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Corporate illegal conduct and directors’ liability: An approach to personal accountability for violations of corporate legal compliance

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ABSTRACT
Corporations increasingly face penalties and other sanctions for legal compliance violations. Accordingly, there is a growing tendency to seek redress against directors and officers to compensate for the resulting losses. This phenomenon is dealt with differently by the various legal systems. Whereas some corporate laws seem to openly embrace a high level of personal liability to compensate for losses due to non-compliance, other jurisdictions express clear misgivings about such forms of redress. This article examines the paradigms of executive liability for corporate non-compliance under common law and civil law. It lays out the foundations of executive liability for corporate compliance violations and develops a notion of directors’ duties for compliance management systems and the monitoring process. In order to avoid excessive liability, it examines to what extent well-established instruments of corporate law can be employed as defences, in particular, the business judgement rule and the liberating effects of delegation.

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1. Introduction
Illegal corporate conduct – for example, corruptive practices, breaches of anti-trust law, environmental law, operational and health regulations, embargos or anti-money laundering provisions by companies – can be referred to as corporate compliance violations (or simply ‘non-compliance’). Changes in regulatory approaches, two decades of significant corporate failures and the great financial crisis beginning in 2007 have led to an increasingly detailed legal environment for companies. New forms of regulation and behavioural frameworks to govern corporate conduct have emerged. They have become the subject of intense analysis in legal theory and practice.¹ At the


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same time, this new and often complex regulation is rigorously enforced in a formerly unseen manner.\(^2\) Accordingly, compliance management systems (CMS), which detail systematic efforts to prevent corporate misconduct, have become a common topic of debate. Despite record fines and growing concern in boardrooms, it seems noteworthy that only a fairly small number of directors, barring those directly and actively involved in the wrongful conduct themselves, have faced personal liability for losses sustained by the company.\(^3\) In most cases penalties are assessed against the corporation exclusively.\(^4\) They are borne by shareholders and – in practice – by employees who typically face job- and cost-cutting as a result of sanctions and other losses\(^5\) incurred by legal compliance violations.\(^6\) This article argues that the current system of highly complex regulatory schemes and public enforcement against corporations should be reconsidered or at least amended by introducing a complementary scheme of high-level personal liability under company law. It employs the term ‘director’ to refer to board members. Under common law, corporate monitoring and the consequences of default have mainly been developed under the heading of Caremark duties.\(^7\) This doctrine has faced criticism for the low standard of personal liability. Consequently, it is often blamed for encouraging uninformed and aggressive risk-taking and for

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\(^2\)This risk is expanded by the sanction being more often linked to annual turnover than to a fixed frame, see, for example, Regulation (EU) 679/2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data (General Data Protection Regulation) [2016] OJ L119/1, art 83 (4% of the world annual turnover of the preceding financial year).

\(^3\)Brandon J Garrett, *Too Big to Jail: How Prosecutors Compromise with Corporations* (Harvard University Press 2014) for the role of senior management in settlement agreements.

\(^4\)On the underlying economic assumptions which make sanctions against companies preferable to sanctions against individuals, see Jennifer Arlen in Alon Harel and Keith N Hylton (eds), *Research Handbook on the Economics of Criminal Law* (Edward Elgar Publishing 2012) 144; the prosecution and liquidation of Arthur Anderson LLP in the aftermath of the Enron collapse resulted in the loss of 28,000 jobs and market disruption in the accounting industry.

\(^5\)These losses mainly exist in private liability claims and most strongly felt in legal systems where class actions are a common occurrence. The losses of Volkswagen in the US, for example, amounted to over US$14 billion paid to private consumers, whereas the fines imposed on the company were only around US$4 billion, see David Shepardson and Andreas Cremer, ‘Volkswagen confirms $4.3 billion U.S. settlement over diesel emissions’ *Reuters* (11 January 2017). Other expenses mostly consist of legal fees for internal investigations and litigation costs.


\(^7\)Re Caremark International Inc Derivative Litigation, 698 A.2d 959 (Del Ch 1996).
absolving boards who overlook legal breaches by company employees.\textsuperscript{8} This stands in obvious contrast to properly defined standards of corporate integrity and undermines attempts to change corporate conduct and culture.

The question of whether directors must prevent harm to the corporation by exercising corporate oversight (through corporate compliance programmes) – and, if so, to what extent a failure to do so implies personal liability – has been described as one of the most difficult in corporate law.\textsuperscript{9} Since the grounds on which board members can be held accountable for corporate compliance violations has been examined by courts of various jurisdictions, the article first provides a comparative overview and an analysis of existing approaches. In the following section, the traditional reservations against directors’ liability arising from illegal corporate conduct, clearly expressed by the Caremark doctrine, are analysed. The third section covers the parameters of personal liability and discusses existing limitations. It pursues the principle aim of the article, which is to strike a balance between barring companies from redress completely and imposing excessive liability on executives. The term ‘excessive liability’ takes into account the fact that liability can result in disproportionate controls, the false allocation of resources and a focus on risk avoidance and self-preservation, rather than pursuit of corporate opportunities. Given the prevalent international nature of legal compliance violations, the transnational context of liability must also be taken into account. In order to avoid the disruptive effects of regulatory arbitrage, the article also sets out some principles of corporate law that might provide guidance for future discussion.

2. Current trends in selected jurisdictions

The most comprehensive and longstanding position with regard to monitoring directors’ duties comes from the United States Delaware courts. It is also important, however, to understand the emerging concepts in other key common law jurisdictions. The following section will explain and compare the different approaches that have been developed. These developments will then be contrasted with the concept of directors’ duties under German law.

2.1. United States: reservations against directors’ liability for failures of oversight under the Caremark doctrine

In the United States, the liability standard with regard to directors’ duties on corporate legal compliance was, and essentially still is, set out by three leading
Delaware cases.\textsuperscript{10} In Graham v Allis-Chalmers Manufacturing Co (1963), the Supreme Court recognised a board’s duty to monitor in order to prevent anti-trust violations by the company’s employees.\textsuperscript{11} This was seen as part of the duty of care resulting from the board’s control over the company. Acknowledging the duty to monitor as such, the court pointed out that only illegality could prompt executive liability. Acts of mere (bad) business decisions of subordinates would not provide sufficient grounds for liability. Furthermore, the court held that monitoring was passive in nature, thus requiring no specific action.\textsuperscript{12} Discharge could depend on the honesty and integrity of the corporation’s employees.\textsuperscript{13} The latter element of the duty of oversight was reconceived in the second landmark case, the iconic In re Caremark International, Inc. Derivative Litigation.\textsuperscript{14} Caremark, a healthcare service company, had incurred fines and reimbursements of roughly US$250 million for kickback payments and other inducements paid to medical doctors.\textsuperscript{15} Reversing the notion of a mere passive obligation, the Chancery Court of Delaware held that the duty of oversight included a duty ‘to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists’. Accordingly it stated that the ‘failure to do so under some circumstances may, in theory at least, render a director liable for losses caused by non-compliance with applicable legal standards’.\textsuperscript{16} However, as the court made clear, liability would not arise from the insufficiency of the system or the wrongdoing itself but only from a sustained, systematic or ‘utter failure’ to provide adequate oversight.\textsuperscript{17} In examining a breach of the duty to monitor, a court would need to consider the design of the system and the board’s role in reviewing it.\textsuperscript{18} In spite of the – seemingly low – standard, the ‘utter failure’ test requires, as the court felt the need to point out, that ‘the role of the board in preventing corporate misconduct had become increasingly significant’.\textsuperscript{19} It also held that a reporting system was essential to the board’s supervisory role under Section 141 of the Delaware General Corporation Law (DGCL).\textsuperscript{20} With respect to CMS, the court expressed its expectation that their design should reflect the benefits granted to corporations under the Federal Sentencing Guidelines and be

\textsuperscript{10}The following overview emphasises Delaware’s legal standard as the U.S. state with the majority of U.S. public companies (see Jack B Jacobs, ‘Fifty Years of Corporate Law Evolution: A Delaware Judge’s Retrospective’ (2015) 5 Harvard Business Law Review 141, 168; also Pan (n 9) 718).

\textsuperscript{11}Graham v Allis-Chalmers Manufacturing Co, 188 A.2d 125 (Del 1963).

\textsuperscript{12}Pan (n 9) 721–22.

\textsuperscript{13}Graham v Allis-Chalmers Manufacturing Co (n 11) 130.

\textsuperscript{14}In re Caremark International Inc Derivative Litigation, 698 A.2d 959 (Del Ch 1996).

\textsuperscript{15}For example, research grants and consultation agreements with medical personnel who prescribed or recommended Caremark’s products and services were made. ibid 964–65.

\textsuperscript{16}Ibid 970.

\textsuperscript{17}Humbach (n 6) 452 on the ‘utter failure’ standard.

\textsuperscript{18}Re Caremark International Inc Derivative Litigation (n 14) 970.

\textsuperscript{19}Ibid 970.

\textsuperscript{20}Ibid.
modelled accordingly. Since the defendant, Caremark International, Inc., had established training programmes and a business ethics manual communicated to its employees, and auditors had not found any material weakness in the system before corruptive practices became known, the court concluded that the board had fulfilled the good-faith requirement.

A third phase of discussion was initiated by the case of *Stone v Ritter* (2006), in which the Supreme Court of Delaware felt the need to establish more restrictive guidelines regarding the duty to monitor. Shareholders claimed indemnification for damages that AmSouth, a bank, had incurred due to US$50 million worth of fines and penalties imposed on the defendant directors for not having prevented a Ponzi scheme run by two employees. The court declared that the oversight obligations of the executive board were part of the duty of loyalty rather than the duty of care. No violation, therefore, was to be assumed if this duty had been discharged in good faith. Imposition of liability under a ‘sciente’ provision would require that the defendants act with actual or constructive knowledge that corporate conduct was legally improper. *Stone* further affirmed that personal liability could only arise either from the ‘utter failure’ to implement a CMS as such or – having done so – for ‘consciously failing to monitor or oversee its operations’. The – prima facie surprising – designation of the board’s duty to monitor as falling under the duty of loyalty needs to be interpreted with regard to two aspects of previous Caremark litigation under Delaware law. First, the courts had difficulties defining the criteria for good faith (or, conversely, the scienter requirement) in this specific context. This led to the controversial impression that the scale ranged from an intention to do harm, on one hand, to negligence, on the other. The second reason for subsuming the oversight obligation under the duty of loyalty was to preclude the defence available under Section 102(b)(7)(ii) of DGCL.

