DANISH LAW

"Saving the GOING CONCERN: Must the Crew Abandon the Ship?"

I - Introduction and background

In order to answer the above question from a Danish point of view, it is essential to bear in mind that officers, directors as well as other gentlemen and crew members all are liable according to general Danish liability rule called the Culpa rule (Culpa-reglen).

The Culpa rule is not statutory, but is primarily based on case law.

According to governing principle of fault, a person is liable in damages for any foreseeable damage caused by wrongful act to which culpability attaches - whether deliberately or negligently - where such damage is caused to an interest protected by the law, and where no defences are available.

The first Danish Public Companies Act was enforced in 1917.

Until a radical amendment of the Danish Public Companies Act was carried through in 1973[1], the Companies Acts in between were all characterized by the absence of Sections regarding liability in damages. However, the amendment in 1973 introduced among others Sections concerning liabilities.

Thus, Sections 140 and 143 state the following[2]:

"*140 - Promoters, members of the board of directors and of the management board who, in the performance of their duties have caused damage to the company due to wilful misconduct or negligence, shall be liable in damages. This consequence shall also apply where damage has been inflicted upon shareholders, creditors of the company or any third party by a violation of the provisions of this Act or the articles of association."*

"143 - (1) Damages applicable under sections 140 to 142 may be reduced where this is found to be reasonable in the context of the degree of guilt, the extent of the damage and the circumstances in general.

(2) Where several persons jointly are liable in damages, they shall be jointly and severally liable for damages. The person whose liability in damages has been moderated under the rules of subsection (1) above shall only be liable for the reduced amount. If one of these persons has paid the damages, such person shall have a right of contribution from each of the other persons who shares liability in damages with him. The amount of contribution shall be a function of the extent of the guilt of each of the other persons and of the circumstances in general."

As far as liability is concerned, the amendments were merely a codification of already existing case law based liability, and did not add anything new.

- [1] Furthermore, the amendment introduced legislation for companies with claim for a smaller capital, Consolidated Act 2002-01-09 no. 10, The Danish Private Companies Act (Anpartsselskabsloven).
- [2] Consolidated Act 2004-10-08 no. 1001, the Danish Public Companies Act (Aktieselskabsloven).

As expressly stated in section 140, the persons in question shall also be liable in damages in case damage has been inflicted upon among others "creditors of the company".

II - The question about liability for officers and directors in relation to the company's creditors where the company might not be able to fulfil its obligations to its creditors

In this connection, please note that both The Public Companies Act as well as the Private Companies Act contains rules assigning liabilities to the officers and directors if a capital loss of a magnitude specified in the Act in question is recorded in the company.

It is generally assumed that the capital rules in the Companies Acts respectively do not automatically imply a tightening of the liability for the officers and directors of the company if the prescribed measures are not implemented as prescribed by the Act.

On basis of the existing case law as regards liability for officers and directors of the company, the courts have shown a quite significant understanding that the management should be given thorough opportunities for keeping the crisis stricken company in operation.

In a leading judgment on the area given by the Danish Supreme Court in 1977[3], the Court attached importance to the fact that serious negotiations were still conducted for obtaining a solution for a crisis stricken company which ran a department store.

In the premises of the judgment it is said: "*On 17 February 1975 in the afternoon - after receipt of the audited annual accounts and the unsuccessful negotiations for aid - the company's situation was critical, and the opportunities for keeping the company in operation were considered extremely poor. However, it appears from the statements that serious negotiations were still conducted with banks and Storcentret that same evening and the following day in order to obtain a solution at the last minute, and, therefore, the court did not agree with the appellant that the liquidation was inevitable and in reality already determined on 17 February 1975.*"

Therefore, the Court did not uphold creditor's claim for damages against the company's directors as they had not stopped the company's credit purchase previously.

Case law can also be perceived in the light of Section 17 of the Danish Bankruptcy Act[4] which runs as follows:

"*17.-(1) Where a debtor is insolvent his estate shall be administered in bankruptcy upon petition made by the debtor or a creditor.*

(2) A debtor is insolvent when he is incapable of paying his debts as they fall due unless such inability to pay may be deemed to be of temporary character only."

