

## **The liability of executive officers**

**in the opinion of the jurisprudence-analysing working group of the Curia**

**The Civil Department of the Curia adopted on 6 February 2017 the summary report drawn up by the jurisprudence analysing working group of the Civil Department of the Curia in connection with the jurisprudence analysis on the liability of executive officers vis-à-vis creditors.**

**As it is well-known, the new Civil Code amended the liability of executive officers on many points and it was capable of being known following the entry into force of the law that only jurisprudence will be able to decide on some open questions that remained unanswered by legislation. Let us see whether the jurisprudence analysing working group has found a solution to each question.**

The jurisprudence analysing working group examined circa 200 final judgements and summarised their sentences, as well as formulated its own position in connection with certain questions, and also made suggestions for jurisprudence and legislation. The jurisprudence analysing working group examined the liability of executive officers first of all in terms of the Bankruptcy Act but also made statements regarding the so-called compulsory strike-off procedure regulated by the Company Information Act, as well as shortly disserted on the liability structure defined by the Civil Code. The object of its examination was the liability of executive officers, regarding which a useful and constructive summary analysis was made for day-to-day practice, at the same time we are still facing uncertain interpretation of the law regarding some questions, probably considering the short period of time elapsed since the entry into force of the new Civil Code.

### **Is it only the executive officer against whom an action may be brought to establish liability?**

On the one hand, the definition of executive officer must be very broadly interpreted, so for example, the definition covers not only the managing director of a business association but also for example the registered officer of an association or foundation. On the other hand, the so-called shadow director, that is the person, who exercises a demonstrably dominant influence on the decision-making process of the legal entity, must also be included.



On the basis of the precedents analysed by the jurisprudence-analysing working group, the following persons shall be deemed as shadow director for example:

- the member of an indebted economic operator, holding a majority or even less influence
- the person having an influence as a result of family (spouse or companion) or business relationships that effectively determines the decisions of the economic operator,
- the definitive supervisory board in their decision-making function,
- the financial institution granting credit to the organisation

### **Subject to what conditions may proceedings be instituted against an executive?**

It can be assessed as a significant statement that the jurisprudence analysing working group analysed in details the conditions subject to which proceedings can be instituted. One of and perhaps the most important condition(s) is that **proceedings may only be instituted vis-à-vis an executive in relation of legal acts taken after a so-called imminent insolvency situation has arisen**. According to the stand point of the jurisprudence analysing working group, an **imminent insolvency situation arises only when the debtor is unable to pay his debts in the absence of liquid assets (objective condition) and the executive officer has become aware of that fact, or he should have become aware of it if he had acted diligently (subjective condition)**.

The jurisprudence analysing working group regarding the relevant case-law analysis pointed out that it may be applicable in 35% of the cases if the debtor was unable to pay its debts, enforcement or liquidation proceedings were instituted against him/her. The courts assessed within the same scope when the debtor was unable to pay the credit instalments, rent, litigation costs, assignment fee of the accountant payable, or laid off his employees. In 26% of the cases, imminent insolvency situation was established on the basis of the examination of the balance sheet data (by comparing the assets and liabilities), whereas in all other cases forensic auditors were appointed. It should be emphasized and can be stated on the basis of the aforesaid that it is **not the commencement date of the liquidation but the occurrence of an imminent insolvency situation that applies to the establishment of the liability of executive officers**.



### **What kind of acts are the executive officer liable for?**

The liability of an executive officer can be established if following the occurrence of an imminent insolvency situation, s/he has failed to fulfil her/his duties by taking into account the priority of the creditor's interests or (according to the later version of the text of the law) the creditor's interest, and behaved in such a way which reduced the assets of the debtor, and s/he is unable to defend herself/himself from liability. The judicial practice analysed by the jurisprudence analysing working group assesses the following as such behaviour (or failure):

- the debtor has sold any of his/her assets but its consideration was not received because, for example, the executive officer had not acted properly in selecting the contracting party.
- any asset has been transferred at a price considerably lower than its real value
- s/he has granted a loan in such a way that s/he should have realistically taken into account that the debt cannot be collected from the borrower,
- s/he has not acted with due care during the selection of the contracting parties
- s/he has taken abnormally unreasonable risk

### **What difficulties can the creditor expect during such proceedings?**

Under the major rule, **the burden of proof falls on the creditor in this type of action** so, for example, s/he must prove the imminent insolvency situation, the decrease in the assets of the debtor, as well as the causal link between the behaviour (failure) of the executive officer and the decrease in the assets of the debtor. However, it is worth emphasising that although the judicial practice is not uniform in this issue, in the view of the jurisprudence analysing working group, the plaintiff of the proceedings (creditor, liquidator) nevertheless takes legal action for the recovery of the debt in favour of the assets of the debtor. Moreover, the creditor may request the court to declare the executive officer to be in default not only to the extent of his/her unsatisfied claim but also up to all claims which cannot be satisfied from the assets of the debtor; however, for not more than that the liability of executive officer can be established.