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22 ibid 971–72.
24 ibid 368.
25 *Pan* (n 9) 733, with reference to the ensuing case of *Wood v Baum*, 953 A.2d 136, 141 (Del 2008).
26 *Re Stone v Ritter* (n 23) 370.
27 *In re Walt Disney Co Derivative Litig*, 731 A.2d 342 (Del Ch 1998); *In re Walt Disney Co Derivative Litig*, 825 A.2d 275 (Del Ch 2003); *In re Walt Disney Co Derivative Litig*, 907 A.2d 693 (Del Ch 2005); *Brehm v Eisner*, 906 A.2d 27 (Del 2006).
28 *Brehm v Eisner*, 906 A.2d 66 (Del 2006).
29 Delaware General Corporation Law, s 102(b)(7) (DGCL) states:

A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) For any breach of the director’s duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law [...].
monitor a fiduciary duty, the court intended to end doctrinal confusion about the meaning of the duty of good faith and loyalty.30

Unsurprisingly, litigation following Stone mostly led to dismissal of the liability suits on the grounds of a failure to demonstrate that the defendant board members had acted with scienter.31 Apart from a further clarification that a fiduciary of a Delaware corporation cannot be loyal (to the corporation) by knowingly causing it to pursue profit by violating the law,32 no significant reconsideration of the board’s oversight duties by the Delaware courts have been observed since Stone. Cases where liability was affirmed, like ATR-Kim Eng Financial Corp. v Araneta33 and AIG v Greenberg,34 did not require a redefinition of the scienter requirement. They were strongly influenced by the defendants having failed to carry out the most basic and essential responsibilities (in the Araneta case) or by the magnitude and consistency of fraudulent conduct by the corporation (in the Greenberg case), rendering the ‘utter failure’ evident. Further cases have expressed even greater doubt about the duty to monitor and its interference with the principle of business judgement. Most emblematic is Re Citigroup, Inc. Shareholder Derivative Litigation,35 where the court held (again) that a duty to monitor must not be extended to business risks. Doing so would undermine the purpose of the business judgement rule.

With the revised Caremark doctrine seemingly affirmed, it seems important to mention the diverging approaches taken by other U.S. courts, mostly in the context of motions to dismiss based on demand futility.36 This rule requires that the claimant of a derivative suit demonstrate that the corporation has not complied with the claimant’s efforts to bring an action against the directors.37 Typically this implies that the company’s litigation committee has acted improperly. Other than under the substantive liability issue, the procedural rule requires only that the claimant prove the possibility of bad faith.38 The recent cases of Barovic v Balmer and Westmoreland v Parkinson are two examples of cases where personal liability for illegal corporate conduct had become substantial.39 Looking at the underlying facts, the common feature

30Pan (n 9) 733.
31Desimone v Barrow, 924 A.2d 908 (Del Ch 2007); Wood v Baum, 953 A.2d 136 (2008).
32In re Massey Energy Co CA No. 5430-VCS, 2011 WL 2176479 (Del Ch 2011).
33No. CIV.A 489-N, 2006 WL 3783520 (Del Ch 2006).
34965 A.2d 763 (Del Ch 2009); with regard to the magnitude of wrongdoing and personal involvement of board members, see also Westmoreland v Parkinson, 727 F.3d 719, 724 (7th Cir 2013).
35964 A.2d 106 (Del Ch 2009).
36Westmoreland v Parkinson, 727 F.3d 719 (7th Cir 2013); Barovic v Balmer, Case No. C14-0540-JCC (District Court Western District 2014); Rosenbloom v Pyott, 765 F.3d 1137 (9th Cir 2014); Jeffrey M Cross and Dylan Smith (2015) 30 Westlaw Journal Corporate Officers & Directors Liability 1.
37Federal Rule of Civil Procedure 23.1 requires that a plaintiff bringing a shareholder derivative action clearly detail ‘any effort[s] by the plaintiff to obtain the desired action from the directors or comparable authority [or] the reasons for … not making the effort’.
38Westmoreland v Parkinson, 727 F.3d 719 (7th Cir 2013).
39Pan (n 9) 736, also with reference to AIG v Greenberg (n 34).
in these cases was not merely a compliance violation of medium- or lower-tier management, but a failure to act in accordance with the law of the board of directors itself. Barovic built on the fact that the board of Microsoft Inc., in spite of having agreed under a formal settlement arrangement with the EU Commission to avoid European anti-trust law violations by including a browser choice in all Windows updates, constantly failed to implement the necessary technical adaptations. It also failed to comply with the EU Commission’s warning letters, resulting in a US$732 million fine against the company. Denying the motion to dismiss, the Court of the Western District gave particular emphasis to the fact that Microsoft had been self-monitoring the settlement agreement with the EU and that the board had greeted this with constant inactivity. In Westmoreland, the board of Baxter Pharmaceutical Inc. had refused a product recall of a potentially life-threatening medical device, hoping to be able to promptly offer a more technically-sound replacement. This was in violation of a decree of consent with the Federal Drug Administration (FDA), under which Baxter had agreed to withdraw the faulty instrument. Again, the board of directors had ignored several calls from the FDA.

Both cases differ significantly from the mere passive involvement of directors in the illegal conduct of company employees in the Caremark cases. They do not refer to mere oversight failures but to legal breaches within the context of genuine decisions by the board itself. What they share, however, is the failure of the board members to implement legal action. They can be distinguished by the fact that the corporate integrity agreement required more specific action from the board itself (allowing browser choice, putting an end to the marketing of a faulty medical device), whereas CMS – once established – are open to delegation, general in nature and need be monitored only passively. This suggests that personal liability for losses needs to be placed in the specific context of the legal compliance violation. In other words, the more precise the regulatory expectations, the more likely it is that management can be held accountable for their disregard. It may, however, also require exemptions, as becomes apparent with regard to the English case law discussed in the following section.

2.2. United Kingdom: director liability and the ex turpi causa maxim

2.2.1. Safeway v Twigger

In England, the most prominent – sometimes referred to as ‘odd’ – example of litigation against directors to recover damages for illegal corporate conduct is Re Safeway Stores v Twigger, heard by the Court of Appeal for England and Wales in 2011. Breaches of the Competition Act 1998 had led to anti-trust

sanctions against Safeway. The resulting losses gave rise to an indemnification claim by the company against its directors. In handling the case, the Court of Appeal neither questioned the duty to monitor legal compliance as such, nor did it refer to the relevant standards of care. Instead it relied on the affirmation that such claims are barred for illegality under the *ex turpi causa* principle. With the company itself involved in the criminal act of violating the Competition Act, it could not be allowed to seek redress against its own directors. The court emphasised that:

In the present case the claimants faced personal liability. Their liability did not depend upon proof that the defendants were their directing mind or will, but it had been sufficient for the OFT to show that the companies intentionally or negligently infringed the provisions of the 1998 Act. It was more in accordance with principle to say that if the liability of the company was personal (rather than merely vicarious) then there was no impediment to the application of the maxim *ex turpi causa*.

It may be useful to place *Safeway* in the context of other cases decided by the House of Lords, particularly *Re Stone & Rolls Ltd v Moore Stephens*, where the majority of the House held that the *ex turpi causa* rule would prohibit recovery only where the wrongdoing was personal and not vicarious. The difference between the two cases was that *Stone & Rolls* was a single member company – making the wrongdoing of its sole shareholder director more attributable to the company – whereas *Safeway*, a listed company, could not be attributed any ‘personal’ behaviour other than that of its management executives (including organs or middle management) and shareholders. It may also be appropriate to contrast *Safeway* with the more recent case of *Re Jetivia SA and another v Bilta*. Here the Supreme Court of the United Kingdom debarred the claimant company from the *ex turpi causa* maxim because it had itself become the subject of the defendant directors’ fraudulent conduct. The Supreme Court found that, while it did not wish to overrule *Safeway*, it was necessary to apply the *ex turpi causa* principle on a case-by-case basis.

It goes without saying that allowing the claimant company to pass on losses incurred by sanctions through legal redress against its directors also

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41According to the court, the principle *ex turpi causa non oritur actio*, in its narrower form, means that a claimant cannot recover for damage which is the consequence of a sentence imposed upon him or her for a criminal act; in its wider version, it means that a claimant may not recover for damage which is the consequence of his or her own criminal act or quasi-criminal act of entering into an illegal agreement.
42Ibid 3, 23, 26, 37, 43.
45Ibid 21ff. The *Jetivia* case also raises questions with respect to *In re Stone & Rolls Ltd v Moore Stephens* [2009] UKHL 39, as the falsifying of balance statements by the director and only shareholder was attributed to the company resulting in the application of the *ex turpi causa* defence. It is questionable whether the rule of attribution in a single-member company like Stone & Rolls Ltd supports the distinction made here.
alters, at least in part, the effect of such sanctions. Accordingly, these types of claims raise general concerns about who must bear the burden of sanctions.\textsuperscript{46} It is likely that the Court of Appeal in \textit{Safeway} felt reluctant to impose the risk associated with violations on the company’s directors for this reason. Furthermore – though \textit{Safeway} does not say so explicitly – it may be that the position of the Court of Appeal was related to the nature of the claim, namely an anti-trust violation. Commentaries have remarked that liability claims here need careful consideration, as they may affect the efficiency of leniency programmes granted by competition authorities.\textsuperscript{47} Leniency is often viewed as the most essential instrument of public anti-trust law enforcement and is, therefore, generally protected against any conflicting legal approach.\textsuperscript{48} This may be because the potential threat of liability dissuades managers from blowing the whistle at all. With this in mind, \textit{Safeway} may not be a definitive rejection of directors’ liability for illegal corporate conduct and oversight failures under English company law but may have more to do with the particular nature of the wrongdoing at issue.\textsuperscript{49} This may also suggest that \textit{ex turpi causa} and attendant questions of attribution are not the appropriate basis on which to decide whether or not to award redress against the company directors.\textsuperscript{50}

\subsection*{2.2.2. Lessons from \textit{In Re Barings plc}}

Whereas indemnification litigation against directors in the UK is said to be a rare event,\textsuperscript{51} oversight duties have been more prominent in removal proceedings under the Directors Disqualification Act 1986 (now 2013).\textsuperscript{52} The landmark case for the disqualification of directors of listed UK companies for oversight failure continues to be \textit{Re Barings plc (No. 5)},\textsuperscript{53} following the insolvency of the bank due to excessive risk-taking by one of its traders. Given the violation of several internal and external regulations, the court’s findings may be seen as the relevant standard for directors’ duties of oversight. All the same, it is unclear to what extent a standard set out in a disqualification procedure in insolvency may be transposed to the context of an indemnification claim.

