize its profits by making often risky business decisions.

¹ Issues analyzed in this thesis research are considered using commercial legal entities as an example, since duties and responsibilities assigned to members of management bodies in commercial legal entities have been most extensively studied in judicial practice and scientific doctrine, and they most clearly express the principles that are followed by this civil law institute. At the same time, we note that conclusions made by the author of the thesis may be applied to non-profit legal entities as well, but it is necessary to account for the special legal capacity of non-profit legal entities and the much lower degree of risk that may be assumed by corporate directors of such organizations as compared with commercial legal entities.

Russia was not an exception, as it was in line in this matter with the continental legal system implying a stricter approach to duties assigned to members of management bodies. However, after the revolution in 1917 and abolition of private forms of business, research on this subject was virtually halted. It was resumed after Russia's turn towards the market economy in the 1990s when the first Russian corporate laws were worked on.

However, due to the fact that the corporate legislation of the Russian Federation was originally created under the strong influence of the Anglo-American law, duties and responsibilities of corporate directors were often interpreted, both in science and in practice, by analogy with institutions that have developed in Anglo-American law countries, despite the fact that they were based on a different legal tradition and that the Russian law was not oriented thereto historically. This resulted in lowered requirements to performance by corporate directors of their responsibilities and, by contrast, in overstated requirements to presentation of evidence by plaintiffs representing a legal entity and trying to hold the corporate directors liable. Such specific features in the United Kingdom and the United States are due to the system of corporate management established there and the peculiarities of the procedural law, which provide the parties with ample opportunities to obtain evidence from each other, but are not adapted to the Russian legal and practical environment.

Moreover, in the private law doctrine, the topic of duties and responsibilities of corporate directors has not been considered substantively. Most studies focus on individual practical aspects of this concept, without attempting to identify the principles and patterns that underlie the same and would allow for adjustment of its regulation and law enforcement practice.

This resulted in a large number of dismissed lawsuits for recovery of damages from corporate directors and low chances for plaintiffs to prove their case in court. According to the calculations made by the author of this thesis research, until 2011, there were approximately twice as many dismissed lawsuits for holding corporate directors liable as sustained ones. The situation began to change in 2013 under the influence of the practice of the Russian Supreme Arbitrazh Court that began to

introduce elements of the continental tradition into regulation of corporate directors' duties and responsibilities in Russia. This allowed aligning the information asymmetry between a plaintiff representing a legal entity in a case over recovery of damages from corporate directors and a defendant – a relevant member of a management body – and developing the criteria for lawful and unlawful behavior of corporate directors. As a result, court practices have straightened out, and the number of successful lawsuits against corporate directors has increased significantly.

In this regard, given the different trends in regulation of duties and responsibilities of members of management bodies in Russia and in the relevant law enforcement practice, it is advisable to analyze specific features of regulation of corporate directors' duties and responsibilities developed in foreign jurisdictions that have influenced the Russian legislation and practice. In this paper, one jurisdiction pertaining to the continental system of law, Germany, and two Anglo-American law systems, the UK and Delaware (United States), were chosen as jurisdictions for comparative law research. The choice of the above jurisdictions for analysis was determined by the following:

- (1) German law is a member of the same legal system as the Russian law, has similar concepts and institutions, and traditionally has a significant influence on the Russian law, including the corporate law;
- (2) the concept of duties assigned to members of management bodies in legal entities was developed in the UK earlier than in other countries, and was then borrowed by other Anglo-American law jurisdictions. In addition, the United Kingdom is one of the few jurisdictions where the content of duties assigned to corporate directors is regulated at the statutory level;
- (3) Delaware stands out for having the most stable and developed judicial practice with reference to corporate disputes in the United States, and it is also a state where the business judgment rule – a key presumption in cases involving the recovery of damages from corporate directors – and conditions for its application have been formulated. Although both the

UK and Delaware relate to the Anglo-American law system, their approaches to duties and responsibilities of corporate directors differ significantly.

Comparison of the above jurisdictions and Russia will make it possible to determine what is the common ground and what is the difference in regulation of the issue under consideration both between the continental law and the Anglo-American law in general, and between these particular jurisdictions, as well as to identify the characteristics essential for duties of corporate directors. These particular characteristics determine a set of facts to be established in a case for holding corporate directors liable, and rules for apportionment of the burdens among a plaintiff and a defendant in this category of cases.

Results of this analysis allow formation of an optimal model that should be followed by the Russian regulation of rights and obligations assigned to members of management bodies in legal entities, and allow determination of the extent, to which it is possible to borrow and apply for own purposes any rules developed in other legal systems. This is where, in the author's opinion, the relevance and significance of this research lie.