- [3] UfR1997.274H (The Havemann-judgment).
- [4] Consolidated Act 1997-02-04 no. 118, The Danish Bankruptcy Act as (subsequently) amended (Konkursloven med senere ændringer).

On basis of the above-mentioned leading case compared with the rule in Section 17. of the Danish Bankruptcy Act, it can be concluded that the officers and directors of a company exposed themselves to a risk of become liable in relation to the company's creditors if the creditors incur a loss due to transactions or neglect on behalf of the company at a time when it should be obvious that the company is incapable of paying its debts as they fall due unless such inability to pay may be deemed to be of temporary character only - the so-called time of hopelessness.

III - Corporate Governance

As mentioned, the question of possible liability for damages for the officers and directors of a company is based on an individual Culpa judgment.

As legal standard, the Culpa judgment is influenced by the current developments of society, and, therefore, one can ask the question whether the recommendations for corporate governance which nationally[5] as well as internationally[6] are recommended might influence the judgment of liability.

As often the case internationally, a number of business scandals in the 1990's were a contributory cause for the establishment of task forces on corporate governance in Denmark.

Furthermore, the scandals in question have implied a number of amendments of the Danish Public Companies Act, the Danish Private Companies Act as well as the Danish accounting legislation - all with the superior purpose of preventing new cases.

In addition to this, Denmark has had a very comprehensive complex of so-called "asset stripping cases" which have been characterised by a number of companies whose sole/superior asset has consisted of cash and deposits for payment of deferred taxes have been acquired by entrepreneurial business men. After acquisition, the purchaser misappropriated the very significant amounts which were often allocated for payment of deferred taxes, either on their own or via a network of companies.

As a consequence of the very large number of asset stripping cases and, thus, very significant losses for the Treasury, the courts have established a very strict liability judgment both as regards criminal law as well as civil law - not just regarding the directly involved asset stripper, but also as regards the officers and directors of the involved companies, and, furthermore, as regards contributory consultants in the form of auditors, attorneys and financial institutions. This has had the result that the better part of the tax evasions have been returned, main in the form of damages from the last mentioned groups, as, for the main part, it has not been possible to recover the evasions from the actual asset strippers. However, in return these have often been sentenced significant sentences for the occurred asset stripping.

Though the recommendations on corporate governance are characterised by soft law, it is reasonable to presume that, in the future, the recommendations will influence the Culpa judgment on which the judgment of the liability of a company's officers and directors as regards damages are based.

- [5] The Noerby-committee's report on Corporate Governance (Nørby-udvalgets rapport om Corporate Governance, Anbefalinger for god selskabsledelse i Danmark, 2001).
- [6] OECD: AD HOC TASK FORCE ON CORPORATE GOVERNANCE, "Principles of Corporate Governance", 1999.

IV - Directors and officers insurance

In case of a company's officers' and directors' liability for damages, the basis is that, according to Danish law, the officers and directors in question are liable jointly and severally to the persons entitled to damages. However, the Courts often make an individual judgment in the mutual relations between the liable officers and directors, taking into account a number of considerations, especially the extent of the exercised fault and the presence of possible liability insurance.

Among others, the last mentioned aspect has implied that, to a wide extent, attorneys as members of a company's board of directors have borne the most significant part of the amounts of damages due to their compulsory liability insurance.

Combined with the constant focusing on the opportunities for claim for damages against the officers and directors of a company, the above-mentioned business scandals have also resulted in a continuous increase in taken out D&O-insurances which cover the civil liability which the persons in question risk to incur as part of the duties as officers and directors.

Please note that D&O-insurances also cover gross negligence as a principal.

V - The Danish perspective in relation to EU Insolvency Law

From a Danish point of view, it is essential to bear in mind that Denmark has, as an EU member since 1972, participated in the EU civil law cooperation that was originally regulated by the third and fourth limbs of Article 220 of the Treaty of Rome [7].