\textsuperscript{46}On the parallel in German jurisprudence, see below Section 2.6.

\textsuperscript{47}The effect of leniency granted with respect to public enforcement can be later thwarted by private litigation. See Anna Morfey and Conell Patton, ‘\textit{Safeway Stores v Twigger: The Bug Stops Here}’ (2011) Company Law 57.


\textsuperscript{49}This also seems appropriate with respect to \textit{Equitable Life Assurance Society v Bowley} [2003] BCC 829, as in this case even the liability of non-executive directors for failure of oversight was affirmed. See also Simon Deakin ‘\textit{What Directors Do (and Fail to Do): Some Comparative Notes on Board Structure and Corporate Governance}’ (2010/11) 55 New York Law School Law Review 525, 536.

\textsuperscript{50}See below Section 5.1 for the relevant basis of liability claims.

\textsuperscript{51}Deakin (n 49) 533 describing \textit{Safeway v Twigger} as a ‘clearly exceptional’ case; Gower, Davies and Worthington (eds), \textit{Principles of Modern Company Law} (10th edn Sweet & Maxwell 2016) 466.


\textsuperscript{53}[2000] 1 BCLC 523 (U.K.).
by a going concern. Furthermore, most of the then-relevant standards of oversight and control had already been set out by prudential regulation. Once again, it seems that the more detailed the regulatory framework, the greater the likelihood that the legal consequences of infringements by the board will be personal. Still, what is of specific relevance to the banking industry may not be equated with the standard of directors’ fiduciary duties under company law as such.

2.3. Singapore

The controversy between common law systems over directors’ duties of oversight can be illustrated by contrasting Safeway with Re Ho Kang Peng v Scintronix Corp, which was decided by the Singapore Court of Appeal in 2014. The company claimed damages against its former CEO (Ho) for a sham consultancy agreement, which was effectively an agreement to pay bribes in order to secure certain businesses for the company’s operations in China. The court found that the defendant, by authorising the respective payments, had been in breach of section 157 of Singapore’s Companies Act, which sets out the duty of care of a director to act honestly and use reasonable diligence in the discharge of his or her duties. In his reasoning, the defendant relied on Stone & Rolls v Moore Stephens arguing liability was vicarious and the claim barred by illegality. The Court distinguished Stone & Rolls, maintaining that ex turpi causa had no application where the company was publicly listed and not a one-man company (with a sole shareholder-cum-director like in Stone & Rolls). According to the court, the wrongdoing in this case was only vicarious and not personal to the claimant. Subsequently, the court refused to attribute the wrongdoing of the complicit directors to the company.

The position taken by the Singapore Court of Appeal is in noticeable contrast to Safeway v Twigger, since both claimants were listed companies with a director acting on their behalf. If the cases can be distinguished, it is only with regard to the specific form of illegal conduct: bribery involves such moral turpitude that the courts are reluctant to allow a corrupt director to raise the defence of ex turpi causa, even if he or she authorised the bribery ostensibly for the benefit of the company. Furthermore, the judgement seems to suggest that the relevant criminal offence was bribery under Chinese law.

54 See below for the practical implications of oversight duties at Section 3.2.1.
55 Another case which provides clarification here was the collapse of Equitable Life Assurance Society that followed the company being held to pay higher bonuses to life insurance holders. Equitable Life Assurance Society v Heyman [2000] UKHL 39, [2002] 1 AC 408 (see Deakin (n 49) 535).
57 Companies Act (Cap 50, 2006 rev edn).
Presuming Singaporean criminal law were applicable\textsuperscript{59} and the claim had been addressing fines imposed by the domestic authority (and not recovery of the bribe money itself), it seems likely that the Singapore court would have seen the claimant’s position differently.

\section*{2.4. Australia}

Whereas derivative litigation or liability suits by companies against directors in Australia may be rarer even than in the UK, a claim brought by the Australian Securities and Investments Commission (ASIC) has received broad attention for setting standards for directors’ duties of oversight. In \textit{ASIC v Healey},\textsuperscript{60} the claimant sought a declaration by the Federal Court of Australia that the entire group of board members of Centro Properties Group, including seven non-executive directors, had breached their statutory duty of care and diligence. Approving the consolidated financial accounts for the group, the board failed to notice a significant error in the financial statements.\textsuperscript{61} This took place after the financial audit committee of the company and its auditor (PwC) had reviewed the financial statements and had likewise failed to identify the errors. ASIC held the false financial statement to be a contravention of the relevant provisions under the Australian Corporations Act (2001).\textsuperscript{62}

The case received attention for the court’s findings regarding (1) the general standard of care and (2) the denial of the reliance defence. The court held that even though a board should be established by persons of various backgrounds, expertise and wisdom, ‘a director, whatever his or her background, has a duty greater than that of simply representing a particular field of experience or expertise’. The judge further emphasised that ‘case law indicates that there is a core, irreducible requirement of directors to be involved in the management of the company and to take all reasonable steps to be in a position to guide and monitor’.\textsuperscript{63} Regarding the reliance on the company’s auditor services, the court found that the ‘legislature had made it clear that the obligations in relation to the adoption and approval

\textsuperscript{59}Prevention of Corruption Act (Cap 241, 1993 rev edn) 37.

\textsuperscript{60}[2011] FCA 717.

\textsuperscript{61}The financial statement improperly classified approximately A$2 billion of short-term debt as long-term debt.

\textsuperscript{62}Section 180(1) of the Australian Corporations Act states:

A director or other officer of a corporation must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they: (a) were a director or officer of a corporation in the corporation’s circumstances; and (b) occupied the office held by, and had the same responsibilities within the corporation as, the director or officer.

\textsuperscript{63}[2011] FCA 717, 16 and 18.
of accounts were those of the directors. The error of the advising audit company, therefore, was irrelevant to the question of the proper discharge of duty by the board members.

Commentaries on ASIC v Healey have highlighted the increasing strictness of the standard of care expected of modern directors. They have also prompted pleas for public enforcement of the duties of oversight. With respect to corporate law, the findings made by the court were described as generic and were therefore attributed immediate relevance with regard to the corresponding sections of the UK Companies Act 2006 (CA 2006). Beyond the general duty of care, English courts would also have to consider the delegation of management tasks under the duty to exercise independent judgement. However, as much as the case imposes parallels to the duty of care under the CA 2006, three concerns remain. First, financial disclosure has become increasingly important for financial markets, thereby fulfilling quintessential regulatory functions in addition to being an instrument of corporate governance. Following the collapse of Enron and in the aftermath of other corporate scandals, financial disclosure has been subject to intense regulation, starting with section 404 of the Sarbanes-Oxley Act and resulting in the financial statement being a personal non-delegable duty of (inside) directors. Failure to act accordingly was not considered a question of mere oversight duties but of active non-compliance. With regard to the directors who fell outside this duty (including outside directors), the situation differs substantially from Caremark, in that there was a failure of horizontal oversight within the board itself rather than over subordinate management. The point needing clarification here is not professional expertise (as the court puts it), but the question of which collective duties may be delegated among board members. Second, the underlying failure concerned financial, and not legal, risk management. The methodology of how to deal with the respective kinds of risks may be different and needs to be discussed. Lastly, it should be noted that the findings did not concern a liability claim but an authoritative declaratory proceeding under Australian prudential law (public enforcement). The directors could have incurred penalties and bans.