This research addresses only issues related to the general duties of corporate directors. Issues related to special duties imposed on them by law and duties ensuing from bankruptcy of a legal entity remained outside the scope of this thesis research.

Level of development of the scientific topic. The first references to the topic of duties and responsibilities of directors in the Russian scientific literature date back to the end of the 19th century. In particular, such issues are dealt with in P. Pisemsky's paper *"Joint-Stock Companies from the Civil Law Perspective"* and in the Draft Civil Code of the Russian Empire. The Russian legal doctrine of that time followed the German model. During the Soviet period, no private law studies of duties and responsibilities assigned to members of management bodies in legal entities were conducted due to abolition of private companies as a form of business. However, the general aspects of civil liability and recovery of damages were actively

studied in the Soviet doctrine, in particular, in the writings by S.N. Bratus, G.K. Matveev, S.S. Alekseev, O.S. Ioffe.

Interest in the issue of duties and responsibilities of corporate directors re-appeared in the 90s. Since that time up to now, a large number of papers on this topic have been published, mostly of a practical nature, such as articles by E. Sauber, Yu.D. Zhukova, V. Yugay. It is also possible to lay the emphasis on publications where the issues of duties and responsibilities assigned to members of management bodies are considered from deeper scientific positions in the context of civil liability conditions and general civil law provisions regarding obligations, i.e., articles by A.A. Makovskaya, A.A. Kuznetsov, F.O. Bogatyrev. It is worth noting the latest researches on the topic of the corporate directors' duties and responsibilities, in particular, the analysis of arbitrazh court practice in cases for holding corporate directors of a legal entity liable for losses caused to it, made by Y.S. Mikhalechuk and D.I. Stepanov. General issues associated with the legal liability, civil liability conditions as well as general theory of legal entities and theory of law, directly connected with the topic under consideration, continue to be studied, for example, in publications by A.V. Egorov, V.V. Baybak, O.N. Sadikov, R.V. Shagieva, T.V. Zakupen, V.V. Zaytsev.

In foreign literature, the problems of corporate directors' duties and responsibilities have been studied in a wide range of sources, some of which, for example, the "Law of Joint-Stock Companies" publication by K. Lehmann, go back to the late 19th – early 20th century. The topic has been addressed both in fundamental works such as the Munich Commentary on the Joint-Stock Companies Act, the Commentary on the German Law on Limited Liability Companies edited by A. Baumbach, "*The Business Judgment Rule*" by S.A. Radin, "*Company Directors*" edited by S. Mortimore, "*Gower and Davies' Principles of Modern Company Law*" by P. Davies and S. Worthington, and in publications of a more applied nature, such as the *Handbook on Manager Liability* edited by Dr. Krieger and Dr. Schneider, special publications on manager liability in Germany, UK corporate law textbooks. In addition, this topic has been covered in the periodical

press, in particular, in articles by M. Eisenberg, H. Horsey, D. Carrad, J. Kessler and A. Herzberg, H. Sale and others. It should be noted that writings devoted to duties and responsibilities of corporate directors in Germany cover these issues in combination with facts and circumstances to be proven in cases for bringing such persons to liability (existence of losses, a causal link between a breach of duty and losses, the guilt), and apportionment of the burdens of proof. Meanwhile, in the United Kingdom and the United States, more attention is paid to the content of the corporate directors' duties and the standards applicable to them. Issues related to essential elements of a civil law violation are dealt with in the general literature on the tort law.

The goal and the tasks of the thesis research. The goal of the thesis research is to identify essential characteristics of corporate directors' duties and specific features of civil liability of corporate directors that follow from the said essential characteristics, based on a comparison of the legal regulation in different jurisdictions. Its achievement was facilitated through handling the following **tasks**:

- (1) to identify essential elements and key features of corporate directors' duties in the jurisdictions under research, determining their content;
- (2) to consider the regulation of the corporate directors' duties in the jurisdictions under research and comparison of the resulting models with each other to identify their common ground and difference;
- (3) to identify the essential characteristics of each of the duties of the corporate directors, to establish their content, and to determine how their fulfillment or breach can be established;
- (4) to determine conditions for holding corporate members liable for breaches of their duties and specific features of proving them;
- (5) to determine factors underlying apportionment of the burdens of proof between a plaintiff and a defendant in a lawsuit to hold a member of a management body liable for breach of his or her duties;

- (6) to determine the key presumptions to be applied in a lawsuit to hold a member of a management body liable for breach of his or her duties, and specifics of their enforcement.