In the Maastricht Treaty, the nature of EU cooperation in the legal field was changed and this had the effect that the cooperation in the civil law area was changed as regards status, but in spite of this, Denmark continued to participate in the civil law cooperation.

However, in the Amsterdam Treaty that took effect on 1 May 1999, Denmark chose in a protocol to the Treaty to remain outside a number of areas of legal cooperation and harmonization by having four derogations or legal opt-outs. The reason for the opt-outs was that Denmark could no accept that the basis for the international civil law cooperation changed in its form from international to supranational cooperation.

Denmark's legal opt-outs concern the authority by which a legislative act is issued and not the nature of the contents of the legislative act. That means that legislative acts that are issued pursuant to Article 61 and Article 65 involve no obligations or rights for Denmark as a member of the EU.

As Council Regulation (EC) No. 1346/2000 of 29 May 2000 on Insolvency Proceedings (the Insolvency regulation) is subject to Article 65 of the Amsterdam Treaty, the opt-out means that the Insolvency Regulation has no legal effect for Denmark. In many ways, this is a strange result, not least in light of the fact that Denmark has participated from the very beginning in the civil law cooperation, and

- [7] U.2002B.167. Civil Law Aspects of Denmark's Legal EU Reservations by Peter Arnt Nielsen, Senior Lecturer, PhD; School of Law, University of Aarhus.

has also subsequently taken an active part in this cooperation with a view to an extension of the civil law cooperation. In an attempt to compensate for this, Denmark has sought to obtain a parallel agreement with the Commission with corresponding contents of the Regulation, but the Commission has refused this.

VI - Conclusion

Duties to creditors arise when the company is unable to pay its debts as they fall due in the usual cause of business[8]. As shown above, it has been demonstrated in case law that in order to incur civil liability, the officers and directors must fulfil the general conditions for damages made according to the applicable damage law, both in relation to the company's public creditors as well as its private creditors.

Therefore, it can be established that the officers and directors have a comprehensive access to act on behalf of the company as long as it is done with the overall goal of maximizing corporate value - which also as a principal will be in the best interest of the company's creditors.

In cases where an example of liability for damages for the officers and directors to the company's creditor have been made in case law, the liability has as a principal been justified by proving neglect of the equality rules prevailed when the company is incapable of paying its debts as they fall due unless such inability to pay may be deemed to be of temporary character only.

Therefore, it can be fundamentally established that the crew seen from a Danish insolvency point of view have absolutely no reason to abandon the ship, as abandonment is likely result in a shipwreck.

By staying on board, the crew will not always succeed in arriving safely in a port, but even if the ship will run aground before, it is often in the creditors' common interest that the crew seeks to keep the ship on course as long as possible.

An important need for amending the Danish legislation in order to increase the prospects of the rescue/reorganisation of multi-national corporate groups would be to give up the opt-outs in order to implement the Council Regulation (EC) No 1346/2000 of 29 May 2000 on Insolvency Proceedings (the Insolvency Regulation), and, thus, the part of the international civil law cooperation.

With effect as at 1 January 2006[9], Denmark has made floating charge possible. Seen from an insolvency practitioner's point of view, this opportunity will primarily be in the financial creditors' interest, and, thus, to the detriment of creditors with unsecured claims.

So far, the regulatory system is so new that it is not possible to say for certain to which extent financial creditors have made use of the established opportunity for floating charge.

However, a reasoned fear exists that the existing opportunities for floating charges will imply a considerable reduction of creditors with a possibility for obtaining dividend. Thus, as an insolvency practitioner I find that the opportunities for floating charge shall be abolished as soon as possible. In this connection, please note that a

- [8] Section 17 of The Danish Bankruptcy Act
- [9] Act No 560 of 24 June 2005 (virksomhedspant)

lot of opposition against adopting the rules regarding floating charge was stated in connection with the passing of the act - especially due to the experiences made in connection with corresponding regulatory systems in a number of the neighbouring countries.

However, except for this I find that the Danish legislation and case law on officers' and directors' liability are both balanced and successful.