64 Ibid 240.
66 Jones and Welsh (n 6).
67 Companies Act 2006, s 174 (CA 2006).
68 CA 2006, s 174.
69 CA 2006, s 173.
70 Weavering Capital (UK) Ltd (in liquidation) v Peterson [2013] EWCA Civ 71.
71 In the case of Centro, the corresponding Australian provision was also to be discharged by the executive board (CEO and CFO) itself.
72 Compliance risk analysis generally requires a qualitative, rather than a quantitative, approach; see also Michael Nietsch ‘Compliance-Risikomanagement als Aufgabe der Unternehmensleitung’ (2016) 180 ZHR Zeitschrift fuer das gesamte Handelsrecht und Wirtschaftsrecht 733 and 757ff.
as a result of the court’s findings; however, in the penalty phase of the case, the court determined that the liability judgement itself was adequate punishment and deterrence.\textsuperscript{73} This obviously lacks consistency with the strictness of the standards set out by the court; indeed, the absence of material consequences may have influenced the harsh and onerous terms. In other words, the decision may have been different had a multi-million dollar charge been brought by a sanctioned company by way of private enforcement.\textsuperscript{74}

### 2.5. Canada

Canada so far seems to be lacking Caremark litigation cases. In an obiter dictum in BCE Inc. v 1976 Debentureholders,\textsuperscript{75} the Canadian Supreme Court observed that fiduciary duties require directors and officers to ensure that their corporation obeys statutory law. This has led to academic debate about the extent of such a duty. The fundamental question raised is whether fiduciary duties can be aligned with the principle of shareholder value.\textsuperscript{76} This merits reconsideration with regard to the origins of the duty to monitor in legal and economic theory, since corporate compliance violations are often said to be directly related to this principle.\textsuperscript{77}

### 2.6. Germany

The first, and most notorious, example of director liability for illegal corporate conduct under German company law was the case of Siemens v Neubuerger.\textsuperscript{78} Siemens AG had been subject to various investigations for corrupt practices. The losses in fines and legal advice were estimated to amount to 2.6 billion Euro. All but one member of the former executive board of the holding company, Siemens, had entered into a settlement agreement with the company. Rejecting the settlement proposal, the former CFO and defendant, Mr Neubuerger, was sued for partial damages by the company. The District Court of Munich (Landgericht Muenchen I) awarded the claim in full, developing a complex duty to monitor corruption risks under the German Stock Corporation Act (AktG), its foundations being the obligation to act in line with all

\textsuperscript{73}A financial sanction was imposed only on the CEO, see David A Katz, ‘For Directors, A Wake-Up Call from Down Under’ (2011) Harvard Law School Forum on Corporate Governance and Financial Regulation <www.corpgov.law.harvard.edu> (accessed 16 November 2015).

\textsuperscript{74}It may also be assumed that the verdict reflected the classification of the error as significant negligence – in spite of it technically being an excusable misinterpretation of the accounting standards for short-term debt – since it took place within the context of the largest acquisition in the company’s history and thus the directors had good reason to examine the accounting in detail.

\textsuperscript{75}[2008] 3 S.C.R. 560 (Can.).


\textsuperscript{77}See Section 5.

\textsuperscript{78}Landgericht Muenchen, BB Betriebs-Berater (2014) 850.
legal requirements regarding the company and to create and monitor a system that prevents violations. In contrast to Caremark, the court considered that failures of the CMS as such would amount to a breach of the relevant duty of care under Section 93 AktG. The obligation to create a CMS and to supervise its operation was also seen as collective in nature, thus creating a corresponding duty of care for the entire executive board (but not the supervisory board). There is a parallel here with ASIC and the case again raises the question of the duty being delegable. The court further held that the standards for countering corruptive practices had to be particularly strict and variations could only apply with respect to the type and size of business, its structure, the relevant legal framework for the business surrounding the corporate activity in question, as well as the geographical market (e.g. business activity in a high- or low-risk country).

Questioning certain aspects of the Munich court’s findings in Neubuerger, commentaries have generally embraced the fundamental position taken toward directors’ oversight duties under the German AktG. It therefore comes as a surprise that in a more recent case concerning the director of a private limited company, a subsidiary of ThyssenKrupp Group, the District Labour Court of Düsseldorf (Landesarbeitsgericht) rejected outright any liability for losses due to anti-trust law violations. This finding was more equitable in nature, as it insinuated that liability would unfairly and disproportionately subject the director to business risks that should be borne by the company itself. It also relied on the assumption that allowing the company redress was detrimental to the sanctions foreseen by law. In spite of the obvious divergence from the Munich court’s findings in Siemens, labour law commentators have subscribed to the court’s position.

It is also noteworthy that the outcome, while relying on an entirely different line of reasoning, shows a remarkable parallel to the position of the English Court of Appeal in Safeway v Twigger. Following the claimant’s appeal in ThyssenKrupp, the German Federal Labour Court (Bundesarbeitsgericht) recently reverted the case to the District Labour Court. Surprisingly, the Federal Labour Court did not deal with the material question of liability, but overruled the earlier sentence on the sole ground of disregard for procedural law in the initial trial. Importantly, the court partially rejected the jurisdiction of the labour courts for the preliminary question of the violation of anti-trust law.

80 Gesellschaft mit beschränkter Haftung (GmbH).
82 Ibid 188.
84 See Bundesarbeitsgericht, Sentence of 29th June 2017 – 8 AZR 189/15.
Nevertheless, it ordered the District Labour Court to resume taking evidence. With this, D&O litigation for non-compliance may remain off-limits for most labour litigation cases in the future and – with the jurisdiction of the (general) civil courts affirmed – it does seem likely that the doctrine developed in Siemens v Neubuerger will prevail.

3. The duty of oversight and existing concepts of directors’ duties – what makes it so hard to accept, whereas sanctioning the corporation seems so self-evident?

The courts’ views on the duty of oversight and compliance management, as well as the consequences of breaches, reveal fundamentally contrasting positions. Whereas the tort law approach in Safeway seems to bar almost any kind of redress, most other legal systems seem to argue about the appropriate standard of liability. However, importantly, these legal systems also express reservations about adopting a concept of personal liability for compliance failure. The following section examines why the underlying duty to monitor may conflict with established concepts of corporate governance.

3.1. Doctrinal aspects

3.1.1. Openness of the standard of care

Looking at the nature of directors’ duties and the relevant standards developed thereunder, it can be observed that the duty of loyalty has evolved as a series of concise principles. The law, on the other hand, tends to set out only a very general and open form of expectations with respect to the duty of reasonable care, skill and diligence (duty of care). This difference explains not only the diverse issues encountered within heterogeneous businesses, but also the varying requirements depending on the life phase of a company (e.g. start up, mature stage, restructuring or insolvency). For this reason, it is questionable whether such a duty can be subject to statutory provisions at all, as was highlighted during the debate preceding the introduction of chapter 2 (and mostly Section 174) of the CA 2006 in the UK. Subsuming the duty to monitor under the duty of care would have helped to overcome

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85Local Court, District Court, Court of Appeal and Federal Court.
86Looking at the principle of loyalty, there are some doubts about the ability of Stone to accommodate the duty to monitor under the duty of loyalty (see further under Section 5.2.).
88The result may be well expressed by describing the model of directors’ duties as ‘essentially facilitative, rather than prescriptive’ (see Deakin (n 49) 527).
89For a general comment, including the sceptical views of Lord Sharman, see Scanlan and others, Companies Act 2006 (The Law Society 2007) 56–57; also Gower, Davies and Worthington (n 51) 464.
the old subjective test\textsuperscript{90} by imposing an objective standard of care.\textsuperscript{91} It is, therefore, useful to distil the elements of such a duty. However, many of the relevant standards in the various areas of business will typically need to be adapted and defined on a case-by-case basis. This is true, in particular, with regard to the monitoring obligations discussed here. These uncertainties are not revealed only by the Delaware courts’ decision to subsume such standards under the duty of loyalty rather than the duty of care.\textsuperscript{92} Even attributed to the duty of care, the law broadly fails to provide the necessary precision. While it may be agreed that nowadays business conduct must take place within the boundaries of law,\textsuperscript{93} and that executive and non-executive directors alike are no longer merely regarded as representatives but are required to actively perform their management role with regard to the company, this alone does not solve the question of under-defined duties in the context of compliance risk management. This may be different in businesses where procedural legislation plays a growing role in the firm (prescribing management practices or addressing micro-constituents). However, this approach differs depending on the area of the law;\textsuperscript{94} the realm of directors’ duties may be unclear within corporate law.\textsuperscript{95}

Another question arises from the fact that in larger companies, management cannot always be accomplished personally. Even in smaller businesses, the delegation of directors’ duties to lower-tier staff is frequently inevitable, as is acknowledged under most Corporate Governance Codes.\textsuperscript{96} Accordingly, the exonerating and limiting effects of delegation are commonly accepted.\textsuperscript{97} Cases like \textit{ASIC v Healey}\textsuperscript{98} and \textit{Siemens},\textsuperscript{99} however, render the exemptions based on delegation questionable by defining compliance management as a core, irreducible requirement imposed on each individual director. This may still leave room for splitting roles and responsibilities among board

\textsuperscript{90}For a case requiring a director to have no more than the skills reasonably expected of a person with his or her knowledge and experience, see \textit{Re City Equitable Fire Insurance Co Ltd} [1925] Ch 407.
\textsuperscript{91}CA 2006, s 174.
\textsuperscript{92}\textit{Stone v Ritter}, 911 A.2d 362 (Del 2006).
\textsuperscript{93}See Section 4.1 for further remarks on legality and business conduct.
\textsuperscript{94}See Chiu and Donovan (n 1) comparing the example of intense procedural financial regulation emerging after the financial crisis in 2007 and the more principle-based requirements of the UK Bribery Act.
\textsuperscript{95}See below at Section 5.1.
\textsuperscript{96}For example, UK Corporate Governance Code 2015 s A, principle 1.
\textsuperscript{97}\textit{Re Dovey v Corey} [1901], A.C. 477:

It is obvious if there is such a duty (of detecting frauds) it must render anything like an intelligent devolution of labour impossible. I cannot think it can be expected of a director that he should be watching either the inferior officers of the bank or verifying the calculations of the auditor himself.


\textsuperscript{98}\textit{ASIC v Healey} (n 60) 16.
\textsuperscript{99}Landgericht Muenchen (n 78) 850.
members. However, with the duty of the board generally considered collective in nature, both demands must be reconciled under a general rule and existing theories of corporate personhood.