The object and the subject of the thesis research. The object of the thesis research includes public relations that develop between a legal entity and members of its management bodies in the process of exercising their functions, and public relations that arise as a result of a breach by corporate directors of duties imposed on them in relation to their legal entity. The subject of the thesis research consists of current regulations, judicial decisions, concepts and interpretations put forward in the legal literature related to duties and responsibilities of corporate directors.

The theoretical and methodological basis of the thesis research. The methodological basis of the thesis research includes general and specific scientific methods. The comparative legal method was the main one as it allows identifying common patterns in the object of research by highlighting the common ground and difference in legal regulation of different legal orders. Use is also made of the historical method as it helps to trace the historical development of the legal institution and to determine whether the historical existing approaches to legal regulation are currently topical to the realities of the modern economy. The systematic method allows offering a consistent legal regulation model embedded into the system of modern civil law. The methods of grammatical, logical, systematic and teleological interpretation are applied to analyze regulations and judicial practice.

The theoretical basis of the research includes theoretical approaches expressed in writings of such Russian and foreign jurists as M. Eisenberg, S.S. Alekseev, A. Baumbach, M. Borman, M. Bruce, S.L. Budylin, V.V. Vitryansky, A.V. Gabov, V. Goette, P. Davies, A.V. Egorov, A.I. Kaminka, A. Keay, G. Krieger, A.A. Kuznetsov, K. Lehman, A.A. Makovskaya, S. Mortimore, P. Pisemsky, S. Radin, L.S. Sealy, D.I. Stepanov, E.A. Sukhanov, L. Talbot, S. Worthington, H. Fleischer, B. Hannigan, K. Hopt, G.F. Shershenevich, U. Schneider. Writings by the above-mentioned scientists reflect both the specifics of the topic under consideration

and the general issues of the theory of legal entities and civil liability, which are important for its consideration in full. **The informational basis** of the research, taking into account its subject, was comprised by the following:

- (1) the Russian laws, including the Civil Code of the Russian Federation – Part One (Federal Law No. 51-FZ dated November 30, 1994) and Part Two (Federal Law No. 14-FZ dated January 26, 1996); Federal Law No. 208-FZ on Joint-Stock Companies dated December 26, 1995; Federal Law No. 14-FZ on Limited Liability Companies dated February 8, 1998;
- (2) the laws of the foreign jurisdictions in question: the UK, Delaware (USA), Germany;
- (3) non-binding instruments adopted in the jurisdictions in question and establishing the corporate management standards.

The empirical basis of the research is the judicial practice of Russian and foreign judicial bodies, reflecting the specific application features of the law and acting as one of the sources of law when used in respect of the UK and the state of Delaware (USA).

Validity and reliability of the research results are confirmed by the performed analysis of the Russian and foreign regulations, judicial practice and doctrinal sources, by setting the goals, tasks and objectives of the research and by the chosen research methods.

Scientific novelty of the research is determined by the fact that a comprehensive analysis of the regulation of corporate directors' duties has been conducted on the basis of the extensive comparative legal and historical material that allowed identifying their essential characteristics, which, in turn, specify the features of determining the conditions of holding corporate directors liable for improper performance of their duties and the features of proving existence or absence of such conditions in a particular case.

The scientific novelty of the research is reflected in the following provisions submitted by the author of this research for defense.

1. The author concludes that the main task of the lawmakers in establishing the duties of corporate directors was to protect a legal entity against abuse on the part of such persons. From the perspective of this task, corporate directors are charged with the duty of loyalty (duty to act on behalf of a legal entity in good faith), according to which corporate directors must put the corporate interests over their own interests and avoid conflicts of interest, and the duty of care (duty to act reasonably), which imposes standards for professional doing business of a legal entity by corporate directors. The above duties may be enshrined in the statute either in general terms as in Russia, or as a set of separate duties specifying their content as in the UK, or as formed in judicial practice as in the state of Delaware. Germany has adopted a mixed approach where the duty of loyalty is formed in practice and the duty of care is enshrined in a general way at the statutory level.
2. The author proves that duties of corporate directors are distinct from duties of an attorney (agent) or trustee.
3. Duty of loyalty is proposed to be defined as a duty of a corporate director to act in all cases in the interests of the legal entity, but not in his / her own interests or any of a legal entities' participants. Based on the analysis of the legal regulation in all four jurisdictions, it is concluded that the duty of loyalty has the same content for corporate directors in all legal entities regardless of specific characteristics of the latter (scale of legal entity's activity, number of its employees, its organizational structure, its type of business, etc.). It performs two functions: it encourages corporate directors to take active actions to serve the legal entity's interests to the fullest extent, and it prevents commission of actions detrimental to those interests, *inter alia*, actions taken in situations of conflict of interest and misconduct. In accordance with these two functions, the content of the duty of loyalty includes: (1) the duty to promote a legal entity's interests, take all necessary and sufficient measures to achieve the purposes of its business; (2) the duty to avoid conflict of interests with a legal entity, including the prohibition to compete with a legal entity and to pursue business