3.1.2. Role of outside directors

By including outside directors in the monitoring process, another unsolved problem becomes apparent. The idea that duties of care, for example, under Section 174 CA 2006, apply to executive and non-executive directors alike has caused intense debate and increasing regulation (mostly by corporate governance codes and on a comply-or-explain basis). All the same, it should be conceded that, with the exception of active oversight regarding the company’s financial statements and its financial risk management, corporate governance codes are still a far cry from equating the role of non-executive directors with that of executive directors. Expecting outside directors to engage actively in duties of oversight, other than within the context of the board itself (with regard to employees, as required by typical Caremark situations), is inconsistent with the fundamentally different roles they have in the company’s corporate governance structure. It is also unreasonable insofar as they lack the authority necessary to effectively exercise proactive control within the company. Corporate law systems built on a dualistic board structure (with executive board and supervisory board separated, as they are under the German system, for example) are even less likely to adopt this approach since they are based on two separate company organs with their members subject to different duties. This suggests that (contrary to ASIC v Healey) the standard of care owed by outside directors when exercising oversight is unlikely to be the same as for executive directors and thus requires separate analysis. Given that standards of compliance management closely relate to the company business, the development of the related duties must focus on the role of executive directors. That said, while the conceptual context of such duties (within a one- or a two-tier structure) may require careful differentiation and detailed discussion, we presume that the different conceptions of company law will not override common principles.

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100Deakin (n 49) 527ff.

101Deakin (n 49) 529.

102UK Corporate Governance Code s 1 A4:

Non-executive directors should scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance. They should satisfy themselves on the integrity of financial information and that financial controls and systems of risk management are robust and defensible. They are responsible for determining appropriate levels of remuneration of executive directors [ … ].

103Karsten Schmidt and Marcus Lutter (eds), Aktiengesetz (3rd edn Otto Schmidt 2015), § 109 recital 11 and § 111 recital 43; Uwe H Schneider and Sven H Schneider, ‘Der Aufsichtsrat der Kreditinstitute zwischen gesellschaftsrechtlichen Vorgaben und aufsichtsrechtlichen Anforderungen’ (2016) NZG Neue Zeit- schrift für Gesellschaftsrecht 41–42.
3.1.3. Waning safe harbour of reliance

The legal uncertainty about the duty of care, the denial of the exempting effects of delegation and the role of outside directors also needs to be placed in the context of the ongoing debate on the reliance defence. Historically, the safe harbour against personal liability produced by the *bona fide* advice of experts was widely accepted, as an inevitable and important aspect of management.104 This also holds true for legal advice on matters of corporate compliance, since in practice such advice is often open to interpretation.105 Whereas in the past the absolving effect of reliance on independent advice was commonly considered a safe haven,106 and in some jurisdictions this was also reflected in the law,107 when it comes to oversight failures, this no longer seems to be the case. By denying the board of directors the ability to rely either on auditors’ statements or on the board’s audit committee, *ASIC v Healey* stands *pars pro toto* for this development.108 Similar tendencies have become apparent in the more recent jurisprudence of the German Federal Supreme Court in other areas of corporate law.109 For example, it was clearly held that reliance would only apply where the source of legal advice was independent. Furthermore, the board was still required to verify the plausibility of the advice on its own initiative.110 With some jurisdictions showing a restrictive tendency, the safe harbour of expert advice is becoming increasingly unsafe. This not only results in a higher risk of personal liability but may also create conflict with previously accepted management practices, in particular delegation.111

3.2. Practical implications of oversight duties

Imposing on the board a continuous and proactive duty to monitor represents a shift away from traditional notions of directors’ standards and duties of care. It is also potentially detrimental to existing principles of company law and it raises questions as to the practical implications of corporate management and governance.

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105 This is due to the ‘principle-based approach’ in regulation becoming more and more frequent and the wording of the law more general, thereby also increasingly open to interpretation, see Michael Nietsch, ‘Geschäftsleiterermessen und Unternehmensorganisation bei der AG’ (2015) ZGR Zeitschrift fuer Gesellschaftsrecht 631 and 644ff.
106 Humbach (n 6) 447–54.
107 DGCL, s 141(e).
108 For the interpretation of a similar case under Delaware law, see Chung v Nara Bancorp, California Court of Appeals, No. B229826, 2012 Cal. App. Unpub. LEXIS 842 1; see also Rokas (n 104) 340ff.
109 On this becoming a broader approach in Germany, see Bundesgerichtshof BB Betriebs-Berater 2011, 2960.
110 ibid 2962.
111 See Section 5.3.
3.2.1. Mistrust as a foundation of business?

The main, and seemingly timeless, issue with the duty of oversight is that it may create distrust within the board and beyond. The problem was colourfully described in *Graham v Allis-Chalmers*, when it was argued that such a duty would require a ‘system of espionage to ferret out wrongdoing’. This point seems broadly accepted given that the development of a high-trust organisational ethos is seen as one of the most important instruments, not only to counter corporate mismanagement and default, but also in order to enable responsible and creative business conduct. A densely woven net of internal controls is more likely to undermine trust-based relationships than promote them, thus inducing procedural friction and increasing the overall costs of business. Critics also insist that the threat of liability would make becoming a director so unattractive that boardrooms would be vacated immediately. While this seems not to be the case in practice, even in jurisdictions with stricter standards, it is undeniable that rising costs (whether due to executive pay and/or D&O insurance premiums) reflect this increased liability risk. In this context, it may not be unreasonable to predict a tendency to overinvest in corporate controls in an attempt to create safe harbours.

3.2.2. Appropriate qualification – fit and proper

Another aspect, less openly discussed but of high practical relevance, is the qualification of directors to exercise effective compliance oversight. Since the courts still seem to acknowledge the benefit of varied wisdom, expertise and backgrounds in boardrooms, it remains unclear how the fundamentally legal issues that drive the monitoring process can be handled by directors lacking lawyering skills. This problem is exacerbated for businesses governed by increasingly complex legislation, often combining highly detailed technical norms (e.g. environmental law, data protection, etc.) with rather open and discretionary terms requiring the monitoring to be ‘proportionate’, ‘adequate’, ‘effective’, etc. Corporate legal compliance becomes even more challenging because of its interdisciplinary nature. Since control in large corporations has to be standardised, it commonly involves sophisticated IT infrastructure. This not only makes it difficult to find directors with the necessary expertise, it also makes it difficult to coordinate the different responsibilities of respective directors.

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113 *Dovey v Corey* [1901] A.C. 477, 485; Deakin (n 49) 532. From the perspective of management theory, see also David F Larker and Brian Tayan, ‘Corporate Governance According to Charles T Munger’ (2014) 3 Stanford Closer Look Series 2ff.

114 Martin Arnold ‘Deutsche Bank rips out IT-systems blamed for problems’ FT (26 October 2015) on the difficulties involved in optimising IT infrastructure with regard to oversight.

4. Foundations of directors’ oversight duties

Having illustrated the doctrinal and practical concerns surrounding the role of the board in compliance management, the following section discusses how these issues could be resolved under a coherent governance scheme. The first question, however, concerns whether the underlying duty to monitor can be accommodated as a general maxim of management.

4.1. Legality as a principle of corporate governance

Legality as a maxim of corporate conduct seems

prima facie

self-evident. Though it is the company (rather than the directors) that is commonly addressed by the law, it should be beyond doubt that this maxim must likewise be respected by the individuals acting as its agents.116

4.1.1. Economic and legal concerns

At the same time, this does not necessarily reflect the view of economic theories underpinning corporate law. Indeed, this principle may not even be consistent with the law. From an economic perspective, profits may be increased by externalising costs through non-compliance (e.g. health costs arising from the breach of environmental laws, such as emission norms, or accidents due to a lack of work safety). This is even described as an ‘intrinsic’ motivation, since in everyday corporate life employees are under constant pressure to improve performance and reduce costs.117 Violating the law may result in fines, damages and transaction costs. However, as long as these can be offset by prior gains, profitability may nonetheless prevail. Violating the law, it is argued, can, therefore, be a rational and permissible choice under the business judgement rule.118 In legal doctrine, the foundations of this economic approach have some grounding in the theory of efficient breach of contracts,119 which discusses the discretionary power of board members to discharge or breach contractual obligations. Surprisingly, this approach is widely accepted in the literature.120 Sometimes it is seen as a mere ethical problem.121 Contrary to what

117Humbach (n 6) 438–39.
one might assume, a corporate policy which accepts breaches of the law is not categorically unacceptable. The problem also becomes evident and practical in redress situations when discussing the causal link between defaulting oversight and resulting loss. Commentaries on the Ho case, handled by the Singapore Supreme Court, have therefore queried whether the defendant could have relied on the argument that bribery payments, in procuring business for the company, on balance benefitted the corporation.

4.1.2. Legality and shareholder value

Major tensions also seem to exist between the principle of legality and the principle of shareholder value. Where breaches of the law occur, shareholder supremacy is often blamed. The underlying assumption (again) is that the pressure on management is such that they must strive for maximum profit by all available means. The diverging expectations created by the respective principles cannot simply be reconciled by defining the shareholder value principle a priori within the boundaries of the law. It remains incongruous to require directors to act in ways that reduce shareholder wealth in the context of shareholder primacy. And this difficulty is even more prominent in the grey areas where a clear legal prerogative is missing. The duties imposed on the company are often (or primarily) intended to protect the interests of third-party gatekeepers – a common occurrence in areas where states use corporate structures for public policy – so transforming corporations into quasi-governmental actors with regulatory and self-regulatory functions.

Does advocating the supremacy of legality mean reopening the epic dichotomy between shareholder value and stakeholder value from a different angle? A common argument made in order to resolve the apparently conflicting maxims is that compliance helps protect the corporation from harm (typically by avoiding sanctions). Still, this does not always hold true since harm is only created where the wrong is detected and the resulting repercussions are not compensated by the gains of breaching the law. Even as enforcement becomes stricter, it is debatable whether the board should be left to decide which path to pursue. It is our opinion that a

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122 Above Section 2.3 (n 56).
123 Wan (n 58) 478.
124 Iacobucci (n 76) 191ff.
125 Stefan Stern, ‘VW has myopic view of stakeholders’ FT (1 October 2015).
127 Iacobucci (n 76) 192.
129 For a definition of compliance risk, see, for example, Leitlinien fuer die Taetigkeit in der Compliance-funktion fuer Unternehmen 2.2., CCZ Corporate Compliance Zeitschrift 2014, 244.
more convincing approach to reconciling the existing tension can be achieved by emphasising the long-term notion of the shareholder value concept (and good corporate governance, respectively). A definition which stresses short-term revenues as the point of reference for corporate decision-making must admit that obeying the law can often be detrimental to that objective (e.g. if a car manufacturer is unable to meet nitrogen dioxide limits established by law and, as a result, forsakes an important market, a loss of profits and a decrease in short-term revenue is inevitable). The imperative of law, therefore, can be accommodated under the shareholder value principle only when revenues are considered from a long-term perspective.\textsuperscript{130} This should include the deferred costs of non-compliance (sanctions, fines, reputational loss and damages), but must also take into account the benefits legal compliance can create for business. Even though empirical evidence is lacking at present, it may be assumed that legal compliance has the potential to improve management.\textsuperscript{131} First of all, dealing with legal parameters will induce greater general awareness of strategic factors relevant to the company (e.g. to continue building diesel-fuelled cars). Industry sectors are often taken aback by changes in the legal system, particularly when the regulatory subject is new. This is especially so when the parameters affect an integral part of the company’s services and products. Dealing with the relevant law should not always be considered a necessary evil; on the contrary, it may create opportunities and pave the way for changes which otherwise would not have been recognised or implemented.\textsuperscript{132} This, in most cases, will not only prevent complete corporate failure but will also support long-term performance (e.g. a car manufacturer gains a competitive edge by anticipating upcoming regulation).\textsuperscript{133} It also enhances the quality of risk management and investor confidence, thereby reducing the costs of capital.\textsuperscript{134} As such, the maxim of corporate legality could well become reconciled with a a more long-term-oriented definition of shareholder value. These benefits show how procedural legislation and the correlated duty to monitor may be consistent with corporate theory.\textsuperscript{135}

\textsuperscript{130}UK Corporate Governance Code, principle 1: ‘The purpose of corporate governance is to facilitate […] management that can deliver the long-term success of the company’.

\textsuperscript{131}Nietsch (n 72) 768.

\textsuperscript{132}To illustrate this, a useful example is the currently debated Volkswagen case. Proactive compliance management not only would have respected existing environmental legal norms but would also (or at least would have been more likely to) have anticipated future stricter standards. It is highly likely that this would have prevented the company from being taken by surprise by new exhaust norms and so would have enabled management to respond with technologically-improved engines.


\textsuperscript{134}Kark (n 121) 38–42.

\textsuperscript{135}See Chiu and Donovan (n 1). Also below at Section 5.1.
4.2. Liability for defaulting directors?

Establishing the principle of legality within the framework of directors’ duties leads us to a separate question: should losses caused by defaulting management entail personal liability? This may be seen as self-evident, given that, under the agency theory, the delegation of control rights by shareholders to the board creates accountability running in the other direction. Yet, within a given context, this may be debatable. To start with a practical concern, it is argued that personal liability would not be able to cover sustained losses (failure to compensate). With regard to deterrence or prevention, personal liability is seen as irrelevant in light of increasingly unforgiving public enforcement. Standards set out, for example, by the United States Federal Sentencing Guidelines, are far more likely to motivate corporate actors to exercise legal oversight than the risk of Caremark liability. Liability then is only marginally relevant to corporate compliance, whereas the decisive sources of law are the regulatory provisions imposed on specific industries. This coincides with other arguments, namely the demand that personal liability be replaced by public enforcement due to the shortcomings of derivative litigation.

In spite of the undisputable predominance of prosecution within the area of corporate compliance violations, the thesis of ‘Caremark’s irrelevance’ fails to convince. Directors’ liability should not be regarded as a competing, but a complementary, instrument of public enforcement. It may even be argued that it can offset some of its shortcomings, particularly in areas where sanctioning the corporation could prove detrimental to the intention of the law being actually enforced (e.g. prudential regulation). The irrelevance thesis also overlooks the fact that avoiding personal loss has become an additional source of motivation necessary to balance the moral hazard of short-term profit.

What can make private liability claims questionable is that they may potentially disturb public law enforcement procedures. This must be taken into account, as mentioned in the context of Safeway v Twigger (highlighting the importance of protecting leniency programmes under anti-trust law), but it may also be of more general concern. The fear of personal liability

136Deakin (n 49) 527.
138Bullard (n 128) 19–21 and 39–43.
139Ibid 19–21.
140Jones and Welsh (n 6) 343ff; Megan W Shaner, ‘The (Un)enforcement of Corporate Officers’ Duties’ (2015) UC Davis Law Rev 271.
142This is explicitly claimed for prudential regulation, where the increased sanctions of financial institutions may weaken their stability and, therefore, should at least be complemented by the personal liability of directors. See Iacobucci (n 76) 202–09.
143See above Section 2.2.
could lead directors to stop cooperating with regulatory investigations or even encourage the active obstruction of prosecution for corporate crime. This, in itself, should not prevent us from recognising the existence of a general principle of personal liability of directors for compliance under company law.\footnote{Deakin (n 49) 527.}

While the potentially negative effects on public enforcement may lead to misgivings about the concept of liability in certain areas, this should not entail a blanket dismissal. Furthermore, it is doubtful whether these exceptions should be granted for the ‘higher purpose’ of publicly sanctioning the corporation itself. Fears of obstruction also seem misplaced; if cooperation with regulators is at stake, it is in the interests of the company to ensure an independent decision. Typically, this is handled by investigation committees, whose members are (or, in any case, should be) uninterested directors and independent advisors. This practice provides sufficient safeguards against undue influence and the tendency to conceal corporate crime. Often directors involved in wrongdoing will have left the company or stepped down from their position.

5. Principles and standards of the duty to monitor

Since directors are not exempt from liability for losses sustained due to illegal corporate conduct, the following section shall discuss the principles and standards of such liability in greater detail. In order to do so, it is necessary, first, to clarify the legal basis of these claims and, second, to discuss the adequate limitations on liability – given the above-mentioned concerns – in order to ensure a balanced approach.

5.1. Sources of law: the rule of corporate law

Determining the standard for legal conduct and oversight requires clarification of the relevant sources of law and their respective effects. First, the underlying duty does not necessarily need to be categorised as corporate law. This explains why Judge Allen (deciding the Caremark case) proposed the Federal Sentencing Guidelines as a point of reference for the specific standards of care. The varied role of company directors is also evident where corporate law is irrelevant, as specific aspects of this duty tend to be established by regulatory statutes outside the area of corporate law.\footnote{Bullard (n 128) 23ff.} This approach receives support from the decision of the Court of Appeal in Safeway v Twigger, which implicitly assigned the matter in part to tort law, applying the ex turpi causa defence to the benefit of the claimant’s directors.\footnote{Likewise, with the Singapore Court of Appeal in Ho, which, while rejecting the ex turpi causa defence, did not dismiss the relevance of tort law as such.}
In order to approach the question ‘Which source of law is relevant?’ and avoid misconceptions, it seems useful to start by emphasising that legal compliance is an element of corporate governance and consistent with the shareholder value principle. Accordingly, the duties associated with compliance are presumed to be managerial and must be addressed by the company’s directors. This is confirmed by the fact that establishing CMS and oversight-mechanisms is an integral part of business administration and may even be technical in character. The resulting obligations require directors to organise the respective procedures of legal risk assessment, communication, training, controls, etc. In some cases, these may be subject to specific regulatory laws addressing senior or micro constituents in the firm (particularly in the financial industry). It may be argued that this marginalises or even substitutes for the discretion of management, with the board’s accountability being reduced in return. All the same, it seems important to note that, for the most part, legal standards to date remain principle-based. That is, while they set out some general duties (e.g. the obligation to create a compliance department or enact counter-corruption guidelines, etc.), they commonly leave the method of implementation and oversight to companies, and thus to the discretion of management. This reinforces the presumption that compliance-related governance pertains to directors’ duties sub specie.

The assumption of legal compliance as corporate law is not undermined by the fact that the wrongdoing prevented, from the corporation’s perspective, may also be a tort (bribery, restriction of competition, personal injury). Safeway and the application of ex turpi causa as a principle of tort law under common law fail to convince, since this blurs the necessary distinction between the illegal conduct itself (attributed to the company) and the directors’ failure to discharge their preventive duties. It also disregards the fact that a tort against a third party from the company’s perspective is not necessarily a tort from the perspective of the duties owed by directors to the corporation. Moreover, the principles of tort law are too general to provide effective guidance in this instance and tend instead to interfere with the more refined concepts of corporate law. This is evident when the English courts try to distinguish various forms of attribution in Stone & Rolls Ltd. and Jetavia, in both cases leading to rather inconclusive results. Tort law may also vary a great deal from one jurisdiction to

147 See above Section 4.1.2.
150 See above Section 2.2.1.
another.\textsuperscript{151} Given the managerial nature of the duty of oversight and the possibility of accommodating the duty under shareholder-oriented corporate governance, it is preferable to address the questions that arise using the principles of corporate law. Consequently, the relevant standards should be developed on the basis of general duties existing within corporate law.\textsuperscript{152}

5.2. Duty of loyalty or duty of care?

A seemingly intricate issue arises from the Delaware Supreme Court’s categorisation of oversight as part of the duty of loyalty in the \textit{Stone} case.\textsuperscript{153} As shown above, it seems plausible that the court intended to end the dispute about the exculpatory provision of Sec. 102(b)(7)(ii) DGCL, while at the same time confining liability as established by the Chancery Court in \textit{Caremark} to members of the board acting with scienter. Methodologically, this has been widely greeted with incomprehension: ‘Trying to squeeze such conduct into the duty of loyalty is like trying to squeeze the foot of Cinderella’s stepsister into Cinderella’s glass slipper – an enterprise equally painful and fruitless’.\textsuperscript{154} Effectively, with compliance programmes being managerial in nature, it seems hard to place this anywhere but under the duty of care. Also, it seems implausible to consider illegal practices (which usually increase profits) as disloyal towards the corporation and its shareholders. Still, the Delaware court’s notion is not as ‘painful and fruitless’ or farfetched as it appears at first sight. Where a director authorises wrongful conduct or wilfully fails to exercise control in order to maximise profits, this will be in the interests of the company only in the short term.\textsuperscript{155} Even if this may not seem sufficient for disloyalty, it can become the case where the acting director is self-interested (e.g. induced by performance benchmarks or misappropriation). Accordingly, non-compliance \textit{can}, under some circumstances, become relevant to the duty of loyalty. However, given that this is an exception rather than the rule, there is no reason to qualify compliance management and oversight as falling

\textsuperscript{151}The principle of \textit{ex turpi causa oritur non actio} is an appropriate example, as this has been replaced in other jurisdictions by a different approach, examining the specific accountability of joint tortfeasors (under German law see §§ 840, 426 BGB). Illegality, therefore, frequently does not bar the entire claim but only limits the potential redress.