opportunities that belong to the legal entity, and the duty to disclose a potential or existing conflict of interests with a legal entity; and (3) the duty to act lawfully within the framework of his / her competence, including to ensure that a legal entity complies with applicable legal requirements. Fulfillment of the duty of loyalty is established by comparing actions taken by a member of a management body with the standard of good behavior described in the proposition of law (this method is denoted by the author as a regulatory standard) and, in some cases, by analyzing actions of a particular director and his or her motives (this method is denoted by the author as a subjective method). The use of the subjective method is more common for the United Kingdom and Delaware than for Germany and Russia that are more prone to the regulatory standard.

4. The duty of care is proposed to be defined as the duty of a corporate director to manage a legal entity and carry on its business in the best possible way. It is concluded that the content of the duty of care is determined on the basis of specific characteristics of a legal entity and its activities. The content of the duty of care includes the duty to act reasonable while taking business decisions on behalf of a legal entity and the duty to duly arrange the management of the legal entity. The duty of care may cover both substantive aspects and aspects related to the decision-making procedure or organization of the management system. At the present stage of legal regulation development, the emphasis is made on compliance with the proper decision-making procedure and organization of the management system, but not on assessing the economic feasibility of actions taken by members of management bodies or the need for continuous monitoring of actions done by employees of a legal entity. The predominant method of verifying compliance with the duty of care is to compare actions taken by a member of a management body with the behavior of an abstract good manager in similar circumstances (this method is denoted by the author as an objective standard). The objective standard is most widely spread in Germany, it is used in Russia and the UK, but to a much lesser extent

it is accepted in Delaware, where the subjective method is applied more commonly.

5. The author substantiates that the peculiarities of apportionment of the burdens of proof between a plaintiff – a legal entity or a representative acting on its behalf – and a defendant – a member of its management body – depend, among other things, on whether the plaintiff has a procedural opportunity to obtain information from the defendant. If procedural legislation provides for the duties of the parties to disclose all relevant documents and information to the other party, and as a result the plaintiff can access the information held by the defendant, the burden of proof is entirely imposed on the plaintiff, and presumptions in favor the defendant are used. The key presumption in favor of the defendant is the presumption of good faith and/or reasonableness of actions of a corporate director. In accordance with this presumption the plaintiff shall prove that the defendant committed or failed to commit a certain action in breach of his / her duties. It is the main rule for distribution of burden of proof in this type of cases in Russia, Great Britain and Delaware. If the plaintiff's access to information in possession of the defendant is hurdled due to absence of mandatory disclosure of evidence and due to possibility to request provision of only certain preliminary known documents, the burden of proof shall be shifted to the defendant, or the plaintiff shall not be required to comprehensively prove the facts and circumstances to which it refers, and the presumptions in favor of the plaintiff shall be used. The key presumption in favor of the plaintiff is the presumption of bad faith and/or unreasonableness of actions of a corporate director. In accordance with it the plaintiff shall prove only that the member of management body committed or failed to commit certain action, and the plaintiff shall substantiate that he / she acted in good faith and / or reasonably. This presumption is used as the main rule for distribution of burden of proof in this category of actions in Germany and as a supplementary rule in Russia.

6. It is shown that the prerequisite for application of the business judgement rule used in all four jurisdictions regardless of initial distribution of burden of proof either in favor of the plaintiff or in favor of the defendant is the corporate directors' good faith and acting in the best interest of the legal entity. As a consequence it may only be applied in lawsuits for breaching the duty of care by a corporate director, but not the duty of loyalty.

The theoretical and practical relevance of the research. The **theoretical relevance of the research** lies in the fact that the factual material underlying this thesis and the conclusions set forth therein may be used in further research and teaching activities. The **practical relevance of the research** is underpinned by the fact that it may be useful to chief executives of legal entities to build an effective system of corporate management and to have a better understanding of their rights and obligations, and the limits of their exercise and performance. The results of this research may also be used in the process of reforming the civil law, in preparing explanations of laws and judicial practice, and in resolving judicial disputes.