\textsuperscript{152}With the assumption that procedural regulation is the exception and principle-based regulation the rule, it cannot be excluded that regulation will follow objectives alien to the firm’s (e.g. when making use of corporate structures for public policy, effectively transforming corporations into quasi-governmental actors with regulatory functions; See Bullard (n 128) and above Section 4.1.2)). This focus may indeed be seen as criticised or as inconsistent with regard to the objectives of the firm and its directors. This does not alter the respective managerial duties but does raise the question of whether proper discharge is owed to the firm, a problem which must be reflected when developing the adequate standards of liability (see below at Sections 5.3 and 5.4).

\textsuperscript{153}See above Section 2.1.


\textsuperscript{155}As explicitly stated by the Singapore Court of Appeal (n 56).
under the duty of loyalty in general. As a consequence, the relevant (subjec-
tive) condition for liability is not acting with scienter, but negligently.

5.3. Delegation of compliance-related duties

In order to avoid the threat of liability becoming excessive and collateral 
arising therefrom, specific limitations must be developed. With oversight 
falling under the category of the duty of care, a quintessential question is 
whether and how this duty can be discharged by delegation. This needs to 
be resolved as much within the company’s board (at the horizontal level, 
e.g. by assigning compliance risk analysis to one individual director or com-
mittee) as with regard to the company’s employees (e.g. by creating a legal 
compliance function operating under the responsibility of managing direc-
tors, to be referred to as ‘vertical delegation’).

5.3.1. Delegation within the board of directors (‘horizontal delegation’) 

It can be seen as a principle of executive liability that the delegation of man-
gerrial duties to individual board members will have a limiting effect on the 
remainder of the board. As long as the relevant task is suitable for delegation, 
the instructed director seems generally capable to deal with it and the matter 
is subject to reporting and plenary debate (and is thus examined on a regular 
basis), the board can, in good faith, rely on the proper discharge of the duty 
by the instructed colleague. The exempting effects of delegation differ 
from one corporate framework to another. Still, they should provide 
common ground for principles of adequate personal liability. With respect 
to corporate compliance violations, limitations have not been widely dis-
cussed. It is unclear whether specific procedures are open to delegation as such. The District Court of Munich in Siemens stated (obiter dictum) that 
the duty to monitor was of a collective nature and, therefore, not delegable 
either horizontally or vertically. This is also implied in the ASIC decision 
and the view seems to be accepted by most of the literature as well. Yet 
the question may warrant further consideration. First, there is no empirical evi-
dence or circumstantial indication that assigning a task to the entire board 
ensures better management decisions. This leads to an open, rather than a 
restrictive, view of delegation as a general concept of high-level management, 
with collective and individual competence being equivalent. With regard to 
non-delegable duties (those that are necessarily collective), they may be

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156See above Section 2.2 and below Section 5.4.1.
157Nietsch (n 115) 1449ff.
158ibid 1452–53.
159Nietsch (n 72) 734.
160Iacobucci (n 76) 853.
161See above Section 2.4.
162Schneider (n 116) 647.
either comprehensive in character (and thus not suited to delegation to individual directors or committees) or of essential importance to the company (and thus requiring the informed consent of all board members). Considering the duty to monitor, one may indeed argue that delegation seems inappropriate; poor judgement may result in severe sanctions affecting the whole or vast parts of a company group, though the decision may have been taken by a subsidiary. The participation of the entire board may help to better identify potential risks and so mitigate them. Further, some areas of legal compliance are close to the corporation’s identity and philosophy. The oft-mentioned ‘Tone from the Top’, compliance codes, mission statements, corporate ethics standards, etc. can be expected to guide conduct only when they are backed by the entire board of directors rather than its individual members. It must also be conceded that the interdisciplinary challenges of compliance, in large companies at least, may warrant restrictions on delegation. On the other hand, it should be acknowledged that CMS does not always affect the company, or group it belongs to, as a whole. It may initially focus on specific branches or departments, while at the same time requiring detailed technical expertise that cannot be reasonably expected of the entire board. In these situations, a plenary decision-making process will often be inappropriate. It should also be acknowledged that allowing delegation does not completely exempt the board of liability, but instead transforms the board’s duties into a residual duty of oversight. Delegated management must still report to the entire board. The relevant procedures are therefore open to discussion and analysis – and even revision if necessary – under the collective responsibility of the board. Outside the areas that are generally collective in nature, delegation of managerial duties of oversight to individual board members should be presumed possible. Accordingly, the risk of liability for compliance failures will prima facie be limited to the commissioned director, requiring him or her to perform with due diligence as long as the remainder of the board has no reasonable doubt that the corporation is acting legally.

5.3.2. Vertical delegation
It should go without saying that the implementation of mechanisms safeguarding legal compliance need not be carried out by the board itself or the individual director entrusted with the matter. Risk assessment, the specifics of internal controls, the communication of compliance standards to employees and further training can, and will for the most part, be reasonably

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163 See above Section 3.2.2; also Nietsch (n 72).
164 It should be emphasised, however, that limitations will require non-interested board members to hear the reports of the director in charge and to assess the efficiency of the compliance programme. It must also be stressed that inactivity can become relevant for the entire board if they have reason to suspect breaches of the law and choose to leave the matter unattended.
left to subordinate managers or even external advisors and trainers. Vertical delegation will not amount to liability even if corporate misconduct occurs, since directors are not accountable for the wrongdoing as such but only for failing to apply the appropriate standard of care. Due care for vertical delegation will vary according to the individual case but may be characterised under the following five principles: (1) Initially, the potential compliance issues of the company must be examined. This may (and usually will) be accomplished with internal or external support, yet it is inevitable that the director him- or herself be aware of the results of this analysis in order to organise the follow-up process (including further delegation) on an informed basis. (2) Employees entrusted with implementation need to be chosen according to their abilities and experience. Problems with the CMS should be actively addressed. Particular attention must be paid to the independence of compliance officers from other business units and departments. Any influence that could compromise judgement should be identified and prevented. This may require a compliance contingent separate from the legal department where the latter (as is often the case) also provides legal advice to business units. Consideration should also be given to the resources necessary to effectively exercise oversight. (3) The director will have to deal with the results of reviews and the shortcomings of the CMS and must initiate any necessary adaptations. (4) Great care must be taken to ensure that illegal conduct can be detected, analysed, reported to a supervisor and acted on in due time (commonly requiring whistle-blowing and reporting mechanisms). Again, this need not be implemented by the directors in person. However, they should stay informed about the existence and the functioning of the reporting mechanisms within their jurisdiction and regularly assess them in order to uncover misconduct. (5) Lastly, the duty of care requires the personal commitment of the director (and therefore excludes delegation to subordinates per se) if there is any suspicion of significant or aggregate illegal conduct and this is based on facts limited to isolated cases or other specific reasons (e.g. lapse of time). The same applies to the self-monitoring of corporate integrity agreements.

5.4. Privileges under the business judgement rule

5.4.1. The general principle

Action based on the principles of horizontal and vertical delegation will generally provide an important line of defence for the director in charge of implementing legal compliance management. At the same time, this will often

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165ISO/DIS 19600:2013 (E), 9.1.7 and 5.3.3. e).
166Westmoreland v Parkinson, 727 F.3d 719 (7th Cir 2013); Barovic v Balmer, Case No. C14-0540-JCC (District Court Western District 2014); see above Section 2.1.
nourish fundamental fears that oversight measures (that have proven insufficient) will be seen as inadequate in hindsight, thus proving liability. The attempt to avoid allegations of foreseeability may lead to risk avoidance, disproportionate and expensive controls, as well as mistrust within the company.167 This raises the question of whether a balance may be struck between effective legal compliance and adverse effects on business by allowing a defence under the business judgement rule (e.g. when potentially effective compliance mechanisms are disregarded for reasons of cost or when trust is given priority over control). This rule is rooted in an almost century-long history of corporate law168 and aims to provide a safe harbour by restraining judicial control over board decisions.169

It is the essence of the business judgment rule that a court will not apply 20/20 hindsight to second guess a board’s decision, except in rare cases where a transaction may be so egregious on its face that the board approval cannot meet the test of business judgment.170

Board decisions privileged hereunder are typically commercial in nature and (often) deal with future business development (their prognostic character prompting uncertainty). They are related to the risk of economic loss and prone to ‘better hindsight’ (that is judicial second-guessing), thereby exposing directors to a risk, which should adequately be attributed to the shareholders.171 Exempting such claims from litigation also enhances the board’s willingness to engage in financial risks. It has, therefore, become a general principle of company law that the judge will not review a board’s wrongful decision provided the board was reasonably informed, acted in good faith to the benefit of the company and was not subject to conflicts of interest.172

The rule itself reflects a presumption that, in making a business decision, the

168Percy v Millaudon, 8 March (n.s.) 68 (La. 1829), Hodges v New England Screw Co, 1 R.I. 312 (1850), and Smith v Prattville Mfg. Co, 29 Ala. 503 (1857).
169For more current cases, see Smith v Van Gorkom, 488 A.2d 858 (Del Sup Ct 1985); Am. Society for Testing v Corpro Cos., No. Civ. A. 02-7217, 2005 WL. 1941653 (E.D. Pa. 2005); Hampshire Group LTD v Kuttner, C.A. No. 3607-VCS (Del Ch 2010); Americas Mining Corp. v Theriault, Nos. 29, 2012, 30, 3012, 2012 Lexis (Del 2012); for further reference, see William A Klein, J Mark Ramseyer and Stephen M Bainbridge, Business Associations (9th edn Foundation Press 2015) 309ff; see generally Marcia M McMurray, ‘An Historical Perspective on the Duty of Care, the Duty of Loyalty, and the Business Judgment Rule’ (1987) 40 Vand. L. Rev. 605; Julian Velasco, ‘A Defense of the Duty of Care’ (2014) 40 J Corp L 647, 653. For Germany, see codification in § 93(1) sentence 2 AktG: ‘(directors) shall not deemed to have violated their duties if at the time of making a business decision they had good reason to assume they were acting on the basis of adequate information and for the benefit of the company’; see also BGHZ 135, 244 (ARAG/Garmenbeck).
170See Walt Disney Co Derivative Litig, 731 A.2nd 342, 262 (Del Ch 1998); for irrationality as the outer limit, see also Brehm v Eisner, 746 A.2d 244 (Del 2000); BGHZ 135, 244.
171This applies even when the loss has been ‘catastrophic’, see Gagliardi v TriFoods, Int’l Inc (Del Ch Lexis 87) 11–12; also Barbara Dauner-Lieb, ‘Unternehmerische Tätigkeit zwischen Kontrolle und Kreativität’ (2005) Festschrift Roehricht 83.
172Aronson v Lewis, 473 A.2d 805, 812 (Del 1984); Hampshire Group v Kuttner, C.A. No. 3607-VCS (Del Ch 2010).
directors of a corporation act according to these requirements. There is no protection for directors who have made ‘an unintelligent or unadvised judgment’. In other jurisdictions, the defence afforded by the business judgement rule may not be as powerful. Nevertheless, being generally accepted as such, it may still provide adequate limitations to liability in the context at hand.

5.4.2. Applicability to oversight duties?

With regard to the requirement that adequate procedures in corporate compliance depend on the particular risks, the size of the company and the market in which it does business, it can be argued that compliance systems need to be modelled according to the individual company. This implies that the design of the system, its functions and mechanisms of control are, to some extent at least, discretionary, further indicating that a company’s director should not be considered in breach of his/her duty of care for failures of the system (resulting in illegal conduct by employees) as such. Yet the court’s statement gives no indication that it would not examine the discharge of the duty of oversight in detail. It seems doubtful then that the court was suggesting that decisions regarding CMS should be privileged under the business judgement rule. Commentators in the literature have also expressed major concerns: (1) It is often said that the duty to obey the law is absolute and cannot admit discretionary freedoms that might permit one to escape liability. (2) Resolving matters of legal compliance differs substantially from the kinds of business decisions the business judgement rule wishes to provide a safe harbour for.

Though these assumptions are not fundamentally disputable, the decision to exclude, a priori, the privilege of the business judgement rule in matters of legal compliance may be questioned. First of all, it is necessary to mention that, unless the board is acting in bad faith or wilfully breaching the law, legality as such is not subject to debate when the board is trying to resolve compliance issues. It goes without saying that wilful, not to mention intentional, violations can never be tolerated or rewarded by exempting them from liability. What is subject to debate, when devising a CMS in a company, is not so much respect for the law as such but the way in which this may be accomplished. This alone may not be reason enough to privilege the board by

173 Mitchell v Highland-Western Glass, Del Ch, 167 A. 831, 833 (1933).
175 See Landgericht Muenchen (n 78).
176 Iacobucci (n 76) 853.
exempting it from liability, if the matter differs fundamentally from mere economic uncertainty. However, it may be worth considering that compliance management decisions can be quite similar to the paradigm of privileged decisions. Modelling an oversight mechanism based on the individual corporation’s needs involves numerous issues of uncertainty and discretion: the company must take into account, for example, the number of employees who will have to support the compliance function, the amount of training required, in which department, centrally or decentralised, and how this is best done (curriculum-based or methodological, by e-learning or face-to-face, etc.). At the same time, views on the means of oversight to be used may be very different. One may argue that in some areas IT-based screening is efficient, where others will require individualised controls. The frequency or randomness of controls may be controversial, as may be the decision to provide warnings or to control unannounced (with potential effects on trust-based management in return). Finally, compliance conception does not stand above economic considerations. Therefore, and though this is sometimes doubted, the duty of the board to act on the basis of a cost-benefit analysis remains. Importantly, this may be taken into consideration where regulation does not aim to prevent wrongdoing by the corporation but imposes a gatekeeper role in order to prevent wrongdoing by third parties.

5.4.3. Decision-making with respect to compliance system design

What follows, as a general rule, is that it seems adequate to privilege at least the initial decisions made on this subject matter. The case, therefore, should not be built on allegations regarding the configuration of a CMS in the first phase (including adaptations designed to safeguard new regulations), these being protected under the discretion of the board. An exception applies where the system ex ante was, beyond any reasonable doubt, unsuitable to prevent corporate wrongdoing. This may result in claims close to the ‘utter failure’ test applied by the Delaware courts, but seems adequate to cover failures of mere initial compliance (which will rarely result in grave sanctions). Furthermore, it appears to be adequate in situations of gatekeeper liability. It also seems important to acknowledge that the ‘premium’ of being privileged under the business judgement rule must be earned by demonstrating a corporate set-up that takes into account the existing guidelines on compliance and could, it is presumed, have prevented corporate misconduct. This will preclude liability mainly in cases where legal risks have been innocuous and far removed from the direct control of the company’s board.

179 Nietsch (n 105) 648–56.
180 For examples of procedural legislation affecting third parties see Chiu and Donovan (n 1).
181 See above at Sections 4.1.2 and 5.1.
5.4.4. Investigative compliance
Granting privileges under the business judgement rule is more difficult where suspicious behaviour has been reported and losses have occurred due to the failure of the board to respond. As mentioned, the board’s duty to instigate investigations remains and should not be discouraged by allowing wilful blindness. Still, this is missing the point, since in practice the core issue more often turns on the way in which these investigations are conducted. Again, various alternatives are possible (e.g. regarding the departments involved, employees, subsidiaries, geographical areas, screening methods, internal or external resources, etc.) and it may not be fair to allege a breach of duty simply on the basis of a flawed investigation which failed to reveal the true facts of misconduct. Non-litigable discretion may be particularly worth considering where the board not only followed the standard guidelines for internal investigations, but can also plausibly demonstrate the basis on which it acted and show that the investigation did not seem doomed to failure ex ante. This is a standard far higher than ‘utter failure’, as the board must show that it took a well-informed decision that seemed adequate to uncover any potentially illegal conduct. It should also be added that no exemption from liability can be granted for failures to counter serious misconduct which has been revealed by an investigation or simply for failing to undertake an investigation.

5.4.5. Corporate integrity and settlement agreements
The safe harbour of the business judgement rule becomes unavailable in cases of corporate integrity and settlement agreements, as these regularly require the company to ensure compliance on a specific issue and in a specific way. This was clearly demonstrated in the cases of Barovic v Balmer and Baxter. If a company has agreed, for example, to implement a browser choice or to withdraw a faulty medical product from the market by a specific date, this matter may not be delegated, nor does it allow discretionary non-compliance. All the same, this does not mean that subordinate employees may not be instructed to carry out the relevant steps (as this will be the appropriate way of implementation). But it requires that the board jointly exercise control of the outcome under the terms and conditions of the agreement (most importantly due dates). The position of the board here is particularly marginal, since the company has already been granted self-monitoring of

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182 See note 155.
183 The case may vary where settlement agreements lack precision and stipulate – as they often do – enactment of ‘adequate’ or ‘efficient’ procedures to prevent future wrongdoing. Here we find an example of individualised but still principle-based regulation. Close analysis of the discretion included therein must be made on a case-by-case basis. If the agreement allows for compliance to be discharged by various means, this must be taken into account when considering the initial setup of a compliance management system. Depending on the circumstances, protection from liability under the business judgement rule might be warranted.
the agreement (as in the cases quoted). In case of doubt about the terms of the agreement, consultation with the engaged regulator is strongly advised.

6. Conclusion

The motivation for this article was the desire to illustrate the factors underlying directors’ liability for losses suffered by companies due to illegal corporate conduct. Departing from the view that a far-reaching exemption for directors is no longer tolerable, it has shown that most legal systems face difficulties in finding a consistent approach and incorporating personal liability within the existing framework of company law. The key challenge is not just to strike a balance between (close to) no liability on the one hand and severe liability on the other. It also raises the question of whether and how legality as a principle can be accommodated under the traditional notion of directors’ duties driven by the shareholder value principle. While this seems feasible under a long-term concept of corporate governance, it may become unworkable where the law imposed on corporations changes their fundamental objective, making them quasi-governmental instruments (concept of gatekeeper liability).

While approving personal liability against the corporation in general, with regard to the delicate balance between oversight and trust, this article proposes that two instruments of corporate law be invoked to tackle excessive liability. One key function here is performed by the limitation effects of delegation, both within the board (horizontally) and with respect to subordinates (vertically). Whereas horizontal delegation will provide a safe harbour in most cases, vertical delegation will require the ongoing involvement of the director in charge of the compliance management process. Given the managerial nature of legal compliance, this article proposes to consider exemption from liability under the principle of the business judgement rule. Looking at the obvious differences between mere business decisions and decisions made when exercising compliance management, this may be questionable. Given the necessary preconditions of the business judgement rule, however, and in particular the need to act in good faith and be reasonably informed, this should lead to a fair outcome. These principles may vary in detail. They are, however, common to most systems of corporate law and should be openly embraced within the transnational context.

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