Evaluation of the research results. The research was completed and discussed at the Department for Legal Support of Market Economy of the Higher School of Jurisprudence of the Institute of Public Administration and Civil Service at the Russian Presidential Academy of National Economy and Public Administration (RANEPA). The research results were used in lectures at the Faculty of Law at the Moscow School of Social and Economic Sciences, at advanced training workshops and in the author's report at the 'Liability in Corporate Law' Conference hosted by the Private Law Research Center under the President of the Russian Federation named after S.S. Alekseev on October 13, 2016.

Certain provisions of the research thesis were published in the author's articles in scientific printed press, including printed press recommended by the Higher Attestation Commission of the Ministry of Science and Higher Education of the Russian Federation for publishing the results of thesis researches, with total volume of 9.32 printed lists.

Structure of the thesis is specified by its goal and tasks. The thesis research consists of an introduction, two chapters falling into five paragraphs, a conclusion and a list of cited sources and references.

In the **introduction** the author provides the reasons for the relevance of the research topic, the level of its scientific development, sets forth its goal and tasks, determines its theoretical and methodological basis, informational and empirical basis, justifies its scientific novelty, formulates the provisions submitted for the defense, provides the information on validity and reliability of research results, evaluation of the research results, lists the author's publications.

In the **first chapter** "*The duties of the members of legal entities' management bodies*" the author provides a historical overview of the development of legal regulation of duties vested with the members of legal entities' management bodies in the considered jurisdictions, analyses doctrinal basis of the models that emerged in these jurisdictions, characterizes each of the distinguished duties – duty of loyalty and duty of care – and reflects on their elements.

In the **second chapter** "*Holding the members of legal entities' management bodies liable for the breach of their duties from civil law standpoint*" the author considers the conditions for the civil liability of the members of legal entities' management bodies for breach of their duties and specifics of distribution of burden of proof between the plaintiff and the defendant in respect of providing evidence of presence or absence of conditions for the liability of the member of a legal entity's management body.

In the **conclusion** the author provides the key takeaways on the research topic.

The list of the author's publications. The author's publications on certain issues considered in this research thesis:

Articles published in editions recommended by the Higher Attestation Commission of the Ministry of Science and Higher Education of the Russian Federation for publishing the results of thesis researches:


1. E.M. Klyuchareva. The Business Judgment Rule in Directors' Liability Cases: Law and Practice of Delaware (USA), Germany and the Russian Federation //

Zakon. 2015. No. 11. P. 132–141 (included in the list of journals recommended by the Academic Council of RANEPa for publication of articles on jurisprudence; included in the RSCI) (0.99 printed lists).

2. E.M. Klyuchareva. Dogmatic and Historical Justification of Company Directors' Duties and Liability in Different Jurisdictions // Bulletin of Economic Justice in the Russian Federation. 2017. No.10. P. 145–176 (included in the list of journals recommended by the Academic Council of RANEPa for publication of articles on jurisprudence; included in the RSCI) (3.7 printed lists).
3. E.M. Klyuchareva. Prohibition for a Director to Compete with a Company: Experience of the UK, Delaware (USA), Germany and Russia // Zakon. 2018. No. 6. P. 115–127 (included in the list of journals recommended by the Academic Council of RANEPa for publication of articles on jurisprudence; included in the RSCI) (1.28 printed lists).

Other Publications

4. E.M. Klyuchareva. The Company Considers the Director's Actions Unreasonable. When He Can Avoid Liability // Arbitration Practice. 2016. No. 12. [Electronic edition] (0.92 printed lists).
5. E.M. Klyuchareva. Liability for Losses Caused to a Company by Unfair and Unreasonable Actions of Members of Its Management Bodies: Specific Features of Parties in Non-Public Companies // Corporate Law in Expectation of Changes: Collection of Articles to the 20th Anniversary of the Law on LLC. / Editor-in-Chief A.A. Kuznetsov. Moscow, 2020. P. 179–198 (1.15 printed lists).
6. E.M. Klyuchareva. Peculiarities of Apportionment of the Burdens of Proof in Cases for Holding Members of Management Bodies in a Legal Entity Liable for Losses Caused to It: Russia, Germany, the UK, Delaware (USA) // Corporate Law: Problems and Solutions: Collection of Works / Co-editor and Editor-in-Chief I.S. Chuprunov. Moscow, 2020. P. 292–314 (1.32 printed lists